

Credit notes: return to the market

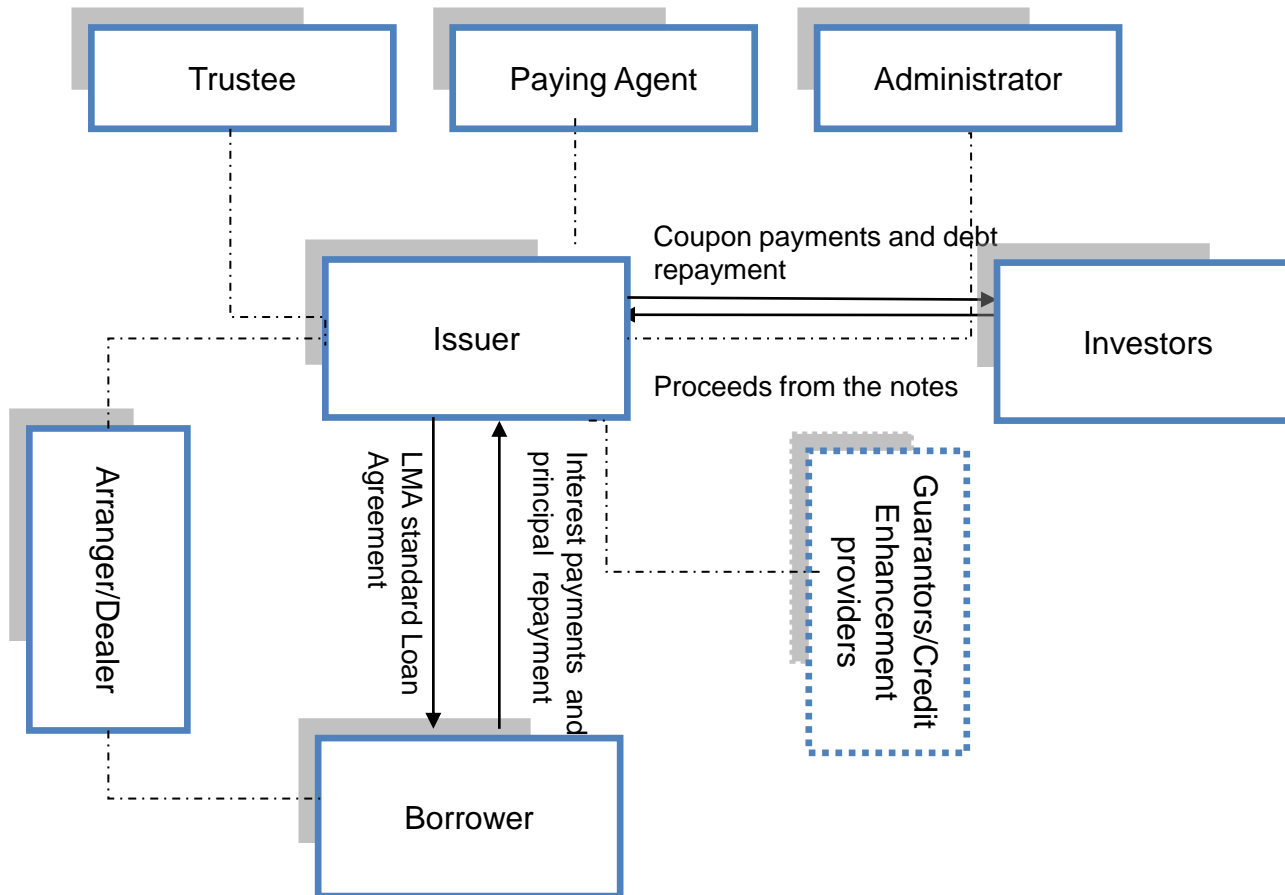
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- ☐ **Basic features of Credit Note**
- ☐ **Rediscovering advantages of the instrument**
- ☐ **Studying financial crisis lessons and fixing bugs**

