

An Introduction to LSTA Distressed Trading Documentation

July 29, 2009



Overview

- What are we trading?
- Differences between Par and Distressed
- Why use LSTA distressed documentation?
- LSTA Distressed Trade Confirmation
- Drafting LSTA distressed documents
- Upstream review
- Purchase price calculation
- Settling a trade

Senior Secured Syndicated Bank Loans

- What does that mean?
- What types of loan are there?
 - Term loan
 - Different types of term loan (i.e., Tranche A Term Loan and Tranche B Term Loan)
 - Revolver
 - Different types of revolver (i.e., US Commitment and Canadian Commitment)
- What is difference between term loan and revolver?
- Who is the borrower or borrowers?

Par vs Distressed

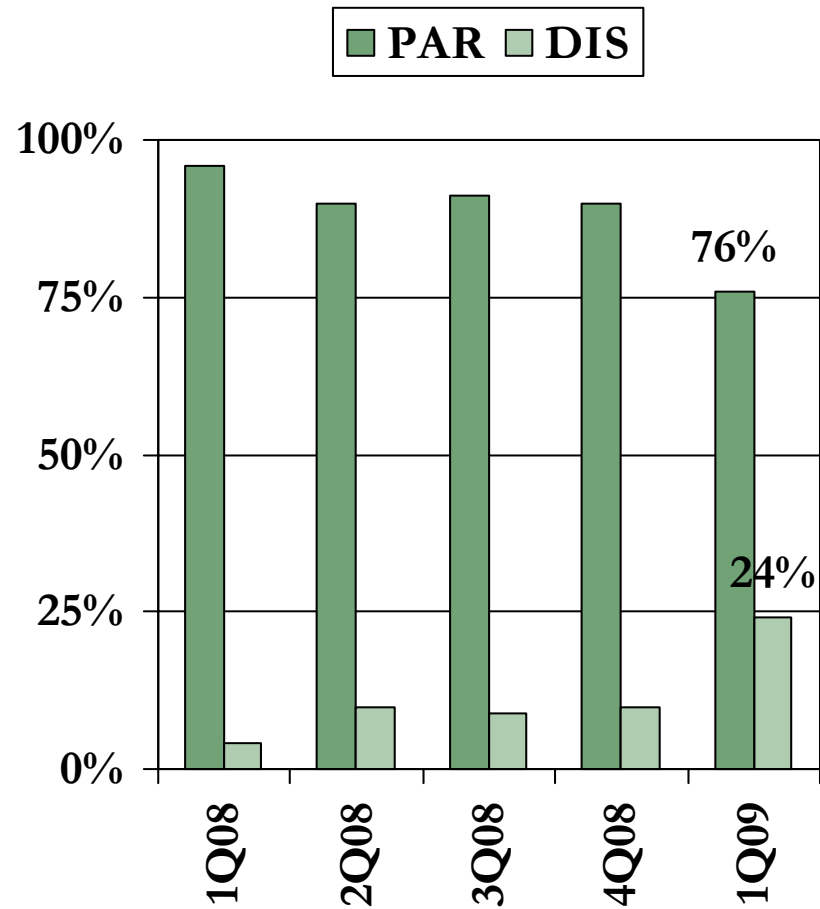
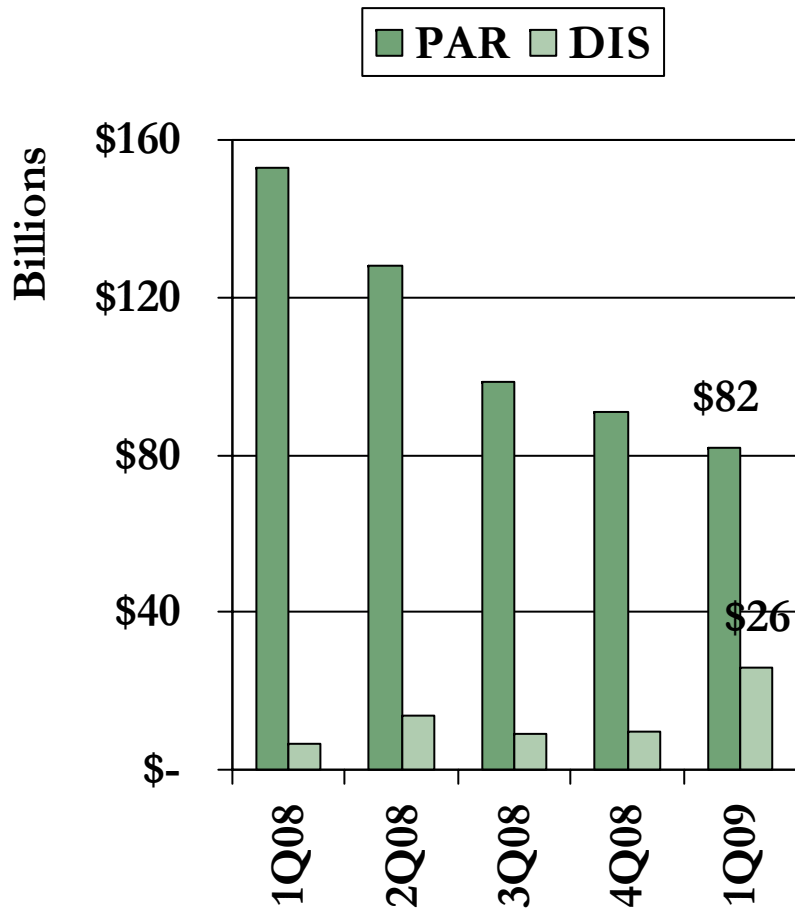
➤ Historical Difference

