

CREDIT DERIVATIVES DETERMINATIONS COMMITTEE FOR THE AMERICAS

MEETING STATEMENT NOVEMBER 7, 2018

This Meeting Statement is not, and does not, purport to be, binding with respect to any other determination of any Credit Derivatives Determinations Committee, nor does it preclude any other Credit Derivatives Determinations Committee or any member of such Committee from making a different determination when resolving a similar question in the future, including any such question that relates to similar facts. Furthermore, the discussion summarized below is not, and does not purport to be, an exhaustive list of factors that each member of the Committee considered when casting its votes as set out in Appendix 1 to the First Statement (as defined below).

SUMMARY

This Meeting Statement makes reference to the November 5, 2018 Meeting Statement (the **First Statement**) of the Credit Derivatives Determinations Committee of the Americas made in connection with the publication of the Initial List of Deliverable Obligations in relation to the Auction for Sears Roebuck Acceptance Corp. (**SRAC** or the **Reference Entity**).

A majority of the members of the Committee voted in favor of excluding each of the Loans listed in Appendix 1 to this Meeting Statement (the **Eligible Assignee Loans**) from the Initial List of Deliverable Obligations, with such votes being cast in the manner set out in Appendix 1 to the First Statement.

Capitalized terms used but not defined in this Meeting Statement have the meanings given to them in either (i) the Credit Derivatives Determinations Committees Rules (September 28, 2018 version) (including in the 2014 Definitions and the Updated 2003 Definitions, each as defined therein) (the **DC Rules**), or (ii) the Eligible Assignee Loans, as the context requires.

1. DISCUSSION REGARDING ELIGIBLE ASSIGNEE LOANS

To constitute a Deliverable Obligation of the Reference Entity, the Eligible Assignee Loans must satisfy either the Assignable Loan or Consent Required Loan Deliverable Obligation Characteristic. The following is a brief summary of some of the Committee's discussions in resolving whether to include the Eligible Assignee Loans on the Initial List of Deliverable Obligations.¹

1.1 Assignable Loan

An "Assignable Loan" is a "Loan that is capable of being assigned or novated to, at a minimum, commercial banks or financial institutions (irrespective of their jurisdiction or organization) that are not then a lender or a member of the relevant lending syndicate, without the consent of the Reference Entity or the guarantor, if any, of

¹ Under Section 3.2(a) of the 2014 Definitions, the term "Deliverable Obligation" means any obligation of the Reference Entity (either directly or as provider of a Relevant Guarantee) determined pursuant to the method described in Section 3.14 (Method for Determining Deliverable Obligation) of the 2014 Definitions. For the purposes of Section 3.14(a), each of the Eligible Assignee Loans should constitute a "Loan" in accordance with Section 3.13(a)(v), being an obligation of a type included in the "Borrowed Money" Obligation Category that is documented by a term loan agreement, revolving loan agreement or other similar credit agreement. For the purposes of Section 3.14(b) of the 2014 Definitions, since the Transaction Type applicable to Credit Derivative Transactions referencing the Reference Entity is Standard North American Corporate (as defined in the Credit Derivatives Physical Settlement Matrix), the Deliverable Obligation Characteristics that the Eligible Assignee Loans must satisfy are: Not Subordinated, Specified Currency, Assignable Loan or Consent Required Loan, Transferable, Maximum Maturity of 30 years and Not Bearer.

such Loan (or the consent of the applicable borrower if the Reference Entity is guaranteeing such Loan) or any agent".²

As the consent of the "Agent" is required for any assignment of the Eligible Assignee Loans, the Committee determined that the Eligible Assignee Loans do not satisfy the definition of Assignable Loan because the consent of the agent is required to assign such loans after an event of default.³

1.2 Consent Required Loan

Consent Required Loan means "a Loan that is capable of being assigned or novated with the consent of the Reference Entity or the guarantor, if any, of such Loan (or the consent of the relevant borrower if the Reference Entity is guaranteeing such Loan) or any agent."⁴

The Eligible Assignee Loans may be assigned, with the consent of the "Agent", and provided no event of default has occurred and is continuing, the "Borrower", provided that such assignment is to an "Eligible Assignee".⁵

The Committee considered two different ways in which the definition of Consent Required Loan may be interpreted.

The First Interpretation

The First Interpretation proposes that a Loan must be capable of being assigned generally to all persons, subject to receiving the necessary consents contemplated by the definition of Consent Required Loan, and that any additional restrictions on the identity of the persons to whom the Loan may be assigned contained within a Loan, such as those restrictions contained in the definition of Eligible Assignee, should cause the Loan to fail the Consent Required Loan Deliverable Obligation Characteristic.

