# Underwriting Syndicated Loans in the Russian Market

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**Abstract**. This article presents an overview of the international syndicated loans market for Russian corporate borrowers. There is a focus on underwriting services provided by banks and the syndications process. The advantages of syndicated loans for borrowers and banks are discussed, as well as the type of deals that are prevalent in the Russian market (underwritten deal, best-efforts syndication, club deal). The main instruments of the market and the corresponding purposes of raising the financing are discussed, including bridge loans, term loans, and pre-export finance facilities. The key structural elements of syndicated loans, including security and financial covenants are discussed. The typical transaction schedule for a syndicated loan is presented, with an overview of the key steps of the process: appointing banks, syndicating the loan in the international market, closing the transaction. We then proceed to discuss the role of underwriting in syndicated lending, including the economics of underwriting and the risks facing the banks. An overview of the approval process for underwriting is presented, with a discussion of two important documents: the underwriting memo and the underwriting commitment letter. In conclusion, we discuss the trends and perspective of underwriting in the dynamic Russian syndicated lending market and the requirements for a successful transaction.
**Keywords:** banking, corporate finance, international syndicated loans market, bank underwriting services, financing Russian corporates, risks and legal aspects of underwriting.

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# Андеррайтинг синдицированных кредитов на российском рынке

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**Аннотация**. В статье представлен обзор международного рынка синдицированных кредитов для российских корпоративных заемщиков. Детально рассматриваются услуги андеррайтинга, предоставляемые банками, и процесс синдикации. Анализируются преимущества синдицированных кредитов для заемщиков и банков, а также структуры сделок, применяемых на российском рынке (подписанная сделка, синдикация по принципу «наилучших усилий», клубная сделка). Рассматриваются основные инструменты рынка и соответствующие цели привлечения финансирования, включая бридж-кредиты, срочные кредиты, предэкспортные кредиты. Описаны основные структурные элементы синдицированных кредитов, включая обеспечение и финансовые ковенанты. Предложен график реализации сделки по привлечению синдицированного кредита и прописаны главные этапы данного процесса: назначение банков, синдикация на международном рынке, закрытие сделки. Затем обсуждается роль андеррайтинга в синдицированном кредитовании, включая аспекты экономики

и риска для банков. Процесс одобрения андеррайтинга включает два важных документа: меморандум и письмо об андеррайтинге. В заключение рассмотрены тенденции и перспективы андеррайтинга на развивающемся российском рынке и требования для успешной сделки.
**Ключевые слова:** банки; корпоративные финансы; международный рынок синдицированного кредитования; банковские услуги по андеррайтингу; финансирование российских корпораций; риски и юридические аспекты андеррайтинга.

## INTRODUCTION

This article is dedicated to the review of the underwriting process of syndicated loans in the Russian market. Underwriting, together with the running of the syndication process, is one of the more important aspects of bank syndicated lending.

A syndicated loan is provided to the Borrower (a corporation or a financial institution) by a syndicate of lenders and is structured, arranged and administered by one or several commercial or investment banks. Banks syndicate the loan, or divide it up into pieces, to share the risk that is compensated by the rewards of joining the deal. The key features of the syndicated loans market are the following: the lenders are the largest international financial institutions; the loans are provided to Russian borrowers in foreign currency; there is one set of documents (including the multi-party Facility Agreement), prepared by reputable international legal firms based on the templates of the Loan Market Association governed by English law; the financing terms and ranking are identical for all Lenders; the information flow and payments are channeled via the Facility Agent; there is an active secondary trading market for syndicated loans.

## OVERVIEW OF SYNDICATED LENDING

Lenders in the Russian market are mostly banks (while a growing proportion of lenders in the global market is represented by institutional investors: pension funds, insurance funds, hedge funds). Banks participate in a syndicated loan to earn a return, or yield, on their investment from interest payments and fees, build or sustain a relationship with the Borrower, win ancillary business (bond mandate, forex, cash management).

