



Final Slide Deck

Sears Roebuck Acceptance Corp.
(DC Issue: 2018-10152)

*Presentation to the External Review Panel
On Behalf of the Proponents of the “Yes” Position*

December 19, 2018

Presenters:

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Plain Language, Reason, and Sound Policy Favor the “Yes” Position

“Each DC Voting Member shall perform its obligations under the Rules in a **commercially reasonable** manner.”
--DC Rules § 2.5(b)

“The written policies and/or procedures shall require DC Decision-makers or CCP DC Decision-makers, as relevant, to Resolve DC Questions based on a **commercially reasonable** analysis of the information.”
--DC Rules, Schedule 6

Plain Language

- Definitions say only that Loans must be “*capable* of being assigned.”
- The “No” proponents read in language that does not exist.

Commercial Reasonableness

- Restrictions at issue here are reasonable grounds to withhold consent.
- Stating reasonable limitations upfront advises the market and does not unduly restrict liquidity.
- These restrictions do not interfere with settlement of the CDS contract.

Policy Considerations

- “Yes” position accommodates evolution in underlying market.
- Definitions should be construed to reflect, not control, market practices.
- Reasonable limitations on Eligible Assignees are conducive to liquidity in the loan market.
- Excluding Deliverable Obligations can distort the auction.

The “No” Proponents Invent Unstated Requirements

Definition of Consent Required Loan

Alternative 1

...to any party...

"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;

Alternative 2

...and without any contractual restrictions.

Compare to Other Definitions

"Assignable Loan" means a Loan that is capable of being assigned or novated to, at a minimum, commercial banks or financial institutions (irrespective of their jurisdiction of 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 such Loan (or the consent of the applicable borrower if the Reference Entity is guaranteeing such Loan) or any agent;

"Transferable" means an obligation that is transferable to institutional investors without any contractual, statutory or regulatory restriction, provided that none of the following shall be considered contractual, statutory or regulatory restrictions:

2014 ISDA
Credit Derivatives
Definitions

ISDA®
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

Objective Standards Clarify When Consent Can Reasonably Be Withheld

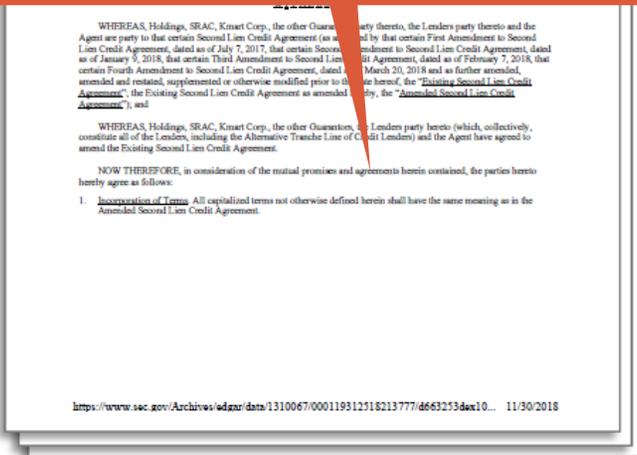
“Eligible Assignee” means (a) a commercial bank or any other Person engaged in the business of making asset based or commercial loans, or any fund or other Person (other than a natural Person) that invests in loans, which bank, Person or fund, together with its Affiliates, has a combined capital and 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.

“For avoidance of doubt, consent will not be given where the proposed assignee fails to satisfy the following criteria”

Reasonable grounds for refusing consent include:

- Reputation of the proposed assignee (DQ Lists, etc.);
- Lack of sophistication;
- Inadequate resources.

All are important for both borrower and lenders.



The Secondary Loan Market is Highly and Increasingly Liquid

Finance and Economics Discussion
Divisions of Research & Statistics and Monetary
Federal Reserve Board, Washington

Loan Sales and Bank Liquidity Risk Management
a U.S. Credit Register

Rustom M. Irani and Ralf R. Meisenzahl

2015-001

This paper examines an increasingly important financial innovation: the secondary market for bank loans. Since the arrival of an active secondary market in the mid-1990s, bank loans have experienced a considerable increase in liquidity.² Data from the Loan Syndications and Trading Association (LSTA) indicate that the secondary market grew rapidly from 2000 until 2007, exceeding \$100 billion of trading volume each year and peaking in excess of \$350 billion in 2007.³ This development raises the question of how bank liquidity risk management has changed in the presence of a deep and liquid secondary loan market.

