

Trading Aircraft Loans Utilizing LSTA Trade Forms

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As many single-investor or club deal loans secured by commercial aircraft (Aircraft Loans) became distressed during the economic downturn that followed 9/11, secondary trading increased dramatically. The Aircraft Loan financing community reacted by morphing from a primary base of commercial banks to a diversified group of commercial banks, investment banks, hedge funds, leasing companies and other aircraft investors. Many of these participants had high-volume syndicated debt-trading desks that were accustomed to trading corporate syndicated bank debt on forms published by the Loan Syndication and Trading Association (LSTA).¹ Because of this familiarity, certain participants began to utilize LSTA trade forms for Aircraft Loan transfers as a means to increase certainty of transaction execution and to reduce transaction costs. While these two goals are key reasons the LSTA forms have attained nearly universal acceptance as the documentation standard in the US syndicated corporate bank debt trading market, the LSTA forms do present a number of issues that require careful attention when they are utilized to close an Aircraft Loan transfer.²

The most important issues when using LSTA forms are: (i) an LSTA trade confirmation creates a legally binding obligation and, depending on the nature of the transaction, the binding obligation may have been created prior to execution of the trade confirmation; (ii) unless specifically modified by the parties, the LSTA forms do not contain very basic representations and conditions precedent that are customary in Aircraft Loan transfers completed using traditional negotiated Aircraft Loan purchase agreements; and (iii) unless specifically modified by the parties, LSTA forms incorporate a very specific and pre-agreed purchase price calculation.

Timing of Binding Obligation

An LSTA trade confirmation is typically the first agreement entered into when executing a trade utilizing LSTA forms. The confirmation has many of the hallmarks of a nonbinding letter of intent in a typical Aircraft Loan purchase transaction. An LSTA confirmation is a very short document that includes the basic terms of the transaction: (i) the purchase price, (ii) a description of the debt being purchased and (iii) any special terms related to the transaction.³ However, as its name suggests, when used in a typical corporate syndicated bank debt trade, an LSTA trade confirmation is not a nonbinding indication of intent, but rather a confirmation of a binding trade that has already occurred, and the documentation of the trade using LSTA forms is in many respects an administrative exercise. In fact, in the syndicated corporate debt market, the custom is to verbally agree to the principal terms

of the trade over the phone on a recorded line, with the binding obligation being created during the phone call.⁴ If the parties to a trade expect there to be any substantive deviations from the LSTA Standard Terms and Conditions, the deviations are typically discussed and agreed to during the phone call. As a result, when utilizing LSTA forms to trade Aircraft Loans, in discussing the terms of the trade during the predocumentation phase, it is important that (i) the parties have a clear understanding and agreement as to if, and when, a binding obligation will be created; and (ii) the parties agree to any additional terms or modifications to the LSTA Standard Terms and Conditions at the time the binding obligation is created, particularly if a binding obligation is intended to arise prior to execution of a trade confirmation.⁵

Lack of Basic Representations, Warranties and Conditions Precedent

LSTA forms do not contain basic representations, warranties and conditions precedent that many aviation industry participants are accustomed to seeing in Aircraft Loan transfers completed using negotiated Aircraft Loan purchase agreements. Below are a few examples:

- No Aircraft Documents Representation. LSTA forms do not contain a representation specifically identifying a definitive set of loan documents that include all the obligations that the purchaser will be assuming in connection with the purchased Aircraft Loans.⁶
- No Consent Rights over Amendments. LSTA forms do not provide a purchaser with any consent rights over amendments that may be effected after the trade date (i.e., date of trade specified in the LSTA confirmation) and prior to the settlement date (i.e., the closing date of the trade).⁷
- No Borrower/Collateral Conditions Precedent. LSTA forms do not contain any conditions precedent regarding the borrower or the collateral (e.g., no default under a credit agreement or lease (in case of a leveraged lease), no loss or damage to the Aircraft, no other liens on the Aircraft, etc.).
- No Documentary Conditions Precedent. LSTA forms do not contain any documentary conditions precedent to speak of (e.g., no opinions, no corporate authority deliverables, etc.).

Any of these terms and conditions may be incorporated into a transaction completed utilizing LSTA forms by including the desired terms, as agreed, in the “Trade Specific Other Terms of Trade” section of the LSTA confirmation.