For Borrowers, syndicated loans offer bigger volume compared to bilateral loans; flexibility of terms and structure; various instruments of the syndicated loans market can be used depending on the goals of the Borrower; access to new banking relationships; efficient and fast transaction execution process.

There are several types of syndicated loans (Taylor and Sansone, 2006):

- Underwritten deal: an underwritten deal is one for which the arrangers guarantee that the Borrower will receive the entire agreed facility amount at pre-agreed terms and conditions and then syndicate the loan in the market. If the arrangers cannot fully subscribe the loan, they are forced to absorb the difference, which they may later try to sell to investors. In case of a bought deal the Facility Agreement is signed by the MLAs before syndication banks join. In a prefunded deal the facility is funded by the MLAs before syndication banks join.
- Best-efforts syndication: a best efforts syndication is one for which the arranger group commits to underwrite less than the entire amount of the loan and undertakes to use best efforts to find commitments in addition to those of the MLA. In this case, the Borrower will receive the full loan amount only in the case of a successful syndication. If the loan is undersubscribed, the Borrower may choose: (i) change the terms of the deal to raise the target facility amount; (ii) close the deal with the lower facility amount; (iii) not to close the deal at all.
- Club deal: a club deal is a smaller loan that is pre-marketed to a group of relationship lenders. The MLAs usually have equal final takes and receive equal fees.

The syndicated loans market offers a number of instruments to Russian borrowers, including the following (Fight, 2004): (i) bridge loans (usually granted in case of acquisition financings or as bridges to bond, rights issue or asset disposals); (ii) short-term loans, such as revolving-credit facilities (for working capital purposes) and backstop facilities (for short term commercial paper programmes); (iii) term loans that can be utilized for a number of purposes, including general corporate purposes, capital expenditure, asset acquisitions, ship and aircraft financings, refinancing of the current loan portfolio; (iv) pre-export finance facilities (long term loans backed by export contracts); (v) project financing.

The structure and pricing of the loan differ according to its type, purpose and other key features. Below is a list of the main structuring features of syndicated loans in the Russian market.

• The amount of the loan ranges from USD100 million to more than USD1 billion.

• Currency is usually USD, but EUR and RUB are also used.

• Tenor depends on the type and instrument. For term loans, the tenor of 3–5 years is the market standard.

• Repayment schedule is usually amortizing (with equal quarterly repayments) following a certain Grace Period (1–2 years). Bullet repayments are used for the best names. There are clauses governing the mandatory prepayment and voluntary repayment procedures.

• General covenants include pari passu ranking, negative pledge, change of control, limitation on loans and guarantees, dividend payments, mergers and acquisitions, disposal of assets.

• Financial covenants such as limitations on Total Debt / EBITDA, Tangible Net Worth, EBITDA / Interest, Total Equity are used.

• Events of Default incorporate cross default, creditors' process, litigation.

• If the loan is secured, then the security is represented by guarantees from other group companies, pledge of fixed assets (mortgage, equipment), withholding rights on accounts for term loans; pledge of shares for acquisition finance transactions; assignment of rights under export sales contracts for pre-export finance facilities; assignment of lessee contracts in project finance.

• Other standard loan market terms and conditions (including Conditions Precedent and Conditions Subsequent, Representations and Warranties, Information Undertakings) are per the Loan Market Association documentation.

• Governing law: English law.

Below is an overview of the execution process for a syndicated loan. Depending on the type of the deal, its complexity and the involved parties, there can be some variations in the process (Iannotta, 2010; Liaw, 2011).

• Selection by the Borrower of the Mandated Lead Arrangers (MLAs) who will execute the transaction. During the selection process the Borrower considers the relationship, loan market track-record, underwriting commitments and final commitments that are proposed by each MLAs.