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November 29, 2018 - Last month we reported that one of the possible reasons that trading volumes have not grown this year alongside outstandings has been a general lack of price volatility in the secondary market. That trend reversed in October as volatility spiked across the capital markets. In loan land, bid levels in the secondary fell by almost 50 basis points, resulting in secondary trading volumes surging 22% in October – to \$65.8 billion. Volumes now total a record \$670 billion over the last twelve months; 5% higher than the same period last year.

LSTA
THE LOAN SYNDICATIONS AND
TRADING ASSOCIATION

Secondary Trading Volumes Surge 22% in October

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...and busiest month in the secondary since March at \$66.4 billion). As volumes ran higher and prices that traded in October hit a fresh record of 1,578 the average monthly total over the previous 12 concentration increased two percentage points to a trading north of 98 cents on the dollar surged six are of total volume. Clearly, accounts that were of the higher priced/lower yielding side of the presumably already on the books. And that trade rage bid on the S&P/LSTA Leveraged Loan Index is ber.

...ess the full Summary, including charts, [here](#). For ta.

<https://www.lsta.org/news-and-resources/news/secondary-trading-volumes-surge-22-in-o-...> 12/14/2018

The Role of Liquidity in the Bank Loan Market

Liquidity in the Pricing of Syndicated Loans*

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Allan A. Zebedee³

April 2007

Forthcoming, *Journal of Financial Markets*

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Liquidity in the Pricing of Syndicated Loans

ABSTRACT

We examine whether banks price expected liquidity in U.S. syndicated term loans. Using extensive data we show that loans with higher expected liquidity have significantly lower spreads at origination, controlling for other determinants of loan spreads such as borrower, loan, syndicate and macroeconomic variables. A matched sample analysis confirms our results. We estimate that the pricing of expected liquidity results in annual savings of over \$1.6 billion to the borrowers, in our sample alone. For the first time in the literature, we identify what

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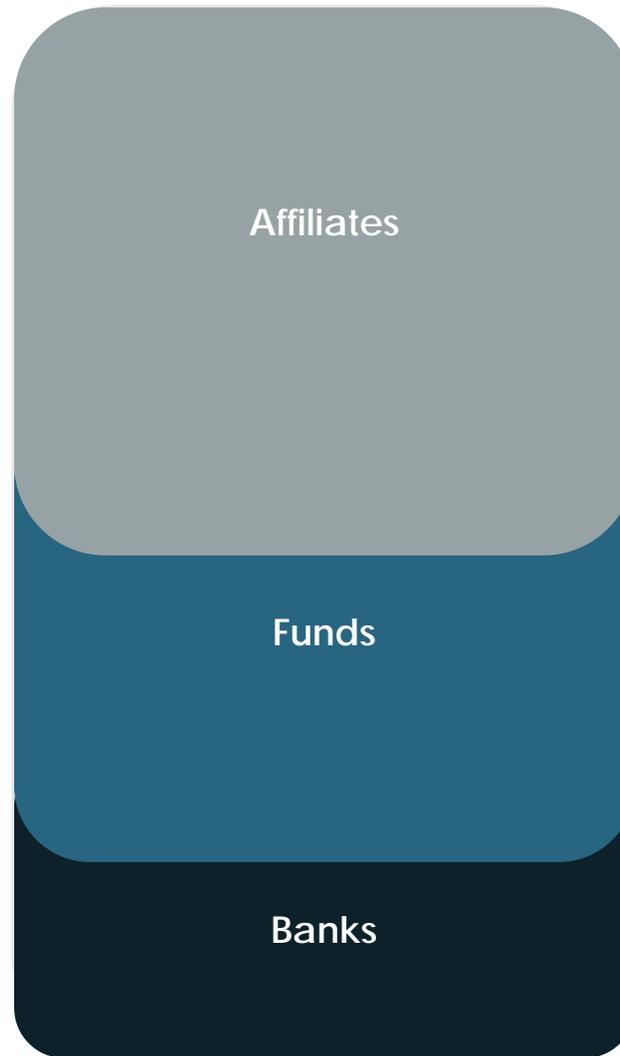
The Universe of Potential Loan Purchasers is Vast

Eligible Assignees

“Affiliate” means, as to any Person, any other Person that, directly or indirectly, controls, is controlled by or is under common control with such Person or is a director or officer of such Person. For purposes of this definition, the term “control” (including the terms “controlling”, “controlled by” and “under common control with”) of a Person means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of such Person by contract or otherwise.

