

New LSTA Trading Documents

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Liquidity in the US secondary bank loan market remained robust in 2009, despite the global economic downturn.¹ The Loan Syndications and Trading Association, Inc. (the “LSTA”), has continued to incrementally modify trading standards and documentation to ensure that documentation issues do not disrupt the orderly settlement of trades.

On January 12, 2010, the LSTA officially released revised forms of documents for trading distressed loans, effective for LSTA trades entered into on or after that date.²

The LSTA forms of Distressed Trade Confirmation and Purchase and Sale Agreement for Distressed Trades now include a more comprehensive procedure for determining the “Shift Date” for any particular distressed loan whereby LSTA members may request that the LSTA itself make a determination of the Shift Date for such loan. Once the LSTA publishes a Shift Date in respect of a particular loan, that date is binding upon all parties who trade the loan on LSTA documentation. This revamped procedure was created to eliminate disputes between loan market participants as to the correct Shift Date, which disputes frequently delay the settlement of distressed trades.

I. What is a “Shift Date”?

The “Shift Date” for a particular loan refers to the date or dates upon which the secondary loan market, as a whole, deems that such loan shifted from trading on a par basis to trading on a distressed basis.³ The only real drawback to purchasing a loan on distressed documentation that should properly be

classified as par is the added time and expense involved in the settlement process.

Buying a distressed loan on par documentation (after the Shift Date), however, can present more significant risks to the purchaser.

A purchaser of distressed loans on LSTA documents in the secondary market receives rights and claims under the “upstream” predecessor transfer documents as part of the bundle of rights transferred by the seller.

Loans which are purchased on par documentation after the Shift Date are considered “defective” as the owner of such loans has no protection against any possible misconduct of the lender or prior lenders that sold on par documents (the “Par Sellers”). In such cases, the market requires the owner of the defective loans and chain of title, if selling on LSTA distressed documentation, to “step-up” and indemnify the purchaser for the risks associated with the misconduct of the Par Sellers. The form LSTA Purchase and Sale Agreement for Distressed Trades provides a simple “check the box” mechanism to facilitate the seller providing these step-up protections. If the “Step-Up Provisions” box is checked, a Shift Date must also be identified in the Purchase and Sale Agreement, as the seller provides step-up representations and indemnities with respect to the conduct of any prior sellers that transferred the loans on par documents on or after the Shift Date.⁴

Memorandum

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“Rather than merely acting as a conduit for information, the LSTA itself reviews trade data it has obtained from dealer members and makes a determination as to the appropriate Shift Date.”

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¹ See Quarterly LSTA Secondary Trading Volume at <http://www.lsta.org/WorkArea/Showcontent.aspx?id=9228>.

² The LSTA also revised the forms of documents used for trading par loans. The Par/Near Par Trade Confirmation was revised to reflect a shorter time period under the Buy-in/Sell-out procedures. The “BISO Trigger Date” was moved from T+20 to T+15, and the related “Cure Period” was shortened from ten business days to five business days. For a fuller explanation of the LSTA’s Buy-in/Sell-out procedures, see “New LSTA Par/Near Par Buy-In/Sell-Out Procedures” at http://www.rkollp.com/2009/05/new_lsta_parnear_par_buyinsell.php.

³ As distressed credits become healthier, there can also be a relevant “Shift Date” for loans that shift from trading on a distressed basis to trading on a par basis (“Par Shift Date”).

⁴ A seller may opt, in certain circumstances (i.e., chain of title is not ascertainable), to provide step-up protections to a buyer without indicating a Shift Date; in such case, the seller would step-up for all prior sellers of the loans, irrespective of when such prior sales occurred.

II. The Prior Shift Date Determination Process

Prior to January 12, 2010, if the parties to a distressed trade were unable to agree on a Shift Date, they could refer to the results of an anonymous poll of disinterested dealers conducted by the LSTA. The poll provided the dealers' views on the appropriate Shift Date for the credit, usually the date upon which each dealer first traded the loan on a distressed basis. Unfortunately, except with respect to the largest facilities, only a few dealers typically responded to any one poll. For those few dealers who did respond, the dates were often scattered and inconclusive. Consequently, until the debt trading community as a whole came to a conclusive date or group of dates, parties to the trade were sometimes left to argue over the most appropriate date.

III. The New Shift Date Rules

Under the newly revised Shift Date rules, an LSTA member who needs to determine a Shift Date for a particular loan contacts the LSTA and requests a definitive Shift Date (rather than a Shift Date poll). Rather than merely acting as a conduit for information, the LSTA itself reviews trade data it has obtained from dealer members and makes a determination as to the appropriate Shift Date. Once determined, the date is posted on the LSTA's web site. In determining such Shift Date, the LSTA will be looking to see whether and when the market convention for trading such loan shifted from par documentation to distressed documentation.⁵

If, however, the LSTA concludes that the trade data is inconclusive, the LSTA will review relevant public information regarding the borrower. Such information may include ratings and loan/bond/CDS pricing, as well as publicly available information on the borrower. As the term "Shift Date" is defined as the market convention for trading a loan, this methodology represents a change. Presumably, rather than looking at changes in how the marketplace trades the loan, the LSTA would be looking at measures of actual borrower

performance to determine when the borrower itself became "distressed". The LSTA does not, however, actually describe in the new Shift Date rules the criteria used to determine when a borrower becomes "distressed."

If the LSTA is still unable to determine the Shift Date after a review of relevant public information, the decision will be handed over to a "Determinations Committee", composed of three members of the LSTA's Board of Directors. The Committee will include at least one Board member from each of a sell-side institution and a buy-side institution.

Within one business day of a selection or determination being made, the LSTA will publish on its website the Shift Date selected by the LSTA or the Determinations Committee (or a determination that no shift from par to distressed trading has occurred).

IV. Transitional Issues

As mentioned above, the new Shift Date procedures apply only to trades entered into on LSTA terms on or after January 12, 2010. A purchaser of distressed loans under a pre-January 12th trade confirmation would be certain to take notice, however, of a pronouncement by the LSTA under the new rules of the Shift Date for that loan, even if the pronouncement is, strictly speaking, inapplicable. One could imagine it being particularly disruptive were the LSTA to select a Shift Date that was earlier than the Shift Date generally accepted in the market for that loan under the old regime. Under such circumstances, we could envision buyers declaring the "old" consensus Shift Date invalid, and demanding sellers to step-up for upstream inventory that, prior to the LSTA pronouncement, had been considered market standard. For this reason, the LSTA would be well advised to take into account any market accepted Shift Dates under the previous rules before issuing Shift Dates under the new ones.

We anticipate that the LSTA will continually update and revise their suite of secondary loan trading

⁵ The new LSTA Shift Date rules are applicable to determining Par Shift Dates as well.

documents. We will endeavor to continue to provide regular updates on these developments.

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If you would like more information on the revised LSTA forms of Par/Near Par and Distressed Trade Confirmations or have any questions on the foregoing, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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