• The Borrower negotiates with the MLAs the Mandate Letter and the Term Sheet of the transaction. These documents set-out the ways of working on the transaction, appoint the MLAs to the relevant roles (including Coordinator(s), Documentation Agent and Bookrunners) and outline the main agreed terms and conditions of the transaction between the Borrower and the MLAs.

• At this stage, the MLAs and the Borrower appoint the Legal Counsels for the transaction (from an agreed list of reputable international legal firms). Once engaged, the Legal Counsels start work on the Facility Documentation, including the Facility Agreement. This is the key legal document that contains all transaction details and standard clauses. The security documentation, depending on transaction structure, can include the mortgage agreement, surety, guarantees, pledge of shares, assets, bank accounts (Campbell and Weaver, 2013).

• Once Mandate Letter and the Term Sheet are signed, the Bookrunners, with input from the Borrower when required, prepare the launch of the syndication process. This includes the following items: (i) agreement on the syndication strategy and the list of potential lenders to be invited to the transaction; (ii) drafting of the Invitation Letter and the Confidentiality Agreement; (iii) preparing the Information Memorandum and the package of financial and marketing materials (financial statements, cash flow model, operating overview, independent industry reports); (iv) making the arrangements for the bank meeting.

• The syndication process is launched by the Bookrunners. Invitation Letters are sent to the potential lenders. After the signing of the Confidentiality Agreement, the potential lenders gain access to the deal information via a secured website.

• During the syndication process the potential lenders attend the bank meeting, negotiate with the Bookrunners and obtain the credit approvals for their commitments.

• In parallel to the syndication, the documentation drafting process is on-going, led by the Documentation Agent.

• At the closing of the syndication process, the potential lenders submit their Commitment Letters (setting out their terms of joining the transaction and being subject to documentation).

• The draft Facility Documents are distributed to the Lenders for review. The Lenders provide their comments, if any.

• The Facility Documents are signed.

• Following the completion of Conditions Precedent, the Facility is utilized by the Borrower.

In terms of timing, the execution of a syndicated loan transaction can take 10–12 weeks.

## THE ROLE OF UNDERWRITING IN SYNDICATED LENDING

Underwriting plays an important role in the syndicated lending market. Underwriting is the key structural component for acquisition financings (especially in the cases of bought and pre-funded deals). In such transactions, the Borrower needs to be guaranteed that it will receive the target amount of the Facility, since financing is a major component of the mergers and acquisitions market (Maxwell and Shenkman, 2010). If the Borrower does not have the financing by the due date, not only will the deal be lost, but penalties may be payable.

Therefore, in cases of acquisition financings and other fully underwritten deals, the Underwriters provide the underwriting for the whole Facility Amount. As part of the syndication strategy, it is then determined that the amounts raised from the market will be used to lower the final commitments of the Underwriters in the loan.

Let us discuss an example. The Borrower would like to raise a USD500 million syndicated loan for financing an acquisition. Two banks are mandated as MLAs, each providing underwriting for half of the target facility amount (USD250 million). The MLAs then syndicate the loan in the market, with the goal to lower the final commitments to USD100 million. Therefore, USD300 million will need to be syndicated from other banks, who will subsequently join the deal as Lenders. If there is an oversubscription of the loan, then the surplus may be used to further increase the Facility Amount to a pre-agreed level. For example, if USD400 million are raised in the market, then USD300 million will be used to lower the commitments of the MLAs and USD100 million to increase the Facility Amount up to USD600 million.

An important component of the underwriting process are the fees and risks.

The Underwriter is usually compensated with the Upfront Fee. This fee is the total amount that is payable by the Borrower to the Mandated Lead Arrangers which will be used by the MLAs to pay out all fees under the deal, including Participation Fees to the banks that join the deal as Lenders. Total Upfront Fees are typically calculated on the final Facility Amount (including any oversubscription).

