

# Alert

## LSTA Introduces New Rules for Application of Delayed Settlement Compensation

August 31, 2016

The Loan Syndications and Trading Association (“LSTA”) is introducing new rules in connection with the application of delayed settlement compensation on par trades that will be implemented in two phases. The first and main phase will launch on Sept. 1, 2016, and the second phase will launch on Nov. 1, 2016.

The new rules introduce a requirements-based model for delayed settlement compensation that will replace the current no-fault model, meaning the parties to a trade must now meet certain requirements in order to be eligible to receive delayed settlement compensation.<sup>1</sup> The purpose of the new rules is to create “urgency” for the parties to close trades within the LSTA-suggested timelines, with the ultimate goal being improved liquidity.

The requirements differ slightly depending on whether the trade is settling on paper or on an Electronic Settlement Platform (an “E-Platform”). The vast majority of par trades today settle on an E-Platform and the E-Platform rules described below will apply, unless the parties designate in the trade confirmation that they will settle the trade manually (i.e., via paper).

The most important requirements under the new regime are highlighted below, but the list is not exhaustive.

In the following scenarios, delayed settlement compensation always applies:

- Any required consents under the Credit Agreement have not been obtained and the Buyer has satisfied its requirements described in this *Alert*.
- “Participation” has been selected as the form of settlement at the time of trade (if the trade was originally expected to settle by assignment, but ends up settling by participation, the requirements described in this *Alert* must still be met).
- Seller has not provided Buyer the KYC information that Buyer has timely requested,<sup>2</sup> and due to that, Buyer has not satisfied its requirements described below.<sup>3</sup>

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<sup>1</sup> The current model provides that, if settlement occurs on a date after T+7, delayed settlement compensation always applies (unless the parties agree otherwise at the time of trade).

<sup>2</sup> Prior to the date Buyer’s requirements are due.

### **Settlement on E-Platform of Trades with a Trade Date of Sept. 1 Through Oct. 31**

Delayed settlement compensation will apply to the transaction if the following requirements have been met:

- On or before T+6<sup>4</sup> Buyer has to: (i) execute online or submit by email its signatures to the trade confirmation and assignment agreement and select a proposed settlement date of no later than T+7 and select “Persisted”;<sup>5</sup> and (ii) pay the purchase price on settlement (collectively, the “Buyer Platform Requirements”).
- Dealer has to submit trade details to the E-Platform no later than T+1 so that the E-Platform can generate the transfer documents. If both Buyer and Seller are dealers, or if neither party is a dealer, Seller has the obligation to submit trade details to the E-Platform.
- If Seller is the dealer, or neither party is a dealer, and trade details are not submitted to the E-Platform within T+1, delayed settlement compensation applies, regardless of whether Buyer has satisfied its own requirements.
- If Buyer is the dealer and trade details are not submitted to the E-Platform by T+1, Seller must provide a notice with the Trade Date, Credit Agreement, Purchase Amount and Facility to Buyer within T+3.
- If notice is timely provided by Seller, then Buyer must submit trade details within T+5<sup>6</sup> for delayed settlement compensation to apply and satisfy the Buyer Platform Requirements.
- If Seller notice is not timely provided by Seller, delayed settlement compensation applies.

Other scenarios where delayed settlement compensation shall apply:

- Buyer has not paid the purchase price because it reasonably believes in good faith that the purchase price calculation on the E-Platform is incorrect, Buyer has timely notified Seller<sup>7</sup> and has complied with its other requirements.
- Buyer hasn’t satisfied its requirements because it is unable to do so due to functionality issues of the E-Platform that the Buyer can’t control. Buyer needs to try and mitigate its inability to perform due to such issues.

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<sup>3</sup> Provided that Buyer has to promptly satisfy its requirements once Seller provides the requested KYC information. According to the LSTA best practices, any KYC documents should be delivered to the agent and the counterparty at least three business days prior to entering into or sub-allocating a trade.

<sup>4</sup> Trigger Date +12 for early day trades. “Early day trade” is a trade for which the Trade Date is a date on or before the sixth business day following the Trigger Date (i.e., the date of initial funding under the Credit Agreement) unless there is no funding of any facilities under the Credit Agreement when it becomes effective, in which case the Trigger Date is the date when the Credit Agreement becomes executed and delivered.