Restrictions on Transfer in the Eligible Assignee Loans

The Eligible Assignee definition contains two types of restriction on the identity of any potential assignee of the Eligible Assignee Loans. Firstly, the assignee must be a commercial bank or any other Person engaged in the business of making asset based or commercial loans, or any fund or other Person (other than a natural Person) that invests in loans. Secondly, such a bank, fund or Person must, together with its Affiliates, have a combined capital and surplus in excess of \$300,000,000. On the basis of the First Interpretation, members in support of such an interpretation proposed that the Eligible Assignee Loans should fail the Consent Required Loan Deliverable Obligation Characteristic because such members interpret that at least one (and in some cases, both) of these types of restriction constitute circumstances where the Eligible Assignee Loans are not capable of being generally assigned, even with the consent of the Agent.

Comparison with the Assignable Loan Deliverable Obligation Characteristic

² Section 3.14(b)(i) of the 2014 Definitions.

³ See Section 9.07 of each of the Eligible Assignee Loans.

⁴ Section 3.14(b)(ii) of the 2014 Definitions.

⁵ "Eligible Assignee" is defined in the Eligible Assignee Loans as "(a) a commercial bank or any other Person engaged in the business of making asset based or commercial loans, or any fund or other Person (other than a natural Person) that invests in loans, which bank, Person or fund, together with its Affiliates, has a combined capital and surplus in excess of \$300,000,000 and which bank, Person or fund is approved by the Agent, and, unless an Event of Default has occurred and is continuing at the time any assignment is effected in accordance with Section 9.07, the Borrowers, in each case such approval not to be unreasonably withheld or delayed, (b) an existing Lender or an Affiliate of an existing Lender or an Approved Fund, or (c) any Permitted Holder; provided that neither the Borrowers nor an Affiliate of the Borrowers (other than a Permitted Holder) shall qualify as an Eligible Assignee." The definitions of "Eligible Assignee" in the First Lien Credit Agreement, the Second Lien Credit Agreement and the IP/Ground Lease Term Loan Agreement are identical.

Certain supporters of the First Interpretation put forward the argument that, unlike the definition of Assignable Loan, which uses the same "capable of being assigned" phrase as Consent Required Loan but which then qualifies that phrase to refer to "at a minimum to banks and financial Institutions", Consent Required Loan does not contain such a qualification and therefore should be read as requiring assignment to all persons without restriction (since, unlike Assignable Loan, Consent Required Loan includes no such qualification).

Purpose of Consent Required Loan

Certain members of the Committee who supported the First Interpretation noted that, in their view, an important purpose of the Consent Required Loan Deliverable Obligation Characteristic is to protect CDS market participants from the risk that a Loan is categorized as a Deliverable Obligation but is subsequently not capable of being transferred to another participant in that CDS market as part of the settlement of a CDS contract. It was argued that, in light of such purpose, it would not be an appropriate outcome for a Loan to be classified as a Deliverable Obligation if it had restrictions on whom it could and could not be transferred to, other than the consent requirements contemplated by Consent Required Loan. If this conclusion were reached it would introduce a risk that a seller of protection in the CDS market who receives a Loan in the settlement of a CDS would not be able to transfer such Loan to another seller of protection as part of settlement of their related hedge CDS contracts.

Past Determinations and Published Interpretative Guidance

Although the Committee determined that, to its knowledge, no previous Committee had considered the exact same issues regarding Consent Required Loan as discussed on this occasion, members of the Committee who supported the First Interpretation were of the view that the First Interpretation (i) is consistent with the legal advice received by the Committee in connection with the interpretation of the Consent Required Loan definition and (ii) is supported by published written materials of a legal practitioner on the law of derivatives that specifically interprets the Consent Required Loan definition.⁶

De Minimis Restrictions

The Committee discussed that notwithstanding the interpretation above, there may be certain restrictions on assignment, such as a requirement that a Loan must not be assigned to a natural person, which may be *de minimis* on the facts and would not therefore, of themselves, prevent a Loan from satisfying the Consent Required Loan Deliverable Obligation Characteristic. Similarly, a restriction that would not reasonably prevent a Loan from being delivered to another CDS market participant (such as a restriction on transfer to anyone other than a commercial bank or any other Person engaged in the business of making asset based or commercial loans, or any fund or other Person (other than a natural Person) that invests in loans) might be considered *de minimis* and therefore not prevent a Loan from satisfying the Consent Required Loan requirement.