The Upfront Fees include the following fees:

• Arrangement Fees: portion of the total Upfront Fees set aside by the MLAs to remunerate the arrangement of the transaction (negotiation, preparation, syndication). This is not a risk fee but a service fee booked at signing of the deal even if the syndication is not closed.

• Underwriting Fees: portion of the total upfront set aside to cover the underwriting risk. This is a risk fee booked at close of primary syndication provided the final take objective has been met.

• Participation Fees: these fees are payable to each bank, including the MLAs, on their allocated final take at close of syndication at the rate applicable to the level of their initial commitment. There is equal treatment between banks, meaning that banks with the same commitment receive the same fee rate.

• Pool Fees: such fees represent the balance of the budgeted Participation Fees that have not been paid out to lenders.

We can continue with considering the above practical example. The Borrower has appointed two MLAs to arrange a USD500 million syndicated facility, each underwriting half of the loan with a target final commitment of USD100 million. The total Upfront Fee is 100 basis points (bps), composed of a 30 bps arrangement fee, 20 bps underwriting fee and participation fees of 50 bps. During the syndication, the Bookrunners offer 40 bps for a commitment of USD100 million, 30 bps for USD50 million and 20 bps for USD25 million. Following the syndication, two Lenders join the deal with a commitment of USD100 million, one Lender with USD50 million, two Lenders with USD25 million each (raising a total of USD300 million and allowing the MLAs to reach the target final commitments of USD100 million). As a result, the MLAs will receive total fees of USD2,350 million, made up from USD0,75 million arrangement fee (half of the 30 bps arrangement fee applied to the full facility amount), USD0,5 million underwriting fee (20 bps underwriting fee applied to the USD250 million underwriting amount), USD0,5 million participation fees (participation fee of 50 bps applied to the final commitment of USD100 million) and pool fees of USD0,45 million (calculated as the

*Table 1.* **The structure of the Underwriting Memo**

| # | Section | Overview and contents |
|---|---|---|
| 1. | Context of the transaction | Summary of the deal structure, the amount and the objectives of the deal, other banks involved. |
| 2. | Borrower | Description, shareholding structure, market capitalization;<br>Ratings: credit ratings have a positive impact on liquidity (in primary and secondary);<br>Financials: audited financials are required;<br>Projections: to ensure compliance with the transaction structure and financial covenants. |
| 3. | Syndication Issues | Highlight of the specific points of the transaction that represent an issue from a syndication or liquidity perspective (deal of large size, long tenor, complicated timeline). |
| 4. | Pricing | Benchmarks: country, industry, structure, tenor, purpose;<br>CDS and secondary market pricing for comparable transactions. |
| 5. | Liquidity Drivers | Borrower's banking relationships, existing debt;<br>Borrower's geographical presence and development strategy<br>Potential side-business: what additional business other banks can achieve as this directly impacts their appetite for the deal. |
| 6. | Syndication Strategy | The number of MLAs in the transaction;<br>Provide indication of tickets and universe of investors;<br>Final takes at the close of syndication. |
| 7. | Risk Factors | Timing is a crucial risk factor in any underwriting exercise, as there is a need to ensure shortest time between underwriting approval, mandate signing, launch and close of syndication;<br>Compliance with the bank's syndication and underwriting guidelines, including syndication protection clauses and specific time limits. |

difference between the budgeted participation fees of 50 bps on the syndicated amount of USD300 million equal to USD1 million minus the amounts of the participation fees of USD1,050 million paid out to the five Lenders that joined during the syndication).

The risks of the underwriting process mainly refer to the case of an unsuccessful syndication, as a result of which the Underwriters will not be able to lower their underwriting amount to the targeted final commitment. In such a case the Underwriter will need to take the final commitment and the residual amount of the underwriting on its balance sheet and develop a strategy for decreasing the exposure. Usually in the case of syndicated loans this will include the selling of the exposure at a discount in the secondary, thereby lowering the fees received from the transaction. Suppose that in the above example, the Bookrunner only raise USD250 million from the market, meaning that each will have to take the USD25 million of residual underwriting on its balance sheet in addition to the USD100 million final commitment. Then the USD25 million will be sold in the secondary market at the price of 98% (discount of 2%), leading to a loss of USD0,5 million.

