ALERTS

Revised LSTA Secondary Debt Trading Documents Effective April 24, 2014

April 23, 2014

The Loan Syndications and Trading Association ("LSTA") announced that new versions of its secondary debt trading documents will take effect on April 24, 2014. The most substantive change across the suite of documents is the incorporation of provisions addressing the Foreign Account Tax Compliance Act ("FATCA").[1] Moreover, the LSTA's participation agreements have been revised to reflect modifications consistent with the changes made to the Collateral Annex last year (as recently discussed in our *Alert* LSTA's Revised Trading Documents Allow Revolver Loan Investors to Protect Their Posted Collateral — But Only If They Ask), and general non-substantive changes to bring the documents up to date. This *Alert* provides a summary of the most important changes by document.

LSTA Par/Near Par Trade Confirmation and Relevant Standard Terms and Conditions ("STCs")

- *Par/Near Par Trade Confirmation*. No changes were made.

- *Par/Near Par Trade Confirmation STCs*. The section of the STCs relating to taxes has been modified to include FATCA provisions. According to such provisions, for any payment of funds or other property pursuant to the transaction described in the trade confirmation, the party required to make the payment to the other party may withhold therefrom an amount required to be withheld pursuant to FATCA, and any amount so withheld shall be treated as having been

paid to the recipient of the payment. Therefore, there is no gross-up. With regard to amounts received in connection with interests in the debt or credit documents (i.e., payments originating from the borrower or the agent) the remitting party who receives such a payment that was subject to FATCA is required to pay to the receiving party a grossed-up amount unless: (i) the receiving party did not comply with its obligations relating to FATCA forms; (ii) FATCA would have been imposed on the receiving party had the receiving party held such interest in the debt or the credit documents directly; or (iii) FATCA withholding was imposed solely as a result of the receiving party's status under FATCA. The receiving party must provide the remitting party with relevant FATCA-related documentation that is reasonably requested, and the remitting party may refrain from making a payment until receipt of the necessary documentation.

LSTA Distressed Trade Confirmation, Purchase and Sale Agreement ("PSA") and Relevant STCs

- *Distressed Trade Confirmation*. No changes were made.
- *Distressed Trade Confirmation STCs*. Like the Par/Near Par Trade Confirmation STCs, the section of the Distressed Trade Confirmation STCs relating to taxes also has been modified to include FATCA provisions substantially similar to those described above.
- *Distressed PSA Transaction Specific Terms*. No changes were made.
- *Distressed PSA STCs*. The section of the Distressed PSA STCs relating to payments and related defined terms has been modified to include FATCA-related provisions substantially similar to those described above.

LSTA Participation Agreement for Par/Near Par Trades and Relevant STCs

- *Par/Near Par Participation Agreement Transaction Specific Terms*. The definition of Elevation Required Consents has been moved from the Transaction Specific Terms to the STCs. The Judgment Currency section has been removed from the Transaction Specific Terms, as the STCs now provide that the exchange rate used for the conversion in a

currency other than the one specified in the contract shall be determined by reference to quotations from a known dealer designated by the mutual agreement of the buyer and the seller.

- *Par/Near Par Participation Agreement STCs*. The most important changes made in the STCs are the following:

  - FATCA provisions substantively similar to those described above have been included;
  - Language has been included according to which it is the express intent of the parties that the sale of the participation by seller to buyer shall be treated as a "true sale" by seller of the participation;
  - Language was added according to which, if borrower or any obligor fails to make timely payment under the credit agreement or adequate protection order of any interest/fees/payments that were paid or credited to buyer on the settlement date if such settlement date occurred seven business days after the trade date and delayed compensation applied, then buyer shall pay seller, upon seller's demand, an amount equal to such interest/fees/payments plus interest;
  - Any funding advance made by the buyer to the seller shall be held by the seller for delivery to the agent for the benefit of the buyer. The seller shall have no equitable or beneficial interest in the funding advance, and such funding advance will constitute property of the buyer;
  - Any seller consent required for an elevation shall be deemed to have been given if the seller has become a subject of a bankruptcy proceeding; and
  - The confidentiality section was made broader to allow the parties to disclose the contents of the participation to directors, officers, employees, agents and counsels of each party and its affiliates.

LSTA Participation Agreement for Distressed Trades and Relevant STCs

- *Distressed Participation Agreement Transaction Specific Terms*. The Immediate Prior Sellers need no longer be identified in the Transaction

Summary of the Transaction Specific Terms, as they are now defined in the STCs. The Covered Prior Seller definition in the Transaction Specific Terms was revised to match the relevant definition used in the PSA. The definition of Elevation Required Consents has been moved from the Transaction Specific Terms to the STCs. Finally, the Judgment Currency section has been removed from the Transaction Specific Terms, as the STCs now provide that the exchange rate used for the conversion in a currency other than the one specified in the contract shall be determined by reference to quotations from a known dealer designated by the mutual agreement of the buyer and the seller.

