

# Lead Left Interview – Bram Smith and Lee Shaiman

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**In February, LSTA EVP Meredith Coffey sat down with the outgoing LSTA Executive Director Bram Smith and the incoming LSTA Executive Director Lee Shaiman to discuss the last 10 years ... and what is on deck for the next 10.**

***MC:** Bram, you joined the LSTA as Interim Executive Director on Sept. 2, 2008, just 13 days before Lehman Brothers collapsed. What were those early days like?*

**Bram Smith:** It was a crazy time. While the near-collapse of Bear Stearns in the spring should have been a portent, no one expected Lehman would actually file for bankruptcy. The markets panicked as nothing like this had happened in living memory. In the loan market, the LSTA took several steps to mitigate the damage. As secondary loan prices tumbled toward 60 due to technicals not fundamentals, we issued an advisory reminding members that a depressed secondary price did not necessarily mean that a loan was distressed or should trade on distressed documentation. Since loans that trade on distressed documentation settle much more slowly, limiting the number of names trading distressed helped liquidity at a critical time.

Additionally, after Lehman filed for bankruptcy, the LSTA convinced the Lehman estate to accept or reject all their open loan trades quickly. If they hadn't agreed to do that, hundreds of millions of dollars of unsettled loan trades could have been in limbo for years. We also convinced the creditors committee that LSTA-form loan participations were "true sales" and not unsecured loans to Lehman, which would have made them part of the estate (which is what happened to LMA participations). This, too, saved our members years of uncertainty and possible steep losses.

***MC:** Lee, you were running about \$5 billion in CLOs at GSO in 2008. What were your starkest memories of those days?*

**Lee Shaiman:** First, we need to remember that the cracks in the market started showing a full year earlier. In late 2007, CLO investors were beginning to get nervous and very few CLOs closed in the second half of the year. By early 2008, European structured product investors across asset classes were in a real panic. By mid-2008, banks had large pipeline and warehouse exposures that they were desperate to shed. If you had to sell an asset, you couldn't find a bid. If you wanted to buy an asset, you could name your price.

And then Lehman hit. Mark-to-market investors suffered a forced unwind and loan prices spiraled down, ultimately bottoming out around 60. The silver lining was that CLOs, which were the biggest single investor type, were long-term, match-funded investors and were not forced to sell. This stabilized the market once the forced sellers were wrung out of the market. I would note that even during the fourth quarter 2008 and first quarter 2009, more than \$200 billion of loans traded. The secondary loan market had many hiccups, but it still functioned and ultimately found a level where trading became active.

***MC:** Bram, while 2008 and 2009 were very tough years, the loan asset class recovered reasonably quickly. What were the milestones you saw as the market fell and recovered?*

**BS:** After hitting a low of 60 on December 21, 2008, secondary loan prices recovered to around 70 by April 2009 and 80 by July 2009. But we didn't see an average price of 90 until March 2010. As prices fell and recovered, the investor base shifted. Many mark-to-market vehicles were unwound and were replaced by opportunistic buyers; these, in turn, ultimately were replaced by long-term real money investors.

Meanwhile, defaults peaked at 11% in late 2009, but quickly retrenched, falling below 5% by May 2010 and below 2% by year-end 2010. Moreover, recoveries were within historical norms. People learned that despite the financial crisis and a sharp pricing drop, loans and CLOs actually performed as promised.

Of course, during that time the loan market actually shrank. Outstandings in the S&P/LSTA Leveraged Loan Index declined from nearly \$600 billion to less than \$500 billion.

**MC:** *How did LSTA efforts post-crisis help protect the loan market?*

**BS:** After the crash, the LSTA refocused, becoming increasingly proactive in Washington and the courts to defend the loan market. First, we met with regulators and lawmakers to discuss what happened in the crash and argue that a wide swath of new regulation was not needed. While much regulation emerged, there were, in fact, some wins. For instance, loans were not included in either the Volcker ban on proprietary trading or risk retention and loan participations were not included in the definition of swaps. Those outcomes were in doubt at the time.

On the legal front, the LSTA became very involved in court cases via amicus briefs. We engaged in over a dozen cases that either raised doubt about whether a trade was legally binding or that questioned important protections for secured lenders. These included three Supreme Court cases and three cases before New York State's highest court – and we batted 1.000, supporting the successful side in all six cases!

Meanwhile, our documents evolved to address new issues that arose during the crisis, such as what happens when a lender defaults? We added provisions in credit agreements to require “deemed consent” and added “BISO” language to our trading terms to allow counterparties to buy-in or sell-out counterparties who were refusing to close trades. Finally, we prepared a counter-report to the American Bankruptcy Institute's report on Chapter 11 reform to protect the rights of secured lenders. It was a busy time!

**MC:** *Lee, you were meeting with investors throughout the last 10 years. How has the perception of the loan asset class evolved?*

**LS:** It has been a huge learning process for investors. As managers and the LSTA traveled the globe meeting investors after the crisis, they explained what loans were and how they performed; they described standardized loan documents and discussed the \$500 billion-plus of secondary trading. As this happened, the investor base grew and evolved. Foreign banks, sovereign wealth funds, pension funds, corporate treasuries and others entered the loan market through separately managed accounts (SMAs). CLO AAA investors such as ABCP conduits and SIVs had all but disappeared, and real money investors gradually came in to take their place. By 2017, we counted institutions from 60 countries investing in U.S. loans. Loans had moved from alternatives to a CORE-plus asset class.

**To be continued the week of April 23**

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