

Effective 25 January 2010—A New LMA Approach to Trading European Loans

By Louisa Watt and Roxanne Yanofsky

Introduction

On 25 January 2010 a significant shift will take place in the European secondary loan trading market with the Loan Market Association's (LMA) launch of combined par and distressed documentation. Any LMA trade entered into on or after 25 January 2010 shall be settled using the revised form of documentation. This memorandum sets out the main changes made to the LMA's currently published standard terms and conditions for both par and distressed trade transactions as well as related trade confirmations and suggests some "best practice" guidelines for debt market participants to follow when conducting trades.

Key Changes to the LMA Trading Documentation

Combined Set of Terms and Conditions

The LMA documentation currently consists of a separate suite of documents for par and for distressed trades. As of 25 January 2010, a combined set of standard terms and conditions for both par and distressed trades will apply. The combined standard terms and conditions are based primarily on the current distressed terms and conditions.

Consequently, the majority of amendments will affect parties entering into par trades. Notable updates include the following:

- The concept of 'a trade is a trade', previously applicable to distressed trades only, will now also apply to par trades. This means that if a condition remains unfulfilled – for example, if borrower consent is refused – the parties cannot walk away from a trade. Automatic fall-back to settlement by funded participation applies in both par and

distressed scenarios, though parties may elect an alternative means of settlement on a mutually agreed basis if the terms of the funded participation cannot be agreed or if the parties have elected for settlement by 'legal transfer only'.

- Whereas previously, distressed representations and warranties had to be included as an additional term of trade in a trade confirmation (the small number of representations and warranties given in a par trade having always been included under the par standard terms and conditions), all representations and warranties are now included under the single set of combined terms and conditions. A seller in a distressed trade still provides additional representations and warranties reflecting the greater risk of borrower insolvency, but a par seller now gives some of the representations and warranties that used to apply only in a distressed trade scenario (discussed below in further detail). In addition, unless the seller specifies in the confirmation that it is an original lender, both par and distressed trades are now assumed to be traded on the basis of predecessor-in-title representations and warranties.
- The new default position is that buy-in/sell-out damages will automatically apply for par trades unless specifically excluded by the parties at time of trade (discussed below in further detail).
- The new default position is that breakfunding compensation will no longer automatically apply in par trades and must be agreed upfront by the parties at time of trade.

Memorandum

January 25, 2010

“On 25 January 2010 a significant shift will take place in the European secondary loan trading market with the Loan Market Association's (LMA) launch of combined par and distressed documentation.”

NEW YORK
WASHINGTON, DC
LONDON

www.rkollp.com

This memorandum may be considered advertising under applicable state laws.

- If “Settled Without Accrued Interest” applies, then Delayed Settlement Compensation is calculated on the basis previously only applicable to distressed trades, so that seller pays buyer interest and recurring fees (based on the rates under the credit agreement) and buyer pays seller interest on the settlement amount (EURIBOR if the loan is denominated in Euros or LIBOR for any other loan). Start dates for calculating delayed settlement remain unchanged at T+10 for par trades and T+20 for distressed trades.

Combined Trade Confirmation

Parties entering into either a distressed or par trade will use one combined form of trade confirmation. The new trade confirmation is based on the current trade confirmation for distressed trades but with the following notable amendments:

- Parties use a tick-box to specify whether the trade is par or distressed. The target timeframe for settlement of T+10 for par and T+20 for distressed still applies.
- The default settlement date is “as soon as reasonably practicable”; any alternative settlement date agreed between the parties must be added as a specific term of trade.
- The concept of “trades flat” now may apply in a par trade scenario as well as distressed.
- “Settled Without Accrued Interest” now includes clawback for borrower default in a par trade scenario. Generally, if “Settled Without Accrued Interest” applies, the buyer pays seller interest and/or recurring fees that it receives as current lender of record from the agent, attributable to the period prior to settlement date (and therefore for the account of the seller). If the agent subsequently invokes a right to clawback in relation to any of these amounts (whether through the buyer or the buyer’s successor-in-title) the seller will be obligated to repay such clawed-back amounts to the buyer.

- “Purchased Assets” in a par trade now include ancillary rights and claims and non-cash distributions.
- Combined forms of purchase documentation (including settlement by funded participation) have been produced for use in both par and distressed transactions.

Termination on Insolvency

Following the dramatic changes in the financial landscape, including the high-profile bank collapse of Lehman Brothers, the LMA has updated the standard terms and conditions to account for a party’s insolvency. A new term in the combined terms and conditions now allows a party to a trade, at its option, to terminate the trade if its counterparty becomes insolvent between trade date and settlement date. As described below, upon termination, it can assert damages against the insolvent counterparty for lost profits.¹

The default position is that a trade is terminated when the non-insolvent party serves notice to the insolvent party, following its insolvency. The non-insolvent party may stipulate that termination is effective upon notice being served, or can give a date for termination of up to 20 business days following the giving of such notice. However, this can be altered by either party by means of:

- notification at any time prior to a party becoming insolvent that automatic termination will apply; or
- including automatic termination as a specific term of trade in the trade confirmation.