- *Distressed Participation Agreement STCs*. The most important changes made in the STCs are the following:

  - The definition of Adequate Protection Payments was revised to provide that if such payments are not being made by the borrower when due they switch to flat, i.e., are for the account of the buyer if and when paid;

  - The definition of Pre-Settlement Date Accruals was revised to exclude any interest and accruing fees for the payment of which no grace period applies due to an acceleration of the loans pursuant to the credit agreement following the date when the borrower filed for bankruptcy;

  - Language has been included according to which it is the express intent of the parties that the sale of the participation by seller to buyer shall be treated as a "true sale" by seller of the participation;

  - If the seller does not receive a distribution made to the prior seller due to the fact that the trade between the seller and its prior seller was done on a date after the trade date, then such distribution is deemed received by the seller for purposes of the distributions section;

  - FATCA provisions substantively similar to the ones described above have been included;

  - Any funding advance made by the buyer to the seller shall be held by the seller for delivery to the agent for the benefit of the buyer. The seller shall have no equitable or beneficial interest in the funding advance, and such funding advance will constitute property of the buyer;

- Any seller consent required for an elevation shall be deemed to have been given if the seller has become a subject of a bankruptcy proceeding; and

- The confidentiality section was made broader to allow the parties to disclose the contents of the participation to directors, officers, employees, agents and counsels of each party and its affiliates.

The LSTA participation agreements make the true sale structure of the participation even clearer. Such structure was tested and proven effective in the Chapter 11 case of *In re Lehman Brothers Commercial Paper Inc.*, where the Bankruptcy Court issued an order establishing that "all cash, securities and other property distributed or payable in respect of true participations . . . are not property of the debtor's estate and shall be promptly turned over to the beneficial holders thereof." Holders of participations under the Loan Market Association regime ("LMA") were not granted the same protection.[2] (See *In re Lehman Commercial Paper Inc.*, 08-13900 (Bankr. S.D.N.Y. Oct. 6, 2008) (JMP) (Order Pursuant to Sections 105(a), 363(b), 363(c) and 541(d) of the Bankruptcy Code and Bankruptcy Rule 6004 Authorizing Debtor to (A) Continue to Utilize its Agency Bank Account, (B) Terminate Agency Relationships, and (C) Elevate Loan Participations)).

LSTA Proceeds Letter and Short-Form Proceeds Letter for Distressed Trades

- *Proceeds Letter*. FATCA provisions substantively similar to those described above have been included.

- *Short-Form Proceeds Letter*. The FATCA provisions in the STCs to the Distressed Trade Confirmation are being incorporated in the Short-Form Proceeds Letter by reference. The majority holders provision was removed from buyer indemnity, as it was a leftover from older versions of the letter.

Authored by David J. Karp, Alexia Petrou and Stephanie Blattmachr.

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

---

[1] The Foreign Account Tax Compliance Act ("FATCA") generally imposes a 30 percent withholding tax relating to certain U.S. source payments on

non-U.S. entities, including non-U.S. financial institutions (which include most private equity funds and hedge funds organized as non-U.S. entities), unless such non-U.S. entities take certain steps to identify and report their U.S. investors. Non-U.S. financial institutions generally can avoid this tax by registering with the Internal Revenue Service (the "IRS") and agreeing to comply with certain due diligence and reporting procedures. Many non-U.S. financial entities will be required to enter into an agreement with the IRS ("FFI Agreement") in which they agree to perform certain due diligence procedures in order to identify their U.S. investors and report specific financial information about those investors to the IRS. Non-U.S. financial institutions with investors who refuse to provide identifying information ("Recalcitrant Investors") or with investors which are themselves non-U.S. entities that do not comply with FATCA will be required to withhold on certain income payments (and eventually on certain gross proceeds paid) to such investors. Many jurisdictions have entered into intergovernmental agreements ("IGAs") with the U.S. government in order to mitigate the FATCA burden imposed on financial entities located in their jurisdictions. Financial entities located in jurisdictions with Model 1 IGAs (such as the United Kingdom, Ireland and the Cayman Islands) generally will not be subject to withholding under FATCA so long as they register with the IRS and comply with the rules and regulations promulgated by their jurisdiction giving effect to the IGA. While each IGA jurisdiction will enact enabling rules specific to its own legal system, it is expected that the due diligence and reporting requirements under these rules will be substantially similar to the due diligence and reporting requirements provided in the FFI Agreement. However, the requirement to withhold on Recalcitrant Investors is suspended under the IGAs. For more detailed information regarding FATCA registration and compliance requirements for hedge funds, please see our April 8, 2014 *Alert*, FATCA Registration and Compliance Requirements for Hedge Funds.

[2] The LMA form of funded participation is governed by English law and contemplates a debtor/creditor relationship between the seller (grantor) and buyer (participant). Under this type of arrangement, the buyer has no beneficial interest in the underlying loan agreement, nor any relationship with the borrower. Instead, the buyer has only a right to receive the economic equivalent of any payments made by the borrower under the loan agreement to the seller, with the seller passing on such amounts to the buyer pursuant to the terms of the participation agreement. As the participant (the buyer) has no interest in the underlying debt or loan

agreement, it has no contractual standing against the borrower if the borrower defaults under any of its payments. Additionally, the buyer also bears credit risk exposure against the seller, should the seller become insolvent during the life of the participation. In such a scenario, the buyer only has an unsecured claim against the seller under the funded participation and cannot claim a proprietary interest or entitlement in, or to, the underlying loan proceeds or security granted under the loan agreement. The result of this structure for the buyer is a "double credit risk" scenario, placing the buyer in an inherently more risky position than if it were to become a lender of record or if it had acquired the bank debt by way of an LSTA "true sale" participation arrangement.

Related People

David Karp

Partner

New York

Practices

BUSINESS REORGANIZATION

DISTRESSED DEBT AND CLAIMS TRADING

Attachments

Download Alert