<sup>5</sup> “Persisted” means that Buyer is financially able to settle the trade without interruption until the settlement date.

<sup>6</sup> Within Trigger Date +10 for early day trades. “Trigger Date” for a trade is the date of initial funding under the Credit Agreement, unless there is no funding of any facilities under the Credit Agreement at or about the time it becomes effective, in which case the “Trigger Date” is the date the Credit Agreement is executed and delivered.

<sup>7</sup> On or prior to the business day on which payment of the purchase price is due.

- There is a material error in the assignment agreement generated by the E-Platform that the Buyer needs to try and fix by T+3,<sup>8</sup> and if error is fixed by T+4,<sup>9</sup> Buyer needs to satisfy its requirements.

#### *Payment Timing*

For a trade confirmation with a Trade Date on or before Oct. 31, 2016, Buyer shall be obligated to pay the purchase price on the date when the assignment is made effective by the agent.

#### *New CLO Issuers on E-Platform Settlement*

- Prior to T+7, Buyer may indicate that it is a newly formed SPV formed to issue CLOs under an Indenture, then Buyer from T+7 through settlement may select a CLO Blackout Period during which the Agent will not make the assignment agreement effective and delayed settlement compensation shall continue to apply.
- CLO Blackout Period means a period of not more than five consecutive business days preceding the effective date of the Indenture under which New CLO Issuer issues notes, provided such New CLO Issuer may designate only one such period before such effective date of the Indenture. The Blackout Period occurs when the CLO exits the warehousing stage, so that the CLO can issue the securities under its Indenture and go live. Before and after the Blackout Period, the CLO will settle trades in the normal course.

#### **Settlement on E-Platform of Trades with a Trade Date of Nov. 1 or Later**

Some market participants need a lead time to settle some trades (for instance, because their custodian is in Europe). Lead time is the time between when the administrative agent is ready to make the trade effective and Buyer is ready to fund. In order to accommodate that and, at the same time, stay within the T+7 timeline for settlement, on Nov. 1 the LSTA is changing the requirement for execution of the trade confirmation and assignment agreement from T+6 to T+5. That means that Buyers can only have either no lead time or one day of lead time.

- By T+5<sup>10</sup> Buyer has to: (i) execute online or submit by email its signatures to the trade confirmation and assignment agreement; and (ii) select a proposed settlement date of no later than T+7 and select “Persisted.”

#### *Payment Timing*

- If the agent notifies the parties on or before 11 a.m. (Eastern time) that the agent can make the transfer effective on that day, Buyer: (i) with no lead time shall be obligated to pay the purchase price on the same date of such notification; and (ii) with lead time of one business day shall be obligated to pay the purchase price no later than the following business day.<sup>11</sup>
- If the agent notifies the parties after 11 a.m. (Eastern time), but on or before 6 p.m. (Eastern time), Buyer shall be obligated to pay the purchase price no later than the following business day.

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<sup>8</sup> T+6 for early day trades.

<sup>9</sup> T+8 for early day trades.

<sup>10</sup> Trigger Date +10 for early day trades.

<sup>11</sup> In this case, Buyer forfeits one day of delayed settlement compensation.

- If the agent notifies the parties after 6 p.m. (Eastern time), Buyer: (i) with no lead time shall be obligated to pay the purchase price no later than the following business day; and (ii) with lead time of one business day shall be obligated to pay the purchase price no later than two business days following the date of such notification.<sup>12</sup>

Notwithstanding the time frame requirements set forth in the three clauses above, as well as the payment timing for trades with a Trade Date on or before Oct. 31, 2016, Seller and Buyer may mutually agree to override such terms on the E-Platform and have the assignment agreement made effective on a different business day than contemplated above (the “Override Date”) and, to the extent the administrative agent makes the assignment agreement effective on the Override Date (the “Override Assignment Effective Date”), Buyer shall then be obligated to pay the purchase price no later than the Override Assignment Effective Date.