- >90% - Par
- <90% - Distressed

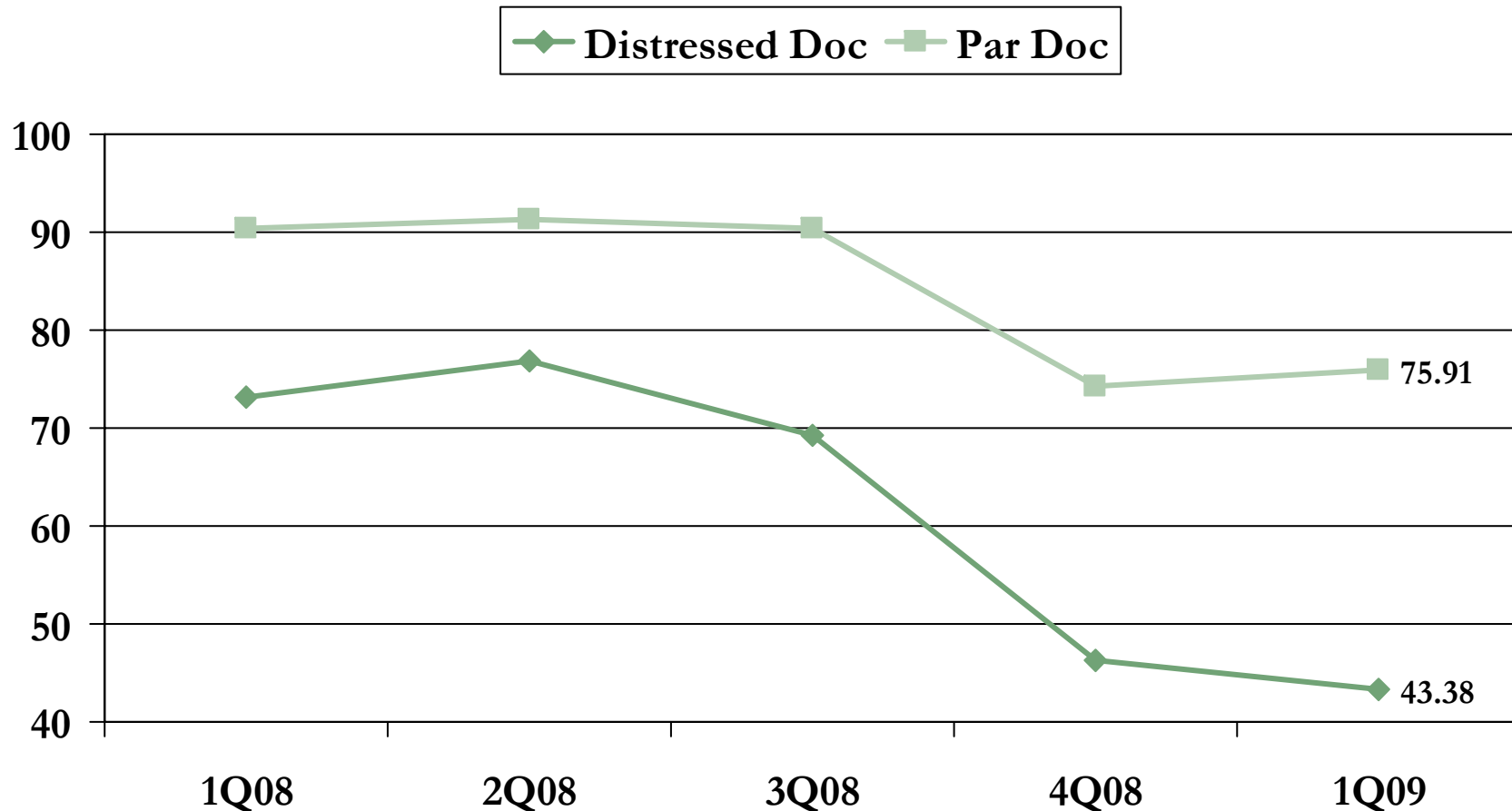
➤ What is general conceptual difference between a par loan and a distressed loan?

