

Overview

This information is intended to provide updated and/or additional information regarding the ING Senior Loan Strategy. It is not intended to be complete information about the Strategy, and it should be read in conjunction with other materials describing the Strategy and any potential investment managed in accordance with the Strategy.

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ING INVESTMENT MANAGEMENT

Senior Loans: Interest Rate Repricing



The senior loan asset class can provide current, floating rate income to investors. This current income is derived from the interest payments made by corporate borrowers on their loans. The amount of this interest is comprised of two separate components, a floating base rate and a fixed-rate spread.

The floating-rate component of a senior loan interest rate is based upon widely accepted market interest rate measures or reference rates. Historically, that rate was the prime rate, but today that rate is almost always LIBOR. The fixed-rate component of a senior loan interest rate is a negotiated spread over LIBOR expressed in basis points. The spread generally remains the same over the life of a loan, although there are exceptions as discussed below.

The combined rate is typically expressed as LIBOR+ [spread] (or L+[spread]), so for example, a spread of 350 basis points over LIBOR is expressed as L+350. Because the rate represented by the LIBOR component will change over time, the amount of interest paid by a borrower will likewise change as the applicable LIBOR changes.

In this supplement, we focus on both the LIBOR and spread components of interest rates for borrowers in the senior loan market. We also discuss how and why these rates change over time.

The LIBOR Component

LIBOR (the "London Inter-Bank Offered Rate") is a daily reference rate based on the interest rates at which banks borrow unsecured funds from each other in the London wholesale money market (or interbank market). These rates can change daily in response to market conditions. When short-term market interest rates rise, the LIBOR component of a borrower's interest rate, and therefore the overall interest rate paid by the borrower, typically goes up as well. Conversely, when short-term market interest rates decline, the interest rate paid by the borrower normally goes down.

There are numerous LIBOR rates available in the market based upon the length of borrowing time. LIBOR rates can be overnight rates to as long as 1- year. A typical senior loan credit

agreement will allow a borrower to choose, with some limits, the length of the LIBOR contract. Borrowers typically choose to base different portions of their loans on LIBOR rates with different maturities, such as 30-day, 60-day or 90-day LIBOR.

Some credit agreements allow for a single loan facility to utilize up to a dozen LIBOR contracts at once. The rates for these different maturities track market interest rate expectations, so borrowers typically choose a rate, or a combination of rates, that they believe will provide the lowest overall borrowing cost. If borrowers expect interest rates to rise they will tend to lock in today's lower interest rates for as long as possible. Conversely, if they expect rates to fall, borrowers will generally opt for shorter LIBOR contracts, looking to benefit from lower rates as quickly as possible when interest rates change.

The length of time between interest rates changes and when the rate on a senior loan changes is referred to as the "interest rate reset period." The reset period varies from loan to loan and, because borrowers can change the combination of LIBOR contracts under which they are borrowing, the interest rate reset period for a particular loan can also change over time. In general, a large diversified portfolio of senior loans can be expected to have a weighted average interest rate reset period of 60 days or less. As a result, duration risk is minimal because the interest income paid by borrowers is generally very responsive to changes in short-term interest rates.

The Spread Component

The spread of a senior loan facility, or the amount of interest that a borrower will pay in addition to the base rate (referred to as "credit" or "nominal" spread), generally remains the same over the life of the loan. However, exceptions can occur, primarily in response to the changing financial position and creditworthiness of the borrower. Some spread changes are built into the terms and conditions of a credit agreement. For example, some credit agreements include a pricing grid which provides pre-negotiated spreads that will apply when the financial condition or performance of the borrower changes either positively or negatively. Other spread changes occur due to changing circumstances.

For example, if loans need to be renegotiated, or if a borrower seeks an amendment or a waiver, lenders often take the opportunity to make a change to the spread component of the pricing. In addition, lenders are typically entitled to higher rates of interest when an event of default has occurred.

GRID PRICING

Pricing on many loan facilities is tied to performance grids, which adjust pricing based on one or more criteria that are set in the credit agreement. The most widely used performance grids for senior loans are based on ratings and financial ratios. In a ratings-based grid, a ratings downgrade from one or more ratings agencies may trigger an increase in a loan facility's credit spread. An upgrade in the loan facility's rating may have the opposite effect. A similar situation may arise if a loan's credit agreement calls for grid pricing relating to financial ratios, such as Debt/EBITDA or "total leverage."

Leveraged-based grids are often used to provide premium pricing to lenders when a loan facility's leverage reaches a predetermined level. Conversely, borrowers who are able to reduce leverage are provided with lower pricing as an incentive. The table below shows a typical pricing grid based upon financial ratios.

Total Leverage (Debt/EBITDA)	Spread (bps)
3.00 or below	L+150
3.01 - 4.75	L+250
4.76 - 5.75	L+325
5.76 or above	L+400

AMENDMENTS

Senior loans can be amended by mutual agreement between the borrower and lenders. Usually a majority vote of the lenders (by holdings) is sufficient, although there are some amendments that will require a super-majority or even a unanimous vote. Borrowers can seek to amend their credit agreements for a variety of reasons; they may wish to increase their borrowing limit to accommodate business growth, or change financial covenants due to declining or improving business performance. Borrowers can also seek to renegotiate their credit agreements when

financing costs in the market go down. When borrowers seek amendments because of deteriorating financial performance, or seek waivers from the application of restrictions or financial covenants in the credit agreement, lenders are often able to renegotiate the spreads at the same time. A higher spread is often the price that a borrower must accept in exchange for obtaining the approval of the lenders for the borrower's requested amendments.

The repricing of a loan facility due to an amendment is generally effective immediately following approval of the amendment. Other amendments can add grid pricing provisions to the credit agreement, in which case a price change may or may not occur, based on the loan's rating and/or financial ratios.

DEFAULTS

Senior loans can experience two types of defaults - covenant defaults and payment defaults. In covenant defaults a borrower will have violated one or more covenants, typically financial ratios that need to be maintained. In payment defaults a borrower will fail to make a scheduled payment on time. When these defaults occur, borrowers and lenders initially may seek to waive such defaults or amend the credit agreement to eliminate the defaults. In such cases, lenders often insist upon higher credit spreads and impose other restrictions on the borrower as the price for granting a waiver or agreeing to an amendment. If a waiver or amendment is not worked out, the lenders may declare the loan in default. When that happens, most credit agreements provide that the interest rate on the loan will automatically increase to a specified "default rate." Such default rates are higher than the normal rates charged on the loan.

Summary

The interest rate paid on senior loans will vary over time for a variety of reasons. Those reasons include normal changes in the base rate or LIBOR component of the interest rate, pre-negotiated changes in the spread based upon improving or deteriorating financial performance of the borrower, changes in the market for senior loan financing, credit agreement amendments, and defaults.

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