### **Settlement on Paper (Manually) of Trades with a Trade Date of Sept. 1 Through Oct. 31**

Delayed settlement compensation will apply to the transaction if the following requirements have been met:

Buyer obligations:

- If Buyer is responsible for drafting the trade confirmation and the assignment agreement, Buyer needs to deliver to Seller the trade confirmation and the assignment agreement on or before T+1.
- If Buyer fails to do so, Seller is obligated to notify Buyer on or before T+3 of such failure (if Seller fails to notify, then Buyer has satisfied its obligations and delayed settlement compensation applies).
- If Seller’s notification is timely provided, Buyer needs to deliver signed trade confirmation and assignment agreement on or before T+5.<sup>13</sup>
- When Buyer receives Seller’s signatures to the trade confirmation and the assignment agreement, Buyer has to deliver within one business day of such receipt its signature to the trade confirmation to Seller and the fully executed assignment agreement to the agent.

Seller obligations:

- If Seller is responsible for drafting the trade confirmation and the assignment agreement, Seller needs to deliver to Buyer on or before T+1 the trade confirmation and the assignment agreement.
- Then Buyer needs to execute the trade confirmation and the assignment agreement by T+6;<sup>14</sup>
- If Seller fails, delayed settlement compensation applies.

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<sup>12</sup> In this case, Buyer forfeits one day of delayed settlement compensation.

<sup>13</sup> On or before Trigger Date +10 for early day trades.

<sup>14</sup> Trigger Date +12 for early day trades.

- If Seller is responsible for obtaining consents and the transaction does not settle by T+7, Seller shall sign the assignment agreement and deliver copy of signature page to Buyer any time from T+7 through settlement, and notify Buyer of proposed delayed settlement date no later than 6 p.m. on the business day immediately preceding the proposed settlement date to the extent Seller determines in good faith all consents for settlement will have been satisfied.
  - If Seller does not timely provide Buyer with advanced notification of a proposed delayed settlement date, then Buyer shall be obligated to pay the purchase price no later than the business day immediately following the date Seller provides Buyer with notification that the transfer has been made effective.
  - If Seller timely provides Buyer with advanced notification of a proposed delayed settlement date and Seller further provides Buyer with notification that the transfer has been made effective: (i) on or prior to 11 a.m. (Eastern time), then Buyer shall be obligated to pay the purchase price on the same day; or (ii) after 11 a.m. (Eastern time), then Buyer shall be obligated to pay the purchase price no later than the following business day.
- Where Buyer is the party responsible for obtaining any required consents and the transaction does not settle by T+7, to the extent Buyer receives notification that the transfer was made effective either: (i) on or prior to 11 a.m. (Eastern time), then Buyer shall be obligated to pay the purchase price on the same day; or (ii) after 11 a.m. (Eastern time), then Buyer shall be obligated to pay the purchase price not later than the following business day.

Other scenarios where delayed settlement compensation shall apply:

- Buyer has not paid the purchase price, because it reasonably believes in good faith that the purchase price calculation prepared by Seller is incorrect, and Buyer has timely<sup>15</sup> notified Seller and has complied with its other requirements.
- There is a material error in the assignment agreement prepared by Seller, Buyer notifies Seller by T+3,<sup>16</sup> and if error is fixed by T+4,<sup>17</sup> Buyer needs to satisfy its requirements.

#### *New CLO Issuers*

- If Buyer has notified Seller on or before T+7<sup>18</sup> that it is a newly formed SPV formed to issue CLOs under an Indenture, and Seller is the party responsible for obtaining consents, Buyer may select at any time from T+7 through settlement a CLO Blackout Period during which Seller shall notify agent not to make the assignment agreement effective and delayed settlement compensation shall continue to apply. If Buyer is the party responsible to obtain consents, and Buyer has notified Seller that it is a new CLO issuer, Buyer shall notify agent not to make the assignment agreement effective per the above.

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<sup>15</sup> On or prior to the business day on which payment of the purchase price is due in accordance with the above.

<sup>16</sup> T+6 for early day trades.

<sup>17</sup> T+8 for early day trades.

<sup>18</sup> Trigger Date +14 for early day trades.

### **Settlement on Paper (Manually) of Trades with a Trade Date of Nov. 1 or Later**

- Obligation of Buyer to execute and deliver to Seller the trade confirmation and assignment agreement on or before T+5 instead of T+6.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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