- ***Par Loans*** – performing loans are expected to be paid in full and on a timely basis (historically traded at or near par value)
- ***Distressed Loans*** – perceived to be at risk for full and timely repayment; trade at varying discounts, depending on the market's assessment of the risk of less than full repayment

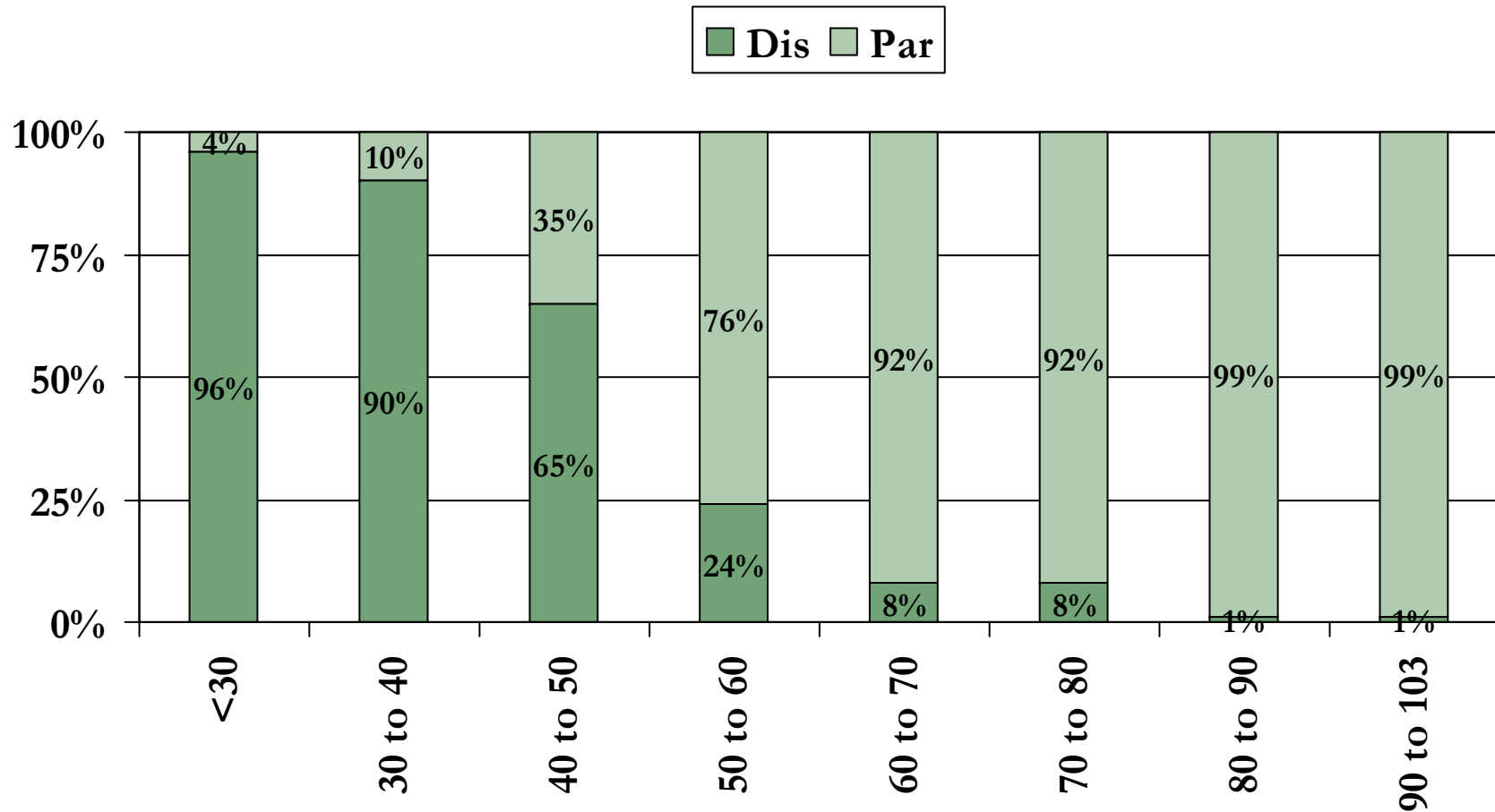
Par and Distressed Trade Volume by Dollar Value (\$)



