EXPERTS' VIEW

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__Michael S. Goldman__ is a Partner in the firm's Corporate Department and is the Practice Lead of the firm's Banking group. His practice includes complex syndicated loan transactions, acquisition and leveraged finance, asset-based lending and securities offerings for both US and international clients. __Tatiana Lapushchik__ is a Partner in the firm's Corporate Department. Her practice focuses on representing financial institutions, as well as corporate borrowers, in domestic and cross-border bank financings across a variety of industries.

Mike and Tatiana share their thoughts on recent developments in loan terms and predictions for 2011:

What were the key trends in loan documentation that you saw during 2010?

2010 was the "year of refinancing" in the leveraged loan market, with much of the liquidity coming from the continued resurgence of the high-yield bond market. The most significant trend during this refinancing boom was the willingness of secured bank lenders to share their collateral with bondholders on a *pari passu* basis. While the high-yield market had a record year in 2010, the syndicated loan market remained choppy at times.

Desiring to take advantage of the surging high-yield market, and concerned about continuing liquidity in the leveraged loan market as existing CLO vehicles enter the end of their reinvestment periods, many borrowers sought amendments to their loan agreements either to refinance, or to permit future refinancings of, their upcoming loan maturities with longer-term debt, often in the form of *pari passu* secured bonds. As a condition to granting these amendments, lenders generally required that the *pari passu* secured bonds be subject to an intercreditor agreement that, while preserving the *pari passu* status of the bondholders' liens, effectively vested collateral-related decisions in the hands of the lenders.

Loan terms are reportedly becoming much more borrower-friendly than many market participants expected. How similar are they to early-2007 loan terms and do you expect them to become increasingly borrower-friendly?

As liquidity in the syndicated loan market improved, borrowers naturally sought to obtain many of the borrower-friendly terms that were characteristic of the 2005 to 2007 period. While many of these terms have reappeared in concept, lenders have required that some be modified to address perceived earlier flaws or provide greater credit protection. For example, leverage ratios may again be calculated on a "net debt" basis, but many deals now permit the borrower to net only cash in excess of its working capital needs or cap the overall amount of cash that may be netted or permit netting only to the extent the lenders have control agreements over the borrower's deposit accounts (or some combination).

Similarly, *pro forma* EBITDA "addbacks" for restructuring, "business optimization" and similar cash charges, or for "synergies" and "projected cost savings," are now often capped, effectively limiting the amount of financial covenant cushion created by these addbacks. Perhaps most significantly, the overall leverage levels that lenders have been willing to allow in new deals, for the time being at least, seem significantly lower.

Recently covenant-lite deals have reappeared in the market. Would you predict a continued increase in these transactions in 2011?

Toward the end of 2010, we saw several proposed LBO financings where financial covenants were stated to be only for the benefit of (and only enforceable by) the revolving lenders and not the term lenders. Because the borrower is still required to comply with a financial covenant, however, we view these structures as more of a reallocation of voting power from the term lenders to the revolving lenders than as a complete derogation of credit protection. We have not seen deals where financial covenants were completely absent.

The unprecedented liquidity in the institutional loan market leading up to the disruption in mid-2007, and the competition among lead arrangers to attract the most lucrative M&A-related loan assignments, directly led to the creation of the covenant-lite loan structure. Today, especially in transactions where "underwriting" banks may retain significant credit exposure, we believe that the internal risk management policies and practices of some arrangers may limit their willingness to underwrite these structures. Although many analysts predict continued improvement in the leveraged loan market in 2011, we would not expect to see a widespread return of true covenant-lite deals in the short term.

What developments do you expect to see in the loan market in 2011?

Continuing with the themes of refinancing and *pari passu* bonds, we expect to see new credit agreements building in an assortment of financing and refinancing options for borrowers, including the flexibility to incur *pari passu* debt in the capital markets for a variety of purposes (including acquisitions), and not just to refinance existing bank debt.