Pre-agreed Purchase Price Calculation

LSTA forms set forth an agreed Purchase Rate expressed as a percentage that, when multiplied by the outstanding principal amount of loans being purchased, forms the purchase price for the loans. The purchase price is adjusted based on a Target Settlement Date (which is analogous to an Economic Closing Date in typical aviation transactions). For trades completed on LSTA par documents, the Target Settlement Date is seven business days after the trade date and for trades completed on LSTA distressed documents, the Target Settlement Date is 20 business days after the trade date. Generally, the adjustment results in the purchaser receiving a credit for all interest accrued after the Target Settlement Date and the seller receiving a cost-of-carry adjustment on the purchase price from and after the Target Settlement Date calculated on the basis of one month’s LIBOR.⁸ While this purchase price calculation methodology is not intrinsically unfair or unworkable, and in many respects is very similar to purchase price adjustments often agreed to in negotiated Aircraft Loan purchase agreements, it is important that parties understand how the calculations work.

LSTA forms were primarily intended to be utilized for transfers of widely syndicated “cash flow”

loans. Investors in this asset class do not, as a matter of practice, need to rely on a seller for information regarding loans being sold. This information is typically provided by the administrative agent of the underlying loan facility to both lenders and prospective lenders via a secure data site. Furthermore, widely syndicated cash flow loans derive their value from the cash flows of the underlying business and the credit quality of the borrower. Aircraft Loan investors, on the other hand, are forced to rely on sellers to provide information regarding the underlying loan documents and related aircraft collateral, and the value of an Aircraft Loan is often highly (or solely) dependent on the value of the underlying collateral. This information and valuation dichotomy gives rise to many of the issues discussed above. While the presence of these issues, in and of themselves, should not deter parties from utilizing the LSTA forms for transfers of Aircraft Loans, it is important that transaction parties understand these issues and modify the LSTA trade forms to fit the specific transaction.

1 The Loan Syndication and Trading Association is an industry trade group created in 1995, which is currently comprised of more than 320 banks, brokers, investment funds, law firms and other parties interested in the corporate syndicated bank debt market. See <http://www.lsta.org>.

2 The LSTA publishes two sets of trade forms – one for par trades and one for distressed trades. The documentation for par trades consists of an LSTA trade confirmation. The par documents are typically used for trades of performing loans where the expectation is that the loans will pay out in full in

accordance with the underlying credit agreement. The documentation for distressed trades consists of an LSTA trade confirmation as well as a long-

form LSTA purchase agreement. The distressed documents are typically used for trades of non-performing loans or loans that are at some stage of

restructuring (or expected restructuring). Both the par documents and distressed documents incorporate by reference the LSTA Standard Terms and

Conditions, which apply to every trade completed on LSTA forms, unless the parties specifically modify those terms in the trade confirmation and/or

3 The special terms are set forth in the "Trade-Specific Other Terms of Trade" section of the LSTA confirmation and contain terms agreed to by the purchaser and seller that are (i) outside the scope of what is contained in the LSTA Standard Terms and Conditions or (ii) intended to modify the LSTA

Standard Terms and Conditions.

4 Further amplifying the binding nature of an LSTA trade, the LSTA Standard Terms and Conditions provide that if, for any reason, the trade cannot be settled by a legal assignment (e.g., if required Borrower/Agent consent is not obtained), the parties will settle the trade by means of participation, and if a

participation cannot be effected, the parties will settle the trade by an alternative means to give the parties the economic benefit of the agreed

trade. Given the unique nature of Aircraft Loans and the relative effect that the specific aircraft forming the collateral can have on the pricing of, and

return that can be realized on, an Aircraft Loan, a forced agreement to settle a trade by means of a participation or the specter of alternative settlement

means may present an untenable position for a purchaser of an Aircraft Loan, both from a counterparty risk perspective and an ROI perspective.

5 Because of the varying transaction practices between the syndicated corporate debt market (for which the LSTA forms were created) and the traditional aircraft secondary loan market, some parties enter into a non-binding letter of intent (rather than an LSTA trade confirmation) as a prelude to

executing a trade on LSTA forms.

6 While the LSTA distressed purchase agreement contains representations that partially address this point, the form representations are more limited than a purchaser would typically receive in an Aircraft Loan trade completed in a negotiated Aircraft Loan purchase agreement.

7 While this would be virtually unheard of in the context of a negotiated Aircraft Loan purchase agreement of a "controlling position" in a loan transaction, it is the LSTA standard because the LSTA forms are primarily intended to be used in the context of widely syndicated debt, where a seller

typically does not have a controlling position that would be necessary to effect, or prevent, an amendment to the underlying credit agreement.

8 While this is a general description of the default purchase price calculation mechanism contained in the LSTA Standard Terms and Conditions, the LSTA Standard Terms and Conditions do contain other "pre-agreed" purchase price calculation options that can be specifically selected.

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