The Committee considered whether the definition of "Eligible Assignee" in the Eligible Assignee Loans would amount to a *de minimis* restriction. In this regard certain members of the Committee noted that the restriction in the Eligible Assignee Loans (and in particular the requirement that any transferee has to be a commercial bank or any other Person engaged in the business of making asset based or commercial loans, or any fund or other Person (other than a natural Person) that invests in loans, which bank, Person or fund, together with its Affiliates, has a combined capital and surplus in excess of \$300,000,000) would **not** amount to a *de minimis* restriction given that such a restriction would very likely prevent the transfer of the Eligible Assignee Loans to certain participants in the CDS market who would not be able to satisfy such capital test.

⁶ Firth, S. and Mortimer, M., 2018, *Derivatives Law and Practice*, Release 36, Sweet & Maxwell, London.

The Second Interpretation

The Committee also considered an alternative interpretation of Consent Required Loan. It was noted in discussions that agent consent requirements are a common feature in the U.S. loan market, making the Assignable Loan Deliverable Obligation Characteristic difficult to satisfy in Standard North American Corporate CDS contracts. Supporters of the Second Interpretation were of the view that the Consent Required Loan definition was principally included to address this reality of the U.S. loan market. This Second Interpretation proposes that, where a Loan is capable of being assigned to another person with the consents contemplated by the definition of Consent Required Loan, such Loan should satisfy the Consent Required Loan definition. Under this interpretation of Consent Required Loan, the inclusion of an Eligible Assignee requirement should not of itself prevent the Eligible Assignee Loans from satisfying the Consent Required Loan definition as long as the Loan remains "capable" of being assigned to another person with agent consent. In this case, the Eligible Assignee Loans are capable of assignment with agent consent to a commercial bank or any other Person engaged in the business of making asset based or commercial loans, or any fund or other Person (other than a natural Person) that invests in loans, which bank, Person or fund, together with its Affiliates, has a combined capital and surplus in excess of \$300 million. Certain supporters of the Second Interpretation believe that an Eligible Assignee concept is common in the U.S. loan market and that the combined capital and surplus requirement was not commercially unreasonable in the context of this Reference Entity. It was further argued that the Second Interpretation is a plain English reading of the definition of Consent Required Loan and such members of the Committee were not comfortable reading extra concepts into the definition of Consent Required Loan as, they argued, would be required under the First Interpretation. In particular, such members of the Committee argued that the words "without restriction", "generally to all persons", and words with a similar effect, are not included in the definition of Consent Required Loan and these concepts should not be read into such a definition.

Comparison with the Assignable Loan and Transferable Deliverable Obligation Characteristics

Supporters of the Second Interpretation compared the definition of Consent Required Loan with the definitions of Transferable and Assignable Loan in the 2014 Definitions, and argued that both such definitions appear to be aligned with the respective transfer practices in the underlying markets for the obligations (bonds or loans) to which they relate and this should inform the reading of Consent Required Loan. In particular, it was suggested that the definition of Transferable in the 2014 Definitions generally reflects transferability in the underlying bond market and is expressly confined to "institutional investors without any contractual, statutory or regulatory restriction"⁷ but that it goes on to permit certain restrictions customarily found in the bond market, such as transfers permitted under Rule 144a or Regulation S. It was also noted that the definition of Assignable Loan requires that a Loan is capable of being assigned or novated to, at a minimum, commercial banks or financial institutions, and that this is, in their view, designed to capture transferability to the types of entities that make loans, and not to those entities who participate in the CDS market. On this basis, advocates of the Second Interpretation argued that Consent Required Loan should also be read in a manner that is consistent with transferability in the underlying market to which it relates (i.e. in this instance the loan market) rather than transferability in the broader CDS market.

Purpose of Consent Required Loan

Certain members of the Committee who support the Second Interpretation disagree with the purpose of Consent Required Loan summarized under the First Interpretation. As noted above, such members of the Committee view the primary purpose of the Consent Required Loan definition as to enable U.S. loans (which are often only transferable with the prior consent of the agent or borrower and would therefore be excluded under the Assignable Loan Deliverable Obligation Characteristic) to be considered for deliverability in settlement of CDS

⁷ Section 3.14(b)(iv) of the 2014 Definitions.

contracts. It was also noted by such members that certain restrictions on transferability (such as agent consent) are often included in U.S. loans to mitigate against the risk that a loan may be recharacterised or interpreted as a “security” under U.S. securities laws, and therefore Consent Required Loan was specifically added to account for this from a CDS deliverability perspective.