4,862 Form ADV filing fund managers (AUM > \$600 million)

1,807 bank holding companies (assets > \$300 million)



Nominees & Participants



Purchasing Through Nominees or Participations is Commonplace and Easy

D. Sub-participation

A sub-participation is essentially a contractual agreement between the lender and the participant to make funding arrangements. It is an entirely separate contract from the underlying facility agreement and does not involve the transfer to the buyer of a legal or beneficial interest in the debt. The participant will, therefore, not have any directly enforceable rights against the borrower. Borrower consent is not usually required and so this method can be confidential.

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A Syndicated Loan Primer

Participations

As the name implies, in a participation agreement the buyer takes a participating interest in the selling lender's commitment.

The lender remains the official holder of the loan, with the participant owning the rights to the amount purchased. Consents, fees, or minimums are almost never required. The participant has the right to vote only on material changes in the loan document (rate, term, and collateral). Nonmaterial changes do not require approval of participants. A participation can be a riskier way of purchasing a loan, because, if the lender of record becomes insolvent or defaults, the participant does not have a direct claim on the loan. In this case, the participant then becomes a creditor of the lender and often must wait for claims to be sorted out to collect on its participation.

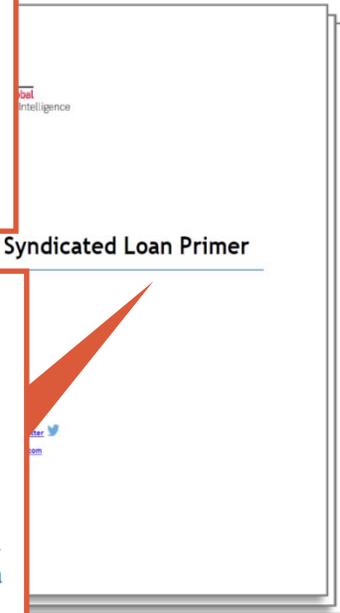
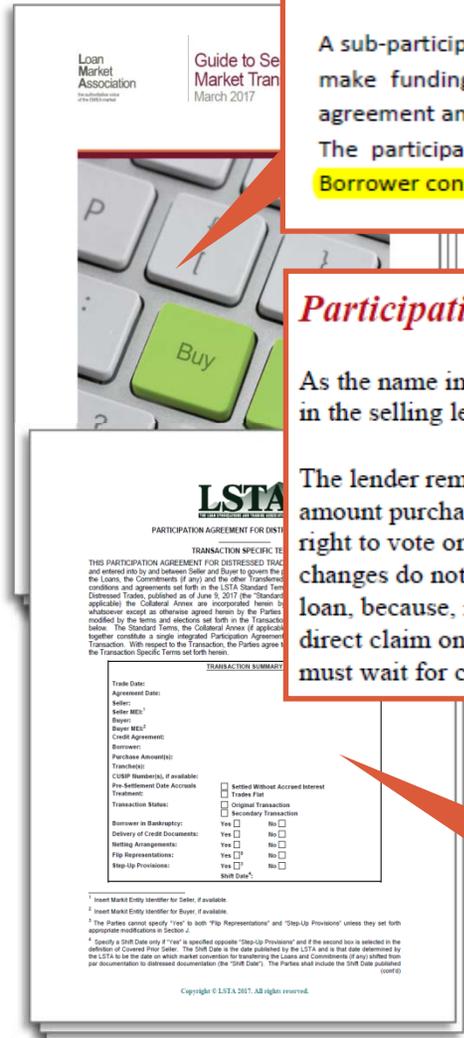
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H. SECTION 11 (VOTING)

H.1 "Voting" select one:

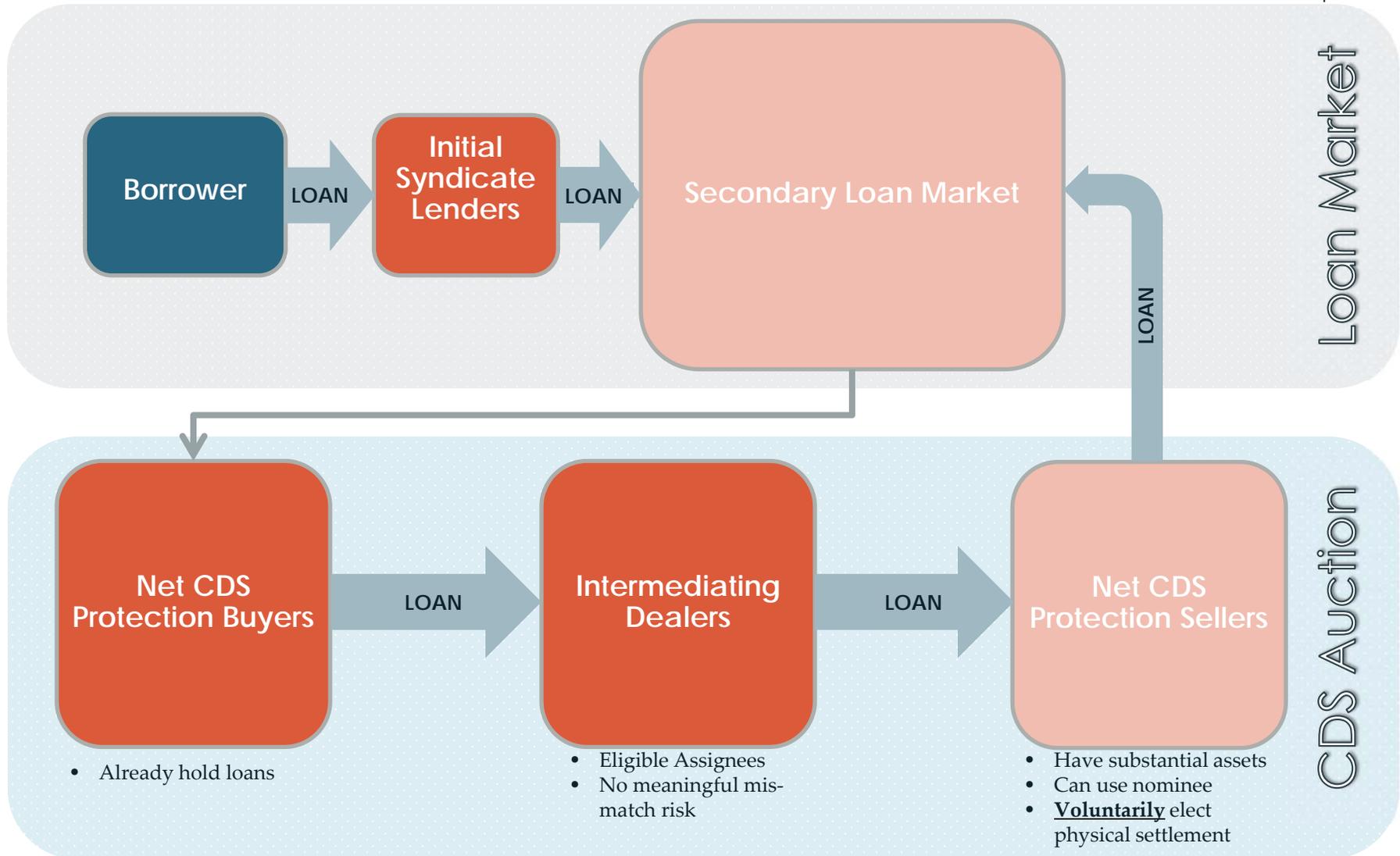
Buyer shall have voting rights with respect to the Transferred Rights, subject to Section 11.1(a) of the Standard Terms and Conditions.