Following early termination, the non-insolvent party shall obtain quotes from at least two broker-dealers on the current price of the traded amount and then calculate the settlement amount (the “Early Termination Amount”) using the same mechanisms as if the trade had settled on the standard LMA terms, except that the purchase rate will be revised based on the average of the quotes obtained by the non-insolvent

¹ The definition of ‘insolvency’ is based on the Bankruptcy event of default condition contained in the International Swaps and Derivatives Association documentation.

party. Once calculations have been made, the non-insolvent party shall provide the insolvent party with a statement showing such calculations and specifying the revised date for settlement (the “Early Termination Payment Date”).

Additionally, the non-insolvent party is permitted to assign its rights to receive any early termination payment amount without the consent of the insolvent party.

The combined terms and conditions do not specifically provide for a scenario where one party to the trade is already insolvent as at time of trade. Any party considering entering into a trade with an already insolvent counterparty should consider amending the combined standard terms and conditions and seek legal advice in this regard.

Buy-in/Sell-out (BISO)

A revised BISO clause has been included in the combined terms and conditions, and unless specifically disapplied in the trade confirmation, will automatically apply for par trades as follows:

- A BISO notice can be served on the defaulting party after T+60;
- The defaulting party then has a further 15 business days to deliver the appropriate trade confirmation and transaction documentation;
- If the default remains unresolved during this period, the non-defaulting party has a further 15 business days to enter into a substitute transaction; and
- Any disputes regarding the substitute transaction price will be determined by the LMA Pricing Panel.

Representations and Warranties

The combined terms and conditions now incorporate all representations and warranties given by both the seller and buyer, including the previously freestanding distressed standard representations and warranties.

Some representations and warranties previously only given by a seller in a distressed trade, including, but

not limited to, a representation that no documents have been executed by the seller which would materially affect the purchased assets or purchased obligations and an ERISA representation, are now applicable in a par context as well.

The LMA is still of the view that given the different risk profile of a distressed versus par trade, certain representations will remain applicable in a distressed scenario only.

Recommended Best Practice

U.S. market participants may find some of the new terms familiar, such as the revised Buy-in/Sell out (BISO) applicable to par trades, default position that breakfunding does not apply, and standard ERISA representations, which are similar to those applicable to LSTA trades. However, the key difference in terms of providing representations and warranties on a predecessor-in-title (or 'Step-Up') basis under the LMA standard terms and conditions still remains.

The new combined par and distressed approach differs significantly from previous forms of the LMA trading documentation and it is important that market participants familiarise themselves with the automatic provisions and be clear on trade date of any specifics of a transaction that require amendments to the standard terms.

The concept of ‘a trade is a trade’ now applying to all par and distressed trades means that parties considering entering into a credit should take special care to ensure prior to doing so that all proper due diligence and background checks have been conducted.

As much as possible, market participants should produce customised checklists incorporating the material points to be discussed at time of trade. Agreeing matters upfront will minimise any negotiations required at a later date and mitigate the risk of delayed settlement.

The following is a suggested list of key terms to be agreed at the outset of any LMA par or distressed trade:

- settlement on par or distressed terms;
- name and amount of debt/claims;
- price;
- interest convention (trades flat, settled without accrued, etc.);
- if delayed settlement compensation will apply (starting from T+10 for par trades and T+20 for distressed trades);
- form of purchase – legal transfer versus funded participation (if by funded participation, whether voting and/or information rights apply);
- termination on insolvency – should automatic termination apply; and
- any additional trade specific terms (i.e.: any additional representations to be given by buyer/seller).

For LMA par trades only:

- if breakfunding will apply (the default position being that breakfunding does not apply); and
- if Buy-in/Sell-out damages will be disapplied (the default position being that Buy-in/Sell-out damages are automatically applied).

* * *

If you have any questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

Louisa Watt

London, England
44 (0) 207 033 3162
lwatt@rkollp.com

Matthew Hughes

London, England
44 (0) 207 033 3180
mhughes@rkollp.com

Roxanne Yanofsky

London, England
44 (0) 207 033 3168
ryanofsky@rkollp.com

This memorandum is provided by Richards Kibbe & Orbe LLP for educational and information purposes only and is not intended and should not be construed as legal advice.

© 2010 Richards Kibbe & Orbe LLP, One World Financial Center, New York, NY 10281, 212.520.1800, <http://www.rkollp.com>. All rights reserved.

Quotation with attribution is permitted. If you would like to add a colleague to our mailing list or if you need to change or remove your name from our mailing list, please email publications@rkollp.com.

Any advice concerning United States Federal tax issues provided in this memorandum is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of (i) avoiding penalties that may be imposed on the taxpayer or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.