Borrower:	mid-cap company/bank considering to build international credit profile
Issuer:	orphan SPV registered in tax-friendly jurisdiction designed to issue notes
Notional amount:	USD 50-150 mln
Status of the obligation:	limited recourse obligations of the Issuer. Payments are limited to the proceeds received by SPV from the receivables obtained upon placement of notes
Generic aspect:	SPV's rights for the receivable are always secured in favor of the Trustee All claims of the noteholders against the SPV under any series are limited to the proceeds from the underlying assets related to that series
Variety of underlying receivables:	Loans, Bonds, Notes, Participation in Loans Usually LMA standard Loan Agreement open to fix a range of covenants, reps and warranties, EOD and imply reporting obligations
Repayment:	bullet, amortizing and prepayment options
Credit enhancements (if needed):	swaps and collateral (direct or from third parties)
Investors:	Russian and foreign banks seeking for lucrative alternative to illiquid loans EM Investment and hedge funds aware of local borrowers profiles «Buy and hold» VIP individuals and asset managers investing money of CIS businessmen

Credit note in Russia is an unrated non listed Eurobond issued by a middle sized company and privately placed among a limited number of investors

Deal structure and key transaction documents



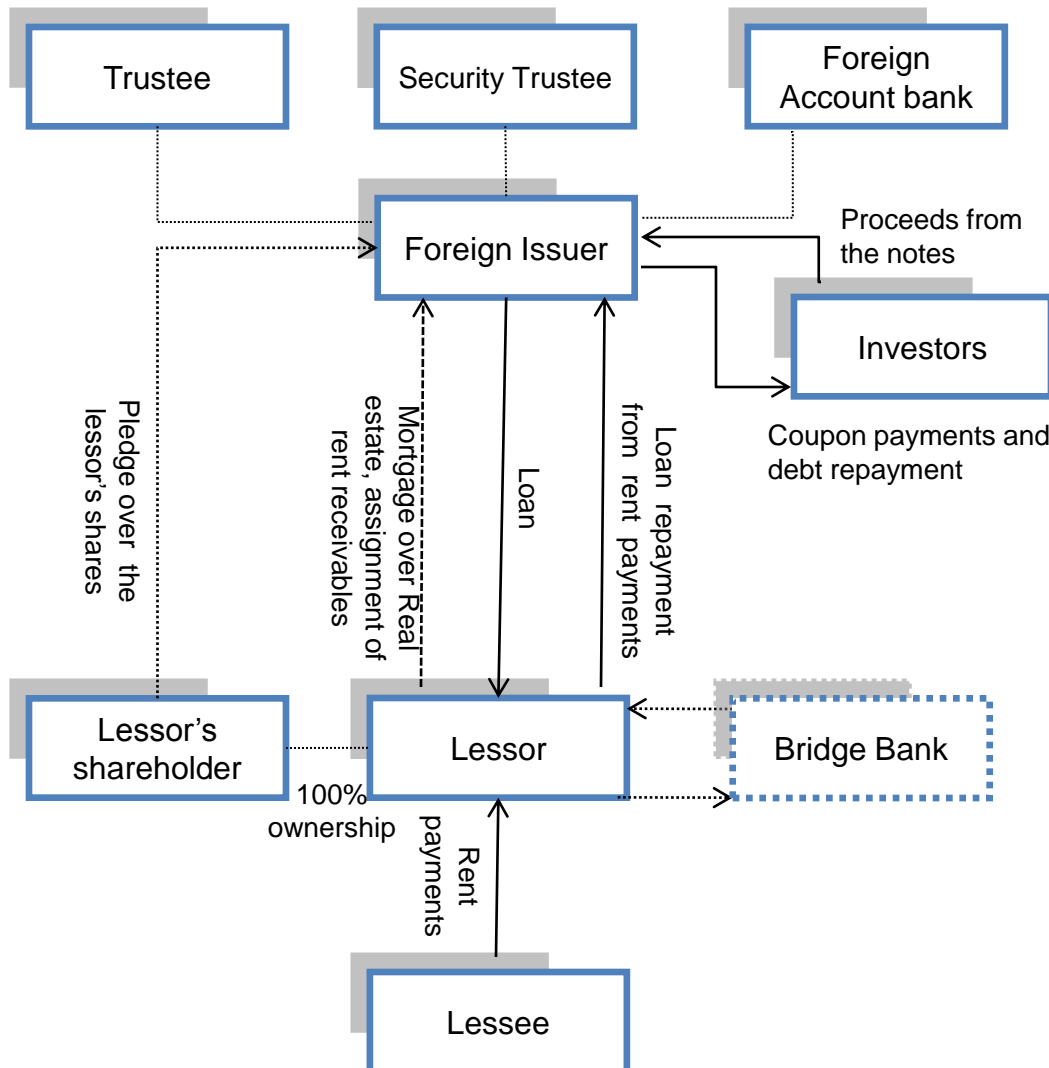
English Law Framework documents:

- Trust Deed
- Agency Agreement
- Distribution/Dealer Agreement
- Information Memorandum

Drawdown documents:

- Loan Agreement
- Pricing supplement (Final Terms)
- Supplement Trust Deed
- Deed of Guarantee and other collateral docs
- Legal opinions (if required by Trustee /IB)
- Process Agent Appointment letters
- Certificates/Notices
- Other deliverables and CPs

Secured Limited Recourse Notes alternative



Key features of transaction:

- The loan is funded by proceeds under notes, loan and notes terms are equal
- Fixed rate notes with bullet repayment or annuity payments
- Monthly RUB lease payments are received by Lessor, than converted into USD and remitted to account held with foreign bank
- Part of the proceeds is directed to interest/annuity payments
- Part of the proceeds is accumulated for principal repayment and reserves

➤ Collateral:

- ✓ Charge over rent proceeds collection account, which is controlled by Issuer
- ✓ Pledge over Real estate and assignment of rent receivables in favor of Issuer
- ✓ Issuer's rights under loan agreement, rent receivables assignment agreement and deed of pledge are secured in favor of the Trustee
- If Lessor goes bust – Lessee goes on paying to rent proceeds account and the Issuer pays coupon and principal under the notes
- If Lessee goes bust – Security Trustee enforces the security

Key advantages of the credit notes

- **Flexible structure** that can be easily amended to match borrowers funding needs
- **Cost efficient instrument** saving borrowers money by using infrastructure of Investment Bank
- **Funding base diversification**, attraction of new foreign investors and the best start in building international credit profile
- **Flexibility in collateral** : guarantees, pledge of shares and participatory interests, mortgage of real estate and assignment of rights to receive cash flow generated by assets
- **Short lead time** and minimum disclosure requirements
- **No need in comprehensive Prospectus** unless the borrower would like to list the issue
- **No need to have International Credit Rating**, but still desirable
- **Easiest access** to international capital market (in case yield matches the risk) and increase of brand recognition among investors
- Allow **to decrease** fund manager's fixed income **portfolio duration**
- **Eliminate operational risk** since Euroclear/Clearstream facilitates settlements in primary and secondary market

Wide range of types

- Secured or unsecured
- Subordinated or senior
- Different currencies: USD, EUR and RUB
- Listed public placement or private placement
- With embedded put or call options
- Different types of a coupon: fixed, floating, zero and step up coupon
- Different repayment methods: bullet, amortizing , redemption by physical delivery
- Different types of notes: dual currency, indexed notes, credit linked and loan participation
- Convertible notes and notes backed by assets

The parameters can be mixed to achieve well balanced structure to match borrowers needs and investors targets

Credit notes vs Eurobonds and Local Bonds: easier and more accessible



Requirements/ key features	Credit notes (LRN)	Eurobonds (LPN)	Local rouble bonds
IFRS Reporting	Desirable for 1 year	Must have for 3 consecutive years	Desirable
Ratings	Desirable, but not obligatory	One or Two preferred	Desirable, but not obligatory
Size/Tenor	USD 50-150 mln/ 1-2 years	USD 100 -USD 1bln/2-10 years	USD 30 – 250 mln/ 1-5 years
Disclosure	Investment Memo and presentation	Comprehensive Prospectus and detailed presentation	Prospectus and presentation
Listing	Possible, but not required	Must have on LSE, ISE, etc	MICEX
Lead time	From 3 to 7 weeks	From 10 to 15 weeks	From 7 to 16 weeks
Expenses Level and Marginal costs*	USD 50-150 K, high marginal cost	up to USD 1 mln, low marginal cost	USD 10 K, marginal cost is almost zero
Liquidity	Low	Medium	High
Collateral	Guarantees, mortgage of real estate, pledge over securities, assignment of receivables and relevant Cash FLOW	Usually no, guarantees possible	Guarantees