Certain members who supported the Second Interpretation pointed out that if a loan is found to be a Deliverable Obligation but subsequently cannot be transferred between CDS market participants, the 2014 Definitions contain fallbacks that may cover such a scenario in any event.⁸ Proponents of the First Interpretation argued that such fallbacks were not designed to remove the need for the application of Consent Required Loan.

Past Determinations and Published Interpretative Guidance

Certain supporters of the Second Interpretation (i) did not view prior legal advice provided to any Committee, including legal advice provided to this Committee, as informative on this issue,(ii) did not believe any prior determinations made by other Committees, which were not factually analogous to this case, were relevant and therefore persuasive in relation to the present discussions regarding Consent Required Loan and (iii) did not agree with the interpretation taken from the published materials, which in their view was merely the view of one practitioner in the market, referenced in footnote 6 above and did not find such material to be dispositive.

Loan and CDS Market Developments

It was noted that it is relatively common in the U.S. loan market for loans to contain restrictions on the entities to which a loan can be assigned. Concern was expressed by certain members who supported the Second Interpretation that the First Interpretation may have the effect of limiting CDS market participants' ability to deliver a number of U.S. loans, essentially turning the CDS market in the United States into a "Bond only" market.

Those members felt that this may be particularly pertinent given that, according to certain members of the Committee, the United States loan market has expanded significantly in recent years. Other members of the Committee noted that it was not the role of the Committee to interpret the 2014 Definitions to respond to changes in the loan market.

It was also noted by some supporters of the First Interpretation that if one were to follow the Second Interpretation it could leave the concept of Consent Required Loan with little meaning in practice.

Conclusion

Having considered the interpretations summarized above, the Committee Resolved by a majority vote that the Eligible Assignee Loans should not be included on the Initial List of Deliverable Obligations.

⁸ Section 9.2 of the 2014 Definitions, for example.

Appendix 1 – List of Eligible Assignee Loans

1. The second lien term loan in an original principal amount of \$300 million, which matures on July 20, 2020 (the **Second Lien Term Loan**), pursuant to that Second Lien Credit Agreement, dated as of September 1, 2016 (as amended, supplemented, or otherwise modified, the **Second Lien Credit Agreement**), between, among others Sears Holdings Corporation (**Sears Holdings**), SRAC and Kmart Corporation (**Kmart Corp.**), as borrowers, Sears Holdings, certain subsidiaries of Sears Holdings, as guarantors, the administrative agent and collateral administrator, and the lenders.
2. The second lien line of credit loans in an aggregate principal amount of approximately \$525 million, maturing not later than July 20, 2020 (the **Second Lien L/C Loans**), pursuant to the Second Lien Credit Agreement.
3. The first lien term loans in an original principal amount of \$750 million, which mature on July 20, 2020 (the **First Lien Term Loans**), pursuant to that certain Third Amended and Restated Credit Agreement, dated as of July 21, 2015 (as amended, supplemented, or otherwise modified, the **First Lien Credit Agreement**), between, among others, SRAC and Kmart Corp., as borrowers, Sears Holdings, the agents, and the lenders.
4. The "first-in, last-out" term loan in an original principal amount of \$125 million, which matures on July 20, 2020 (the **FILO Term Loan**), pursuant to the First Lien Credit Agreement.
5. The asset-based revolving credit facility with current commitments of \$1.5 billion (including a letter of credit sublimit of up to \$1 billion), subject to a borrowing base formula, which matures on July 20, 2020 (the **Revolving Credit Facility**), pursuant to the First Lien Credit Agreement.
6. The letter of credit facility with current drawings of \$271 million, pursuant to that certain Letter of Credit and Reimbursement Agreement dated December 28, 2016, which matures on December 28, 2019 (the **L/C Facility**) and issued pursuant to and in connection with the First Lien Credit Agreement.
7. The loans in an aggregate principal amount of \$250 million (the **IP/Ground Lease Term Loans**), pursuant to that certain Term Loan Credit Agreement, dated as of January 4, 2018 (as amended, supplemented, or otherwise modified, the **IP/Ground Lease Term Loan Agreement**), between, among others, SRAC and Kmart Corp., as borrowers, Sears Holdings, certain subsidiaries of Sears Holdings, as guarantors, the administrative agent and collateral administrator, and the lenders.