## THE UNDERWRITING MEMO AND COMMITMENT LETTER

Usually, the MLA will be required to receive a separate approval for underwriting the syndicated loan (in addition to the general credit approval for the transaction). Each bank has its own unique processes for this procedure. The approval of management, treasury and, most importantly, risks is required to proceed with the underwriting.

The key instrument of the approval process is the Underwriting Memo. This is a substantial document prepared by the bank's Loan Syndications team. The Loan Syndications team answers all questions and provides timely updates, in if there have been any changes relating to the Borrower, the loan market, the syndication process.

The structure of the document is outlined in the following table.

Within the underwriting approval, the MLA's net underwriting amount and final commitment are clearly stated, since exposure is one of the key factors of the approval process:

- Net underwriting amount: the total amount the MLA is to sell in the loan syndication market;

• Final commitment: the total amount the MLA will keep on its balance sheet;

• Underwriting: the sum of net underwriting and final commitment;

• Actions in case of an oversubscription: firstly, the final commitments of all the participants are scaled back; secondly, the Facility Amount is increased (following consultations between the MLAs and the Borrower).

As noted, timing is one of the crucial considerations in underwritten syndicated loans. Usually, the following timetable is applied to such transactions:

• 60 days: underwriting approvals are valid for 60 days. If an offer by the MLA to the Borrower is not made and accepted within this period, a new underwriting approval must be obtained. Accordingly, no underwriting offer can have an expiry date exceeding the validity of the underwriting approval.

• 30 days: syndication must be launched within 30 days from the date of the Mandate Letter.

• 90 days: syndication sell-down period is 90 days from launch of syndication. Sell down typically lasts no more than 35 days from launch to the execution of facility documentation.

Therefore, the whole process may take up to 180 days, during which time there may occur significant events and changes in the market. Therefore, significant preparation for such deals is required by the MLAs, as well as the inclusion of syndication protection clauses into the legal documentation of the transaction (Wight et al, 2009).

We will now consider the main legal document of the underwriting process — the Underwriting Commitment Letter. This letter is executed by the MLAs and the Borrower and contains the clauses that govern the underwriting and syndication process.

The first sections of the letter include the description of the Facility (Borrower, amount, purpose) and the definitions. The first clause is the Appointments clause and describes the roles which the MLAs will have in the transaction. The second clause lists the Conditions to the arrangement of the deal, including the timing, preparation of the Facility Documents, receipt of credit approvals by the MLAs. Clause 3, Underwriting Proportions, lists the amounts that the MLAs underwrite. Clauses 4–6 are the important syndication protection clauses, Clear Market, Market Flex and Material Adverse Change:

• Clear Market: the Borrower shall not without the MLA's prior consent arrange, announce or award any mandate for any other financing in the loan syndication or capital markets. The purpose of the clear market clause is to ensure that the Borrower will not launch or support any asset that could compete for the same liquidity pools targeted by the deal which could compromise placement. For the Clear Market clause, several carve-outs can be agreed, including, for example, capital markets instruments (such as bonds) that will not compromise liquidity for most corporate loans as they target a different investor base.

• Market Flex: during the period from the date of the Term Sheet and Mandate Letter to the date, following the close of primary syndication, on which all the Lenders subject to such syndication become party to the Facility Documents, any Mandated Lead Arranger or Underwriter shall be entitled after consultation with the other Mandated Lead Arrangers and other Underwriters for a defined maximum period to change the pricing, terms and/or structure of the Facility if that Mandated Lead Arranger or Underwriter determines that such changes are advisable in order to enhance the prospects of a successful syndication of the Facility. The Company agrees to amend the Facility Documents to reflect any changes decided above. For the purposes of this flex clause, «successful syndication» means the Underwriters each reduce their participation in the Facility to a defined final hold.