Trade Price as a Proxy for Doc Type?



Distribution of ALL 1Q09 Trade Price Segments by Doc Type



Par vs Distressed

➤ Par Documentation

- LSTA Par Trade Confirmation
- Assignment and Acceptance (plus funding memorandum)
 - Only two material seller representations
 - Title representation (clean title, free and clear of liens and encumbrances)
 - Principal amount representation
- Buy-in & Sell-Out Provisions (“BISO”)
 - Par Confirm only includes BISO provisions
 - Completely revamped by LSTA in February 2009

Par vs Distressed

➤ Distressed Documentation

- LSTA Distressed Confirmation
- LSTA Purchase & Sale Agreement (“PSA”)
- Assignment and Acceptance (“A&A”)
- Purchase Price Letter (“PPL”)

➤ PSA provides additional protections and benefits for buyer

- Seller’s representations bolster buyer’s due diligence on the debt.
 - Most important representation given by seller is the “no bad acts or omissions” representation (s.4.1(h) of the PSA)

Par vs Distressed

- PSA provides additional protections for buyer...
cont'd
 - Indemnities
 - Voting rights
 - Distribution obligations

Lender Liability

- What is it? Allegation by borrower that it does not owe money to lender, and lender in fact owes borrower money for damages
- Examples of lender liability
 - Common law fraud
 - Breach of fiduciary duty
 - Duress
 - Tortious interference with contractual rights
 - Implied covenant of good faith & fair dealing
 - Deepening insolvency
 - Equitable subordination – Bankruptcy Code §510
 - Recharacterization of debt into equity
 - Statutory causes of action (e.g., RICO)
 - Fraudulent transfer
 - Preference – Bankruptcy Code §547
 - “Insider” – preference period extended from 90 days to 1 Year

“A Trade Is A Trade”

- Traders agree to material terms on phone or by electronic communication (e-mail, Bloomberg, etc.)
- What are **material terms** of trade?
 - Borrower
 - Credit Agreement
 - Borrower can have multiple existing credit agreements (e.g., 1st lien and 2nd lien)
 - Type of Loan (Term or Revolver)
 - Purchase Amount
 - Purchase Rate
 - Interest Convention
- Binding “oral” agreement once material terms agreed upon
 - LSTA – statute of frauds exception under New York GOL §5-701 in October 2002
 - Distressed Confirm - Section 22 “Binding Effect”

Face of Confirm

- Complete “face” of LSTA Distressed Trade Confirm (2 -3 page document)
 - Supplemented by LSTA Standard Terms for Distressed Confirm (12 page document)
 - To extent inconsistency between “face” and standard terms the “face” of trade confirm will govern
- Include material terms of transaction
 - Trade Date
 - Name of Seller and Buyer
 - Description of Debt (i.e., Credit Agreement, Borrower & CUSIP number)
 - Type of Loan
 - Purchase Amount
 - Purchase Rate
 - Interest Convention

Form of Purchase

- What is Form of Purchase?
 - Assignment – default setting
 - Assignment Only
 - What does that mean? What are the ramifications?
 - Participation
 - What is difference between Assignment and Participation?
 - Assignment of Participation
 - Sub-participation

Face of Confirm - Interest

- What is the interest treatment?
 - Settled Without Accrued Interest (“SWOA”)
 - Trades Flat
 - What is the difference?
 - When does loan trade SWOA vs trades flat?
- PIK Interest – what does that mean?
 - How does PIK Interest affect trade?
 - What happens if PIK interest capitalized pre-trade date vs post trade date?