*including Road Show expenses but excluding JLM fee and auditors fee

Recent Financial crisis revealed a range of drawbacks

➤ **Poor communication between SPV, Trustee, Borrower and Noteholders**

➤ **Noteholders need Trustee to act**, but it is difficult to get his immediate involvement

- ✓ Inactivity of the Trustee in the absence of the formal instruction from the group of noteholders and guaranteed indemnification
- ✓ Unwillingness to confront with the borrower for the noteholders rights
- ✓ Excessive reimbursement requirements
- ✓ Slow reaction on borrowers and investors requests

➤ **Much time and money is spent on convening noteholders meetings**

➤ **Abuse from the borrowers side**

➤ **Almost impossible to get anything** from the defaulted borrower:

- ✓ Questionable financial condition of Russian borrowers
- ✓ Difficulties relating to enforcement of foreign courts rulings
- ✓ Difficulties of enforcement collateral
- ✓ Lack of cooperation in legal field between Russia and UK

Selection of the defaulted credit notes*

- RUB 5 bln 3m MOSPRIME +7% due 10/09
issued by Eurocommerz 10/07 and defaulted 04/2009
- USD 37.5 mln 16%/18% due 06/11
issued by Incom-Lada 06/08 defaulted 12/08
- USD 100 mln 13.75% due 03/10
issued by SibServCompany 03/08 defaulted 03/09
- USD 140 mln 12% due 03/11
issued by RTM 02/08 defaulted 03/11
- USD 280 mln 10% due 07/10
issued by Ritzio International 07/07 and defaulted 07/09

Introduction of Enforcement Agent

- Local EA is appointed by SPV to act against borrower
- Such EA will monitor the accuracy of debt servicing by the borrower and could enforce the security upon direct request from the noteholders
- EA should be a party interested in advocating noteholders' interests

Improvement in cooperation with a Trustee

- Include Trustee's obligation to immediately inform investors and noteholders
- Set a procedure of trustee's reimbursement to let him act (introduction of funding agreement)
- Lowering the threshold for Holder's Request to announce a default (in case of nonpayment)
- Allow noteholders to directly instruct SPV to accelerate the debt or enforce the security without Trustee

Furnishing of information

- Trustee's obligation to resend all info received from the SPV/borrower to noteholders through clearing house or directly in case the noteholders details are known

Resistance to borrower's abuse

- Ignorance of the SPV/Trustee's request is an Event of Default if it is not remedied within reasonable time
- Formal ban on holding the notes by the borrower or its affiliates and related parties
- Trustee's right to regularly request a certificate from the borrower confirming that abovementioned is fulfilled
- Other methods of supervision

Simplification of noteholders meeting arrangements and voting procedures

- Cutting the time for convening noteholders meeting
- Ban on trustee's requirement to guarantee his reimbursement when convening meetings
- Programme agent is to calculate votes and act as a tender and tabulation agent

Standardization of documents

- Transaction documents to include notices and forms to be exchanged among counterparts in case of default and restructuring to save time on further negotiations
- Underlying security documentation should contemplate out-of-court enforcement (if possible)

Arranger

- Development the structure and consulting on best terms of the notes
- Transaction documents and offering memo drafting
- Coordination of legal counsels, Trustee, Agents , SPV work on the transaction

Bookrunner and Dealer

- Search for the investors and marketing of the notes
- Building a book of orders
- Settlement on DVP basis through Clearing houses or technical purchase of the notes with a subsequent distribution among noteholders



Market maker

- Trading of the issued notes
- Providing quotes to support liquidity in the secondary market

Ancillary Functions

- Bridge finance provider
- Post closure services
- Enforcement agent functions
- Analytical coverage during notes life: issuing credit reports

Thank you