Buyer shall have no voting rights in respect of the Transferred Rights, subject to Section 11.1(b) of the Standard Terms and Conditions, except with respect to the following matters: _____

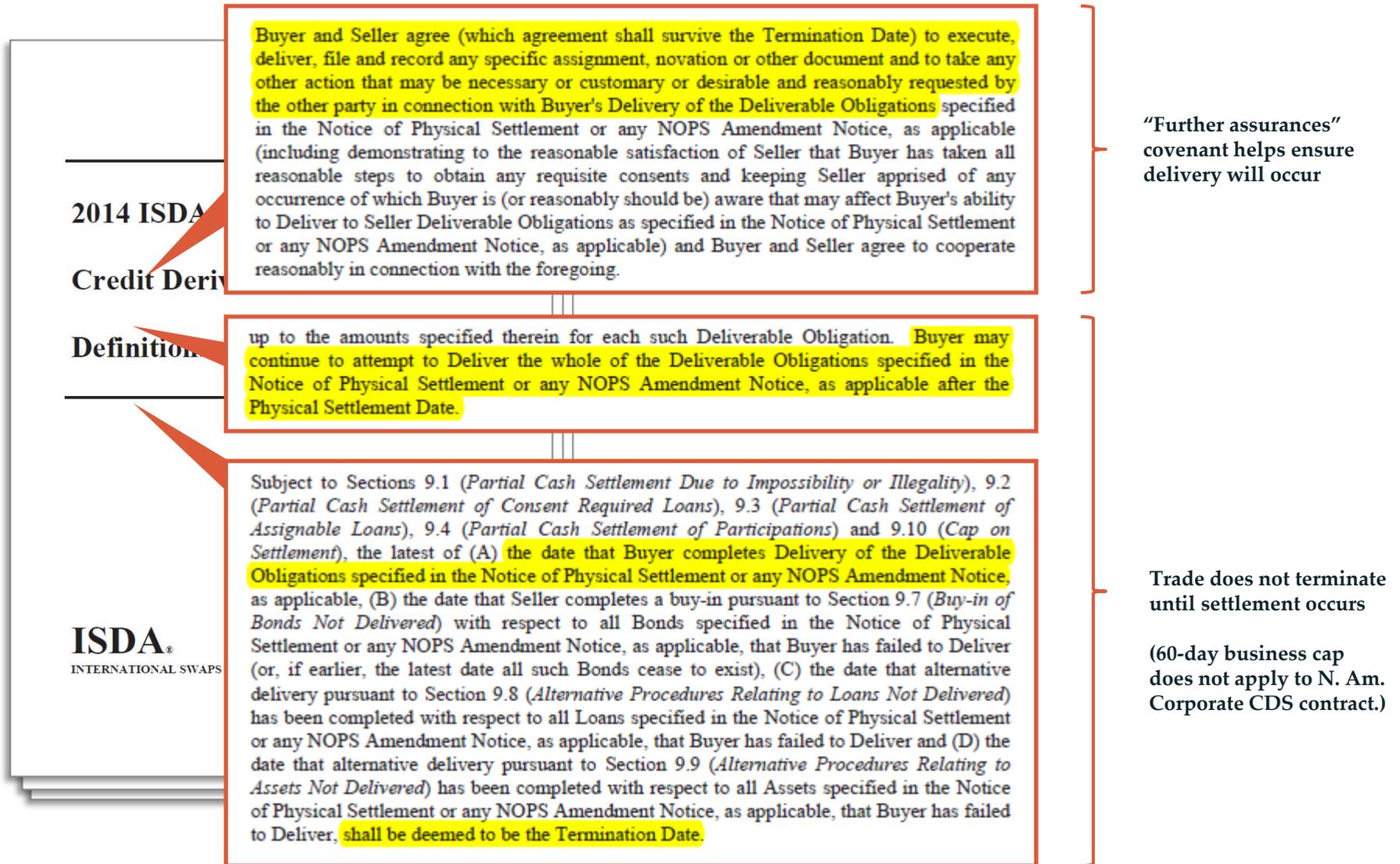


All CDS Contracts Will Settle Without Issue

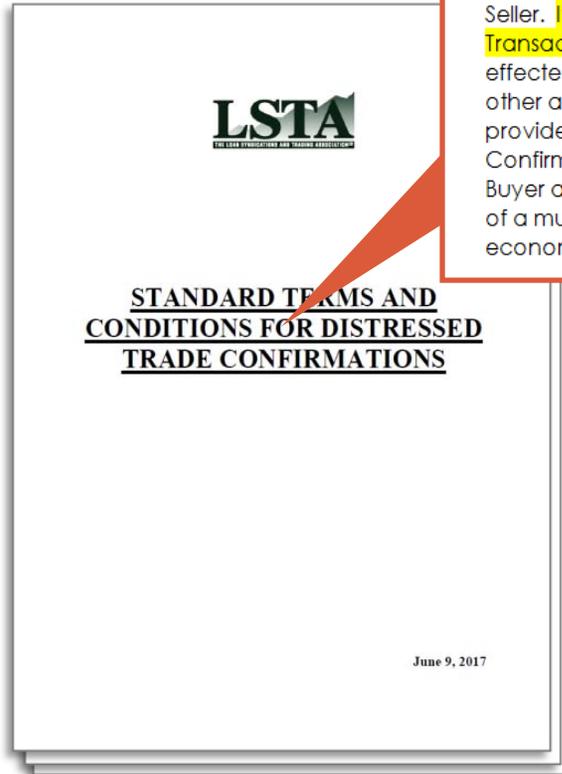
- Eligible Assignee
- Eligible Assignee or Holder via Participation