Face of Confirm - “Other Terms of Trade”

➤ Revolver Trades

- After Lehman and Bear, difficult to obtain borrower consent
 - Example Ford and GM Revolver facilities

➤ If buying revolver with contingent funding obligations and settle via participation – special issues arise

- “No voting rights” or “majority voting rights”
- Counterparty credit risk – seller may require collateral arrangements and posting of collateral
 - LSTA Collateral Annex to Participation Agreement

Face of Confirm – “Other Terms of Trade”

- Trading as Principal or Riskless Principal
 - What is the difference? What are the implications?
- Transfer fee – common market practice for dealer to only agree to pay ½ of one transfer fee if trade allocated to multiple funds

NOTE: Improve liquidity if “other terms of trade” are agreed to at “time of trade” by traders - often not the case and leads to delay in settlement and negotiation of terms

NOTE: No time deadline in LSTA confirmation for closing trade - required to use “reasonable efforts” to comply with LSTA timeline (par trades – T+7; distressed trades – T+20)

Trade Chronology

- What does attorney do when he/she receives the trade confirmation?
 - Obtain and review credit documents
 - Credit Agreement (“CA”)
 - Amendments to CA
 - Importance of obtaining amendments – GM example
 - Exhibits (including Form of A&A) and schedules
 - Other material credit documents (i.e., security agreement and intercreditor agreement)

Trade Chronology

- How to obtain CA and other credit documents?
 - Client or administrative agent if existing lender
 - Intralinks
 - Counterparty
 - Confidentiality Agreement required – if not existing lender (LSTA Form of Master Confidentiality Agreement)
 - If borrower is a public reporting company from SEC web page

Key Issues to Consider – “Successors and Assigns”

- Must review successors and assigns language which governs transferability
 - Eligible assignee issues
 - Competitor
 - Disqualified institution
 - Restriction on transfers to borrower or “affiliates” of borrower
 - Gaming credits
 - Minimum size/minimum hold requirements
 - Required consents
 - Identify correct name of borrower(s) and tranche(s) as defined in CA
 - Often incorrect in trade confirmation

Key Issues to Consider – Borrower in Bankruptcy

- What you need to know if borrower is in bankruptcy
 - Filing date and where case filed
 - Bar date and proof of claim
 - Adequate protection order (“APO”)
 - APO – how does APO affect interest treatment?
 - NOL order?
 - Plan support agreement
 - Is there one? How does that affect the trade?
 - Disclosure statement and Plan of Reorganization
 - Confirmation Order

Key Issues to Consider – Borrower in Bankruptcy

- Where to obtain information about bankruptcy cases?
- Bankruptcy Court Web & Pacer Sites – Search docket
 - <http://bkinformation.com/courtwebs.cfm>
- Claims Agent Websites
 - Kurtzman Carson Consultants: <http://www.kccllc.net>
 - Epiq Bankruptcy Solutions: <http://chapter11.epiqsystems.com>
 - Garden City Group:
<http://www.gardencitygroup.com/businessreorganization/archive/all>
 - BMC Group Inc.:
<http://www.bmcgroup.com/restructuring/clients.aspx>
 - Donlin, Recano & Company:
<http://www.donlinrecano.com/cases/cases.aspx>
 - Logan & Company: <http://www.loganandco.com/clients.asp>

Documentation Process

- First steps to take to expedite documentation process
 - Obtain administrative details for both parties
 - Tax form from buyer if not lender
 - Is buyer a lender? If not, can buyer get into credit as an “affiliate” or an “approved fund”
 - Fill out Transaction Specific Terms of PSA (“TSTs”)
 - TSTs is a nine page document which is supplemented by LSTA Standard Terms for Distressed Trades (“Standard Terms of PSA”)
 - Standard Terms of PSA is 28 page form document; Standard Terms can be modified by additional provisions section of TSTs

