

Sears Roebuck Acceptance Corp.

Should the CDS Auction Settlement Terms for Sears Roebuck Acceptance Corp. be modified, as allowed by the DC Rules, to prevent a market participant from creating an Open Interest to buy exceeding the face amount of all Deliverable Obligations not otherwise owned or controlled by that market participant?

In such a case, should the CDS Auction Settlement Terms expand the list of deliverable obligations? Should the DC consider a decomposition of the CDX HY credit indices in order to increase liquidity in SRAC CDS?

We refer to the DC's decision to accept the submission of an Eligible Market Participant under Section 3.2(d) of the DC Rules on November 9, 2018 in relation to a requested delay of the auction date as a result of the potential auction of various Medium Term Notes (the "MTNs"). This auction has now occurred and it is currently the subject of dispute before the Bankruptcy Court.

We respectfully request that the DC uses this same procedure under the DC Rules to take further action in respect of the auction for SRAC so that the Final Price accurately reflects the market value of the Reference Entity's obligations. It is evident from examining the record of the Bankruptcy Court⁽²⁾ that the MTNs have been monopolized by a single party which has also ensured that the Reference Entity sold the MTNs to it on condition that no further MTNs were made available to the market. This is producing a "short squeeze" which the auction was in part designed to defeat.

The risk of short squeeze is all but guaranteed.

The approved list of obligations deliverable to the Sears auction sums to more than \$2 billion, largely exceeding the Net Open Interest of \$460 million as of December 2018. However, if we are to analyze more closely the deliverables which can be sourced by market participants, we would arrive at a much different conclusion, with less than \$140 million of very illiquid bonds, which are openly trading in the market.

One market participant has acquired \$880 million of deliverable obligations (the MTN) in, what has been widely published as a disputed matter⁽¹⁾ and also holds of at least \$155 million SRAC unsecured notes. Sears and its affiliates control \$2.3 billion of MTNs and \$525 million of second lien loans. Sears has agreed not to sell any of the MTNs in its possession or in possession of any of its affiliates. ESL, the long-time Sears majority owner, with an open bid on the estate, has no economic or strategic interest to sell its loans (the \$525 million under external review). The market participant which bought \$880 million of the MTNs, is also the largest seller of CDS on SRAC according to recent court filings⁽²⁾.

The unavailability of MTNs has driven up the price of other scarce deliverable obligations with the average price of the deliverables trading in the market (CUSIPs: 812404BE0, 812404BK6, 812404408, 812404507, 812404AX9, 812404AZ4) soaring 45+ points in less than a month (i.e., 65+ points above the purchase price of the MTNs in the November 21st, 2018 MTN auction) and 60+ points above second lien obligations of the same obligor (currently not deliverable under ISDA definition).

Possible Amendments to the CDS Auction Settlement Terms.

As referred above, according to Section 3.2(d) of the DC Rules, the DC is permitted to make changes to the CDS Auction Settlement Terms: "If the Convened DC determines that the Credit Derivatives Auction Settlement Terms and Final List are not broadly reflective of the Deliverable Obligations and ability to settle which would have been available if Physical Settlement had been the applicable Settlement Method and that this would cause prejudice to either Buyer or Seller under a Relevant Transaction, it may Resolve by Supermajority to make amendments to the Credit Derivatives Auction Settlement Terms and/or Final List as applicable in an attempt to avoid or mitigate against such prejudice. Such amendment may only be made after a public comment period unless the Convened DC Resolves by a Supermajority to allow such amendment without a public comment period."

We therefore respectfully request that the DC consider the addition of a new Deliverable Obligation to the Final List (as further described below), although it does not meet the strict requirements of the Deliverable Obligation Characteristics. This obligation nevertheless should be included in order to ensure that the auction better reflects economic realities. We think that the DC can do this pursuant to Section 3.2(c)(iv) of the Rules.

If the following obligation were to be added to the Final List it will ensure that more Deliverable Obligations are available at a price which more accurately reflects market dynamics and better ensure that the auction is conducted in a fair and equitable way. That security (CUSIP 812350AE6) is a senior note issued by Sears Holding Corp, secured by a second lien on some of the debtors assets and guaranteed by Sears Roebuck Acceptance Corp, the Reference Entity, and other of the debtors' subsidiaries. These notes should not recover any less than the SRAC unsecured notes and rather reflect the maximum economic value of the SRAC unsecured notes.

We recognize that the guarantee of the Reference entity is not qualifying under a Standard North American Corporate CDS Contract but would be qualifying under any other Corporate CDS contract in all other regions and acceptable deliverable under any CDS contract outside of North America.

We also respectfully request that the DC considers working with the relevant Regulatory and Supervisory bodies to de-compose the CDX HY credit indices (SRAC is a 1% constituent) in order to increase liquidity in SRAC CDS, enable a more efficient risk transfer, and to maintain the CDX Index Market integrity. De-composition of the credit indices has been previously implemented in the Norkse Skog Restructuring Credit Event. Norske Skog de-composition was approved in spite of certain operational issues and constraints that the industry faced during the processing⁽³⁾. We believe similar issues can be addressed by the market this time around. We therefore think that the DC should work with other relevant Regulatory and Supervisory market bodies to decompose the HY CDX indices into a HY CDX contract excluding SRAC and a SRAC CDS contract (every holder of index will get commensurate amount of SRAC contract – equivalent to 1% of index exposure), therefore adding \$750 million of liquidity to the CDS market (SRAC is a 1% component of the \$75 billion CDX HY indices). To be clear de-composition does not affect the market participants' net risk position.

We confirm that a copy of this statement may be provided to the members of any Credit Derivatives Determinations Committee convened under the DC Rules in connection with the General Interest Question to consider the issues discussed herein, and that it may be made publicly available on the ISDA Credit Derivatives Determinations Committee website. We accept no responsibility or legal liability in relation to its contents.

⁽¹⁾ Market participants have accused, in front of the Bankruptcy Court, the “buyer of the MTNs” to “have taken steps to corner the market in the available supply of Deliverable Obligations so that it can squeeze the ISDA auction by withholding from that auction the Deliverable Obligations that it has acquired”⁽²⁾, a violation of the securities laws.

According to Section 9(a)(2) of the Securities Exchange Act of 1934, as amended, – that it is an offense “to effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange, any security not so registered, or in connection with any security-based swap or security-based swap agreement with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others”.

⁽²⁾ Bankruptcy dockets - <https://restructuring.primeclerk.com/sears/Home-DocketInfo?DockSearchValue=omega> (dockets number 1077, 1177, 1199, 1214, 1292, 1294)

⁽³⁾ <https://www.isda.org/a/kKiDE/credit-steering-committee-statement-02-june-2016.pdf>