Problems & Pitfalls in Accounting for Syndicated Bank Loans

Session #303
Tuesday June 9, 2015 9:45am – 10:45am
Problems & Pitfalls in Accounting for Syndicated Bank Loans

Presented by:

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  Accounting and Regulatory Specialist - SunGard iWorks

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  Vice President, Accounting
  Regulatory Investment Reporting– Prudential
Agenda

- Glossary and Terms
- What is a Syndicated Bank Loan?
- Characteristics and Structure
- Insurance Companies’ Participation in Bank Loans
- Workflow, Timing, and Processing of Bank Loan Transactions
- Accounting and Reporting Considerations
- Questions
Glossary and Key Terms

- **Borrower** – usually a large corporation that has the need to borrow a large amount of money
- **Arranger** – the lead bank that advises the borrower on the types of loans it requires
- **Bookrunner** – an Arranger who canvasses the market for potential investors
- **Syndicate** – group of lenders who provide the loan(s)
- **Secondary Market** – other investors who purchase the rights to the cash flows from members of the syndicate (or each other)
- **Loan Deal** – the overall arrangement negotiated and agreed upon by the borrower and the arranger
- **Facility** – a group of loan contracts to a single borrower. Also called Tranches
- **Loan Contracts** – individual loans to same borrower that make up a loan facility
- **Distressed Loan** – occurs when the borrower breaks a term of the loan
- **Loan Defaults**
  - Technical Defaults
  - Payment Defaults
- **Remedies** – agreements between loan holders and borrower on how to “fix” loan defaults
  - Amendments
  - Refinance
  - Corporate Restructure
What is a Syndicated Bank Loan?

- **Syndicated loans** are debts issued by a consortium of lenders to a single borrower, usually a large corporation.
  - The Loan Amount is big – typically $100’s M to Multibillion $.
  - Loans are used to fund takeovers, corporate restructures, expansion projects, etc.
  - Single lender cannot fund or take on the debt alone.
What is a Syndicated Bank Loan?

Source: The Loan Syndications & Trading Association
http://www.lsta.org/
What is a Syndicated Bank Loan?

- **Key Players**
  - **Borrower**
    - Large Corporation
  - **Agent Bank – aka, The Arranger**
    - A bank who advises the borrower and puts together the “Deal”
    - Bookrunner – An Arranger who canvasses the market for potential investors
  - **Syndicate**
    - Group of lenders who provide the funds for the loan(s)
  - **Secondary Market**
    - Other investors who purchase the rights to the cash flows
### Example of Borrowers in SBL Deals

<table>
<thead>
<tr>
<th>Name</th>
<th>Tranche</th>
<th>Loan Rating</th>
<th>Coupon</th>
<th>Maturity</th>
<th>Average Bid (pct. pts.)</th>
<th>Weekly Change (pct. pts.)</th>
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<td>Incremental TL</td>
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<td>WR/NR</td>
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<td>Caa1/CCC+</td>
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Source: LSTA/Thomson Reuters Mark to Market Pricing
# Largest Deals in 2014

## U.S. LOANS: LARGEST DEALS OF Q1 2014

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<th>Date</th>
<th>Borrower</th>
<th>Deal Type</th>
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<th>Amount (USD Mn)</th>
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<td>GRIFOLS WORLDWIDE OPS</td>
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<td>WESTERN DIGITAL TECH</td>
<td>Revolver/TL</td>
<td>Technology</td>
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**Source:** www.Bloomberg.com
Three Levels of a Syndicated Bank Loan (Typical)

- Deal Level
  - Overall arrangement negotiated between the borrower and primary lender

- Facility
  - Grouping of Loans made available to bank investors and institutional investors
    - Individual Loans could be divided up into different facilities

- Loan Contracts
  - Individual loans made to the borrower under the overall deal
    - Term loans
    - Revolving credit
    - Letters of Credit
### Example of a Facility with 2 Initial Loans

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<th>Loan #</th>
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<th>Loan ID</th>
<th>Count</th>
<th>Freq</th>
<th>Start Date</th>
<th>Next Payment</th>
<th>Maturity Date</th>
<th>Resat Days</th>
<th>FIC Participation</th>
<th>Global Amount</th>
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<th>Base Rate</th>
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<td>4.000%</td>
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<td>39</td>
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</table>