Documentation Process

- Additional provisions
 - Gaming credits – LSTA standardized rider
 - Allocation of expenses
 - Temporary participation
 - Canadian bankruptcy proceedings
- Need to list “upstream” chain of title in Annex of TSTs

NOTE: Importance of keeping inventory – must update timely and be very careful to update accurately

Upstreams

- With respect to \$1,200,000 of the loans assigned hereby, Purchase and Sale Agreement, and related Assignment and Acceptance, each dated as of May 25, 2009, between BofA, as seller and Credit Suisse, as buyer. [relates to distressed]
 - With respect to \$500,000.00 of Loans assigned hereby, Assignment and Acceptance, dated as of April 1, 2009, by and between JPMorgan Chase Bank, N.A., as assignor, Bank of America, as assignee, and the Agent. [relates to par/near par]
 - With respect to \$700,000.00 of Loans assigned hereby, Assignment and Acceptance, dated as of May 5, 2007, by and between Credit Suisse, as assignor, Bank of America, N.A., as assignee, and the Agent. [relates to par/near par]
- With respect to \$800,000.00 of Loans assigned hereby, Purchase and Sale Agreement, and related Assignment and Acceptance, each dated as of May 8, 2009, between Goldman Sachs, as seller and Credit Suisse, as buyer. [relates to distressed]
 - Purchase and Sale Agreement (original assignment) and related Assignment and Acceptances, each dated as of April 27, 2008, between Wachovia Bank, N.A. , as seller, and Goldman Sachs, as buyer [relates to distressed]

LSTA Purchase & Sale Agreement

- What is in Standard Terms of PSA?
- Material sections include the following:
 - Seller's representations and warranties – Section 4
 - No proceedings
 - No bad acts or omissions
 - Complied with credit documents and predecessor transfer agreements (“PTAs”)
 - Purchase price calculation
 - No setoff
 - Not party to any other document or agreement
 - No notice of impairment
 - Buyer's representation and warranties – Section 5

NOTE: does not include eligible assignee representation

LSTA Purchase & Sale Agreement

- Material sections include the following:
 - Indemnification – Section 6
 - Seller indemnification includes
 - Disgorgement indemnity
 - “Insider” indemnity
 - Unofficial or official creditor’s committee

NOTE: Seller does not indemnify if APO payments are recharacterized as principal

- Distribution section – Section 8
 - “Clawback” obligation under Section 8.4 for SWAC trades
- Voting – Section 11
 - Record date

Documentation Review - Upstreams

- What does Attorney look for in drafts and upstreams?
- Shift Date Issues – What is meant by Shift Date? How does market determine when credit “shifts” from par to distressed?
 - Price is a factor but not determinative (LSTA Market Advisory 2008)
 - Bankruptcy
 - Payment or covenant default
 - Ratings downgrade
 - Market convention
 - Is default anticipated?
 - Negative trends: earnings, macro pressures on industry

Documentation Review – Step-Ups

- Stepping Up – What are you stepping up for?
- Material representations of prior sellers who held loans during “coverage period”
 - No bad acts
 - No proceedings
 - Performance of obligations
 - Setoff
 - Consents and waivers
 - No other documents
- Indemnity step-up
- Distribution step-up

Documentation Review – Step-Ups

- Example of when Step-Ups applicable:
 - Hedge Fund X selling loans on distressed documents to Dealer B and trade still open as of today July 29th
 - Hedge Fund X purchased loans from Dealer A on June 15th on par documents
 - Shift date is May 10th
 - Dealer B will want Hedge Fund X to step up for material reps of not only Hedge Fund X but also Dealer A **and for any other prior seller** who held the loans from and after 5/10/09 through 6/15/09.
- LSTA Shift Date Polls
 - How do they currently work?
 - Proposed determinations committee

Documentation Review

- Credit risk of upstream sellers (i.e., now defunct hedge fund)
- Includes Market Standard Provisions (i.e., Canadian insolvency proceedings)
- Make sure no issues on resale – marketable loans
 - Want no problems when go to sell loans downstream

Documentation Review

- Important to stay current on credit
 - Daily Bankruptcy Review
 - Wall Street Journal
 - LSTA Weekly Recap
- Paydowns and PIK increases after trade date
 - Changes purchase amount and upstream allocation

Documentation Review

- Amendment or other credit activity post trade date
 - What happens if amendment (or other action) decision required of lenders generally after trade date but prior to closing date?
 - Who decides what action to take? Seller or Buyer?

