ALERTS

Revised LMA Secondary Debt Trading Documents Go Live on 3 March

28 February 2014

The Loan Market Association ("LMA") has initiated a "plainer English" project and revised its secondary debt trading documents in order to make them more market friendly. As part of the plainer English project, the LMA Standard Terms & Conditions for Par and Distressed Trade Transactions ("STC") and the majority of the LMA secondary documents were amended and will go live on 3 March 2014. The existing STC (dated 14 May 2012) and LMA secondary documents will continue to apply to all trades undertaken prior to 3 March 2014 that are subject to LMA terms. All trades subject to LMA terms agreed on or after 3 March 2014 will be on the basis of these revised STC and LMA secondary documents.

Whilst the "plainer English" project did not substantively change the underlying concepts within the STC, the main changes are the following:

- A proceeding that has been instituted against a buyer or seller seeking a judgment of insolvency or bankruptcy and that is required by law or regulation to not be publicly disclosed does not constitute an insolvency event and does not result in termination of the trade. Prior to the relevant amendment of the STC, the trade would terminate automatically or following a termination notice depending on the terms of the trade.

- The seller and the buyer will act as principals, unless otherwise specified in the trade confirmation. Previously, each of the buyer and the seller had to indicate in the trade confirmation whether it was acting as a principal or an agent.

- The seller and the buyer agree that the courts of England are the most appropriate and convenient courts to settle any disputes relating to a trade that is subject to the STC and neither the seller or the buyer will argue to the contrary.

- Provisions for electronic signatures have been added.

When trading European bank debt and claims on LMA standard documentation, investors should consider the following:

1. Pre-Settlement Control Voting Rights

The STC do not account for how voting rights are allocated between the trade date and the settlement date. Therefore, any voting decisions during this period remain with the seller, unless the terms of trade state otherwise. While it is good practice for the seller to confer with the buyer on an upcoming voting scenario after the trade date, the seller generally has no contractual obligation to do so.

The sellers will often request certain carve-out language, where they do not have to follow the buyer's instructions (usually in relation to voting where the seller believes that it will cause a reputational issue, or a breach of the seller's regulatory requirements). In addition, if the seller is only selling a minority piece of its entire position to the buyer and cannot split the vote, the seller may vote in accordance with the instructions of the majority of the position.

Consequently, obtaining the benefit of voting between the trade date and settlement date may not guarantee that the buyer's instructions will be followed. The best guarantee for the buyer that it will be able to vote based on its preferences it to expedite settlement and become a lender of record.

2. Obtaining Borrower Consent

Obtaining borrower consent to an assignment, when required, can be a significant hurdle for new lenders to overcome in Europe. Recently borrowers have been exercising their consent rights more frequently. This is on the premise that, in the current economic climate, borrowers have a genuine fear that the new lender may not be sympathetic to the company in the context of any future waiver or planned credit amendment. Most LMA based credit agreements provide that borrower consent cannot be

"unreasonably withheld or denied". For more on the borrower consent issue, please refer to our 16 Sept. 2012 blog entry from *Distressed Debt Investing*, "Prospecting for European Distressed Loans".

3. Sub-participation

An LMA sub-participation agreement (unlike the Loan Syndications and Trading Association participations that are used for U.S. credits and grant in favour of the participant a beneficial or equitable ownership interest in the underlying loan) is characterized as a loan from the sub-participant to the grantor (in the amount of the purchase price) to be repaid solely to the extent the borrower makes payments on the underlying loan. Consequently, the sub-participation creates a debtor/creditor relationship between the grantor and the sub-participant. Under such arrangement, the grantor is generally obligated to pay to the sub-participant a pro rata amount equal to principal, interest, fees and other distributions received by the lenders under the credit agreement.

Due to the nature of the sub-participation arrangement, the sub-participant has a contractual relationship with the grantor only, and has no direct rights against the borrower. The sub-participant is not a direct party to the credit documentation and the grantor does not transfer or assign rights or obligations under the credit documentation to the sub-participant. Accordingly, in the event of the insolvency of the grantor, the sub-participant will only have the right to claim as an unsecured creditor in the insolvency of the grantor.

Authored by David J. Karp , Sonya Van de Graaff, Alexia Petrou, and Anthony Lombardi .

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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David Karp

Partner

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