

DERIVATIVES ON STEROIDS (NOTIONALLY)

LEVERAGED TOTAL RETURN SWAPS

TOGETHER WITH our investment bank clients, we have devoted significant time and energy to developing total return swap structures that employ notional leverage to provide counterparties with an opportunity for enhanced returns. At its core, a leveraged total return swap permits a party to receive the economics of an investment in a hedge fund (or other financial reference asset) in excess of that party's actual out-of-pocket contribution. The complex permutations on this structure bring into play intellectual technology borrowed from the fields of mathematics and physics. By providing a counterparty with a leveraged return against interest-based swap payments on a notional amount, these structures place increased pressure on key elements of the dealer/counterparty contractual relationship. We work with our investment bank clients to address these areas. For example, we assisted our clients in crafting portfolio guidelines and related protective provisions, the breach of which may result in a de-leveraging of the enhanced potential return. We also assist in developing valuation terms, which allow for haircuts and other adjustments to be made under certain circumstances and which figure prominently in determining whether required equity-to-leverage ratios have been met. Particularly with hedge fund-based structures, we have collaborated with our clients in addressing the "gap" risks that lurk between each leveraged TRS and its related hedge.

We have considerable experience with single reference asset and basket transactions. We advise on reporting requirements for counterparties, reference funds and, when applicable, underlying investments. With our in-depth knowledge of master agreements and confirmations, we are able to work efficiently with clients on trade-specific representations and termination events. Frequently, we are called upon to assist in preparing and customizing credit support arrangements and to advise on collateral terms. Our team members who are tax specialists review each trade to ensure that withholding and other tax matters are appropriately addressed. Where "plan assets" might be implicated at the counterparty or reference asset level, we call upon our ERISA team members to help guide a transaction through "prohibited transaction" and other ERISA restrictions. We pride ourselves on applying these multiple disciplines as a single integrated team and without losing sight of the trading and market dynamics to which our clients are acutely sensitive.