Trades Will Settle Seamlessly Even If Auction Is Not Run



LSTA Forms Prescribe What Actions are “Necessary or Customary or Desirable and Reasonably Requested”

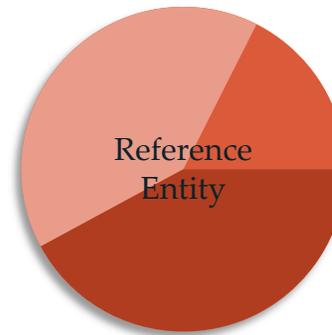


If Buyer and Seller are unable to effect settlement of the Transaction as specified in the Confirmation, a valid and binding obligation to settle the trade nevertheless continues to exist between Buyer and Seller. If a Transaction that is to be settled by assignment cannot be settled on such basis, such Transaction shall be settled as a participation; provided that if settlement by participation cannot be effected, the Transaction shall be settled on the basis of a mutually agreeable alternative structure or other arrangement that affords Buyer and Seller the economic equivalent of the agreed-upon trade; provided, further, that if “Assignment Only” is elected in the “Form of Purchase” section of the Confirmation (an “Assignment Only Election”) and the Transaction cannot be settled on such basis, Buyer and Seller shall not settle the Transaction as a participation but shall instead settle on the basis of a mutually agreeable alternative structure or other arrangement that affords Buyer and Seller the economic equivalent of the agreed-upon trade.

- LSTA standard terms clearly provide for participations and nominees being “**necessary or customary or desirable**” means of achieving settlement.
- Loan market standard conventions may be “**reasonably requested**” by CDS participants.

Example of an Auction Squeeze

- CDS protection sellers (“Sellers”):
 - Have a net \$200 million sell position; and
 - Own \$100 million of the senior bonds.
- Assuming no market imbalance, Sellers would have to pay \$160 million to settle CDS contracts.
- The Squeeze:
 - In Auction Phase 1, Sellers submit buy requests of \$110 million.
 - Even if all \$100 MM other bonds are tendered by CDS protection buyers, net open interest will be \$10 MM to buy.
 - In Phase 2, there are no senior unsecured bonds left to fill open interest. (Sub bonds do not qualify as Deliverable Obligations.)
 - If loans are not Deliverable Obligations, open interest will not be filled; auction terms will set final price at 100% – a total squeeze.
 - Sellers will have to buy \$110 MM in bonds for par, but escape \$160 MM CDS cash settlement. All protection buyers get zero, defeating the purpose of CDS protection.



- \$300 MM loans trading at \$.50
- \$200 MM senior unsecured bonds trading at \$.20
- \$150 MM subordinated bonds trading at \$.01

DC Members – Not Attorneys – are Real “Leading Market Participants”

“Yes” Proponents

- Barclays Bank
- Citibank
- Credit Suisse
- Goldman Sachs
- JP Morgan Chase
- Elliott
- Pimco

“No” Proponents

- Bank of America
- BNP Paribas
- Deutsche Bank
- Mizuho Securities
- Societe Generale
- Alliance Bernstein
- Citadel Americas
- Cyrus Capital

“Yes” proponents represent a larger proportion of the U.S. loan market (33% vs. 22%)