NOTE: Public vs Private Issues – don't want to restrict counterparty

Documentation Review

- After trade date borrower has payment default
 - Does that affect interest treatment? Flip to Flat?

- Non-bankruptcy credit goes into bankruptcy after trade date
 - How does that affect transaction?
 - Does that affect interest treatment?

Purchase Price Calculation

- Questions to ask before calculating purchase price
 - Is the loan a term loan or a revolving credit facility?
 - What was the agreed upon purchase rate for the loan?
 - Has the loan amount changed between trade date and settlement date? (i.e., was there a principal pay down or a borrowing?)
 - What was the agreed upon treatment of interest? (i.e. “trades flat” or “settled without accrued interest”)
 - Have any fees been paid? (ordinary course fees, i.e., commitment, facility and letter of credit fees or non-recurring fees, i.e., amendment, consent, waiver or other similar non-recurring fees)
 - Is the settlement date a “delayed settlement date” occurring after the T+20 date?
 - Is there an agent fee?

Purchase Price Calculation

➤ Term loan purchase price calculation prior to T+20

Outstanding Principal Amount	\$5,000,000
Purchase Rate	60%
Purchase Price	\$3,000,000

Purchase Price Calculation

- Term loan purchase price calculation prior to T+20 with pay down

Settlement Date Principal Amount	\$4,500,000
Purchase Rate	65%
Subtotal	\$2,925,000
Credit for paydown	$(1-PR) \times \$500,000 = \$175,000$
Purchase Price	\$2,750,000

Purchase Price Calculation

- Revolving credit commitment: purchase price calculation prior to T+20

Commitment Amount	\$10,000,000
Settlement Date Funded	\$0
Settlement Date unfunded	\$10,000,000
Settlement Date Funded	\$0
Purchase Rate	80%
Funded purchase rate	\$0
Credit for unfunded	$(1-PR \times \$10,000,000) = \$2,000,000$
Purchase Price	(\$2,000,000)

Purchase Price Calculation

➤ Term Loan: Purchase Price Calculation after T+20 with Trades Flat Interest

Trade Date	April 1, 2009	
T+20 Date	April 29,	
Settlement Date	May 5, 2009	
Average LIBOR rate	0.89%	
T+20 Principal		\$5,000,000
Purchase Rate		70%
T+20 Purchase Price		\$3,500,000
Delay Compensation		$\$3,500,000 \times 0.89\% \times 6/360 = 519.17$
Total Purchase Price		<u>\$3,500,519.17</u>

Purchase Price Calculation

➤ Term Loan: Purchase Price Calculation after T+20 with SWOA Interest Treatment

Interest Rate	7.85%	
Outstanding Principal		\$5,000,000
Purchase Rate		70%
T+20 Purchase Rate		\$3,500,000
Delay Compensation		$(\$3,500,000 \times 0.89\% \times 6/360 = \$519.17)$
Credit for Interest		<u>\$5,000,000</u>
Total Purchase Price		<u>\$3,493,977.50</u>

Final Steps

- Once pricing and documentation agreed upon distribute documentation for signatures
- Coordinate closing with agent and obtain agent and borrower consent (if necessary); new LSTA “borrower deemed consent” language

When To Use Proceeds Letter?

- Effective date of bankruptcy plan
 - Prior to closing trade debtor emerges from bankruptcy
 - How does this affect transaction?
 - Settlement by proceeds letter
 - When do you use LSTA form of Proceeds Letter?
 - Issues with respect to transfer of equity distributions
 - §1145 exemption under bankruptcy code
 - Shareholders agreement

Loan Only Credit Default Swaps – “LCDS”

- Credit event – bankruptcy or payment default
- Physical settlement rider
- Fixed timelines for settlement

When to Use a Netting Agreement?

- Bilateral netting letter
 - LSTA Form of Bilateral Netting Agreement – Par/Near Par
 - LSTA Form of Bilateral Netting Agreement – Distressed
- Multilateral netting letter
 - LSTA Form of Multilateral Netting Agreement – Par/Near Par
 - LSTA Form of Multilateral Netting Agreement – Distressed
- When are these types of settlement applicable?