1. Fictional Insurance Company Participation = .01% of Global Amount
2. Interest Rate is LIBOR + Spread. LIBOR is less than Floor of 1.0% so Base Rate is used
Characteristics and Structure

Simple Loan Deal

Diagram showing the structure of the loan deal with relationships between the borrower, arranger, loan deal, facilities, and syndicate of investors/lenders.
Characteristics and Structure

- **Payments, Maturities, Rollovers**
  - Payments are on pass-through basis
    - Made as cash is received
  - Interest comes in at different amounts, different times
    - Based on individual loan contracts
  - Principal payments frequently received on reset dates or maturity
    - Unscheduled principal frequently received
  - Maturities frequently roll over
    - To one or more contracts
      - With their own terms
<table>
<thead>
<tr>
<th>Descr</th>
<th>Contract #</th>
<th>Date</th>
<th>Day Count</th>
<th>Freq</th>
<th>Start Date</th>
<th>Next Payment</th>
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Characteristics and Structure
Fictional Insurance Company Holdings in Hilton Worldwide Bank Loans as of 6/30/14: $555,000
How do Insurance companies participate

- Purchase a pro-rata portion of the loans (Facility level)
  - Not as original lenders
  - Between 25 to 33% of insurance companies invest in SBLs and growing
  - Represents approx. $15B+ of invested assets
  - Roughly 4% of outstanding syndicated bank loans

- Indirectly
  - CLOs (Collateralized Loan Obligations)
  - Hedge Funds
  - Mutual Funds
Insurance Companies Investment in Bank Loans

- Why do Insurance Companies invest in Bank Loans
  - Hunt for yield
    - Alternative to fixed rate high yield bond investments
      - Higher Credit Quality
        » Credit enhancements
        » Priority over bond investors
  - Hedge against rising interest rates
    - Most loans are floating rate – a spread over LIBOR
  - Maintain a diversified portfolio
    - Exposure to different counterparties than with a bond portfolio
Insurance Companies Investment in Bank Loans

- What is the outlook for investments in SBLs
  - Participation by insurance companies is expected to grow
    - Bank loans add value when short-term rates rise
      » Speculation that rates will start to rise late 2015
    - Companies looking to replace maturing bonds
      » Many 30 year bonds are due to mature in 2017 and 18
What do insurance companies invest in?

- Facilities
  - Assigned a CUSIP #
    - May have an ISIN
    - LOANXID – identifier applied to Syndicated Loans
  - Traded based upon Par
    - Global Amount vs. Position Amount
      » Position is based upon % of “ownership” in that Facility
  - Usually comprised of more than one loan contract
    - Different Maturities / Reset Dates
    - Different Interest Rates / Spreads
    - Different Payment Schedules
Types of Bank Loan Transactions – Contract Level

- Trades
- Income
- Principal Repayment
- Income Accruals
- Fees
- Agent Notices - Rollover of Contracts
- Restructures
Workflow, Timing, and Processing of Bank Loan Transactions

Prior to 2005
- Manual process of agent faxes – most activity at monthend
- Contract level info in trade and accounting systems – very time consuming

2005-2012
- Continue process of agent faxes, manually
- Contract info only in trade system
- Roll up to Tranche level in accounting system
- Some feeds from trade to accounting system

2012-Present
- Implemented new trade system
- A system feed for agent faxes – publics only
- More automated feeds – intraday feeds
Workflow, Timing, and Processing of Bank Loan Transactions

Tranche Level – roll up of contract characteristics

- Calculated Tranche Level Weighted Average Coupons (WAC)
- Sum of all Principal Repayments and WAC should produce a Book Yield for the Tranche
- Accruals for all contracts are rolled up
- Weighted Average Spread (WAS)
- One set of Security Master data for accounting
Bank Loans are considered Fixed Maturities for GAAP.

Bank Loans are on Schedule D for STAT rolled up to one Tranche Id.

Data Integrity checks:

- Yield
- Coupon
- Principal schedule = 100
- Accruals

Reconciliations: trade system to accounting system.
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