• Material Adverse Change (MAC): applies to the Borrower, the Guarantor, material subsidiaries, the loan and other financial markets, the national economy. Usually covers the period from the date of the Term Sheet and Mandate Letter to the date of signing of the Facility Documents. Exceptions to this clause require specific justification and sign-off from the Underwriters.

Clauses 7 (Fees, Costs and Expenses) and 8 (Payments) cover the commercial aspects of the transaction. Clause 9 outlines the syndication strategy and the involvement of the Borrower in the process. The next clause, Information, describes the requirements the Borrower must meet in providing the materials (financial, operational, legal) to the MLAs. The letter also includes clauses relating to the legal aspects of the relationship between the Borrower and the MLAs: Indemnity, Confidentiality, Publicity, Conflicts, Assignments, Termination, Survival, as well as Governing Law and Arbitration.

## UNDERWRITING IN THE RUSSIAN MARKET

In the last few years, there have been several important trends regarding underwriting in the Russia market. The number of banks active in the syndicated loans market has decreased. The remaining banks have generally become more selective, with a greater focus on relationship with the Borrower, credit risk metrics, transaction structure (including financial covenants). Banks are also paying more attention to getting senior roles in deals (Coordinator, Bookrunner) and being sure of the subsequent success of the syndication. If these criteria are not met, then the bank is likely to decline the deal.

Underwriting is limited to the blue-chip Borrowers with high credit ratings. In particular, acquisition financing and cases when the Borrower requires the funds quickly and is ready to compensate the underwriting risks of the bank. However, bought and pre-funded deals have become exceedingly rare.

In terms of deal types, there is a trend for underwriting on a "best efforts" basis. Banks invited during the syndication aim for a lower ticket than previously, sometimes declining the invitation to buy the deal for better offers in the secondary market after it is free to trade. Lenders also pay greater consideration to the return criteria. Transactions have been competing for liquidity, with lenders are prioritizing deals based on risk return consideration. A continued upward pricing pressure should be expected.

Deals are also done with a limited syndication among senior lenders (in what can be called an extended MLA phase), before going out for a general syndication on "best efforts" basis in order to raise additional liquidity and/or reduce MLA holds.

Due to the high market risk for some Borrowers, the share of club deals has increased in recent years. In club deals banks adopt take-and-hold strategies with the exact final commitments, avoiding any underwriting risks.

However, investors still view Russia as an emerging market, with the country limit is a key constraint for lenders.

The Borrowers should note that the negotiation power of senior lenders has increased and that there needs to be a consensus on the pricing to complete the transaction. Relationship banking is absolutely key, side business consideration is important for providing support for clients

The market has also become segmented, with different liquidity available for various industries, as well as deal types (pre-export finance facilities compared to term loans). The market is still focused on the natural resources sector, that remains the most attractive industry to banks, with the Borrowers having a strong corporate risk profile. These deals act as benchmarks in terms of structure and pricing. Tenors remain short expect for pre-export finance structures which can achieve 5-year maturities. But the market is expected to progressively develop in the medium term, with focus on Borrowers from other industries, such as retail.

In the current market, a successful deal requires a combination of the following factors: (i) relationship support; (ii) good credit quality; (iii) strong structure and proper pricing; (iv) substantial efforts by the Borrower in the syndication process. Ticket sizes may have to be reduced to meet investors' exposure constraints, leading to potentially larger syndicates. Time to market should be carefully managed: in the current volatile market, banks do not want to hold underwriting risks for too long and prefer to de-risk in as short time as possible. There is a heightened requirement to see syndication protection clauses in mandates (clear market and market flex) and a more conservative documentation reflecting the deal structure (including the opening financial covenants). These requirements are particularly important for underwriting commitments.

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