US Loans - Bookrunners (R11)										Jan 1 - Jun 30		
Bookrunner	Proceeds per Bookrunner (US\$m)					# of Deals per Bookrunner			Imputed Fees (US\$m)			
	2018 Rank	2017 Rank	Proceeds	Market Share%	Market Share Ch.	# of Deals	Market Share%	Change in # of Deals	Manager Fees	Market Share%	Market Share Ch.	
Bank of America Merrill Lynch	1	1	205,747.8	13.7	1.3 ▲	664	31.6	-24 ▼	629.2	11.8	2.4 ▲	
JP Morgan	2	2	185,137.0	12.3	1.3 ▲	570	27.2	-36 ▼	472.7	8.8	0.6 ▲	
Wells Fargo & Co	3	4	137,652.9	9.2	1.7 ▲	474	22.6	-62 ▼	417.4	7.8	1.6 ▲	
Citi	4	3	112,804.8	7.5	-1.7 ▼	285	14.1	-54 ▼	289.2	5.4	-1.6 ▼	
Barclays	5	6	69,788.4	4.6	-0.8 ▼	261	12.4	-36 ▼	274.2	5.1	-0.4 ▼	
Goldman Sachs & Co	6	5	65,610.9	4.4	-1.2 ▼	212	10.1	-31 ▼	256.4	4.8	-1.0 ▼	
Morgan Stanley	7	8	56,376.4	3.8	-0.2 ▼	148	7.1	-37 ▼	211.8	4.0	-0.2 ▼	
Mitsubishi UFJ Financial Group	8	11	55,369.2	3.7	1.2 ▲	158	7.5	-2 ▼	172.4	3.2	1.2 ▲	
Deutsche Bank	9	7	49,391.0	3.3	-0.9 ▼	201	9.6	-25 ▼	212.9	4.0	-0.2 ▼	
Credit Suisse	10	9	46,208.2	3.1	-0.8 ▼	200	9.5	-21 ▼	201.3	3.8	-1.6 ▼	
RBC Capital Markets	11	10	41,103.5	2.7	-0.4 ▼	194	9.2	5 ▲	166.7	3.1	-0.2 ▼	
BNP Paribas SA	12	13	37,261.7	2.5	0.5 ▲	112	5.3	6 ▲	106.5	2.0	0.5 ▲	
Mizuho Financial Group	13	17	30,747.1	2.0	0.4 ▲	108	5.1	5 ▲	95.0	1.8	0.5 ▲	
SunTrust Banks	14	14	29,447.9	2.0	0.1 ▲	189	9.0	-12 ▼	120.6	2.3	0.2 ▲	
US Bancorp	15	12	29,049.2	1.9	-0.2 ▼	169	8.1	-22 ▼	95.6	1.8	0.0 -	
PNC Financial Services Group	16	15	27,360.0	1.8	0.0 -	171	8.1	-5 ▼	104.0	1.9	0.2 ▲	
HSBC Holdings PLC	17	18	25,811.2	1.7	0.2 ▲	87	4.1	0 -	97.6	1.8	0.6 ▲	
Jefferies LLC	18	16	18,174.9	1.2	0.5 ▼	95	4.5	5 ▲	101.6	1.9	-1.3 ▼	
BMO Capital Markets	19	19	17,157.7	1.1	-0.1 ▼	125	6.0	-34 ▼	77.1	1.4	-0.3 ▼	
TD Securities Inc.	20	27	16,397.8	1.1	0.4 ▲	65	3.1	1 ▲	62.8	1.2	0.3 ▲	
Scotiabank	21	23	15,766.9	1.1	0.3 ▲	61	2.9	-5 ▼	42.7	0.8	0.0 -	
Citizens Financial Group	22	21	15,446.3	1.0	0.0 -	119	5.7	-8 ▼	77.2	1.4	0.0 -	
Capital One Financial Corp	23	29	14,098.1	0.9	0.2 ▲	111	5.3	12 ▲	44.2	0.8	-0.1 ▼	
Sumitomo Mitsui Finl Grp Inc	24	31	13,987.6	0.9	0.3 ▲	44	2.1	13 ▲	52.3	1.0	0.3 ▲	
KeyBanc Capital Markets Inc	25	20	13,269.7	0.9	-0.1 ▼	101	4.8	-14 ▼	50.7	1.0	-0.2 ▼	
Top Twenty Five Total			1,329,195.2	88.4	1.0 ▲				4,432.1	82.9	1.3 ▲	
Bookrunner Total			1,504,773.6	100.0		2,099		-157	5,352.2	100.0		

Thompson Reuters Global Syndicated Loans Review, First Half 2018