

SPECIAL SITUATIONS CLIENT BULLETIN

Quick Guide to Credit Document Transfer Provisions for Loan Purchasers

Credit documentation transfer provisions, which may in the past have been viewed as rather boilerplate, have increasingly become points of contention in the documentation process. Today these provisions are often highly negotiated and may include significant restrictions on transferability.

To avoid wasteful expenditures of resources, we recommend that clients who are potential buyers of loan positions assess the relevant credit agreement transfer provisions as a gating exercise for each possible acquisition, before coming to an unwelcome realization that these provisions may actually prevent them from acquiring an exposure. Towards that end, this bulletin provides a useful, high-level summary of key transfer provision considerations that can be incorporated into credit documentation reviews.

(A) Consent Requirements: As a general matter, credit documents may grant consent rights over transfers to some mix of several different constituencies, including agents, issuing banks, swingline lenders, borrowers and, less often, sponsors. The consent rights in favor of agents, issuing banks and swingline lenders are relatively standard—especially in respect of undrawn or revolving exposures. Consent rights in favor of borrowers (including their parent entities) and sponsors, however, may serve as a significant gating item for a prospective purchaser’s entrance into a credit.

Borrower and sponsor consent rights have become heavily contested provisions. The formulation of these provisions may depend on the relative strength of the borrower or sponsor vis-à-vis the lending syndicate, the bullishness of the market and the negotiation dynamics at the time of origination, among other things.

Borrower and sponsor consent rights are typically (though not always) conditioned on “not to be unreasonably withheld or delayed” type language.¹ A fair bit has been written on the interpretation of this qualifying language, but there is little legal precedent to serve as reliable guidance. Consequently, borrowers and sponsors are often able to withhold their consent as a matter of prerogative, with lenders reluctant to challenge the borrower’s or sponsor’s exercise of consent rights for reasons that can include business relationship concerns and uncertainty in the probability of success.

Presented with strict borrower or sponsor consent rights, prospective purchasers in the market should assess the borrower’s or sponsor’s inclination to provide transfer consent and whether an existing relationship or other point of leverage can be used to open up a path to ownership. This initial assessment can help prospective purchasers avoid the

¹ *Issuing banks and swingline lenders are often given consent rights which are absolute, as they will be sensitive to their exposure to the creditworthiness of any incoming assignees.*

time and expense of performing preliminary reviews of credits for which they cannot satisfy the credit transfer requirements.²

Most constructions of borrower or sponsor consent rights provide that if the borrower or sponsor, as the case may be, does not respond (by consenting or withholding its consent) within a specified time period (eg, 5 business days), then consent is deemed to be given. Though it is important that the concept of deemed consent be incorporated into the consent rights provision for a borrower or sponsor (otherwise, it could indefinitely sit on a request, effectively keeping an open trade in limbo until it suits it to respond), it is fairly unlikely that a borrower or sponsor would not be sufficiently organized to respond before a deemed consent deadline, particularly in a more distressed scenario where the trading in the relevant credit is likely to be more active.

(B) Exceptions to Consent Provisions: Borrower and sponsor consent rights in respect of transfers typically contain a number of exceptions. Transfers to other lenders in the syndicate and their affiliates or affiliated funds or investment vehicles are usually carved out of the consent requirements.

Some credit agreements might also build in a concept of a “white list”, or a schedule of effectively pre-approved entities or types of institutions which may acquire loan exposures under the credit documents without borrower or sponsor consent. More often found in the European credit markets, these “white lists” may specify a large number of different financial institutions and may run to several pages in length.

Additionally, the existence of a “default” typically strips borrowers and sponsors of their transfer consent rights. Whether all defaults or only specified defaults (typically payment and bankruptcy defaults) strip borrowers and sponsors of their transfer rights has become an actively negotiated point in recent years. It is important for lenders and potential purchasers to understand whether a default (and which defaults) under a credit agreement will result in a borrower or sponsor losing its consent rights, as it will significantly impact the ability of the lenders to manage their loan exposures in a more distressed scenario and the liquidity of the loan in the secondary market.

(C) Ineligible or Disqualified Lenders: A credit agreement may also designate certain parties as being disqualified from becoming lenders as a matter of course (unless the borrower and/or sponsor otherwise agrees, which given the context is often rather unlikely).

“Competitors” are typically specified as being disqualified from acquiring an interest in a credit agreement. More recently, “loan-to-own investors” and “distressed funds” (or similar) have also become disqualified entities. The specific definitions for “competitor” and for “loan-to-own investor” and, certainly, for “distressed fund” should be read in detail, as they could be worded to capture a larger group of entities than might be

² Prospective purchasers should always confirm they satisfy the credit agreement’s definition of eligible assignee, though these definitions are usually drafted broadly enough to include most likely buyers of credit exposures in the secondary market.

assumed, and in particular more standard credit funds might be unwittingly caught up by an overbroad or loosely-drafted definition.³

Rather than a blanket disqualification of “loan-to-own investors” and/or “distressed funds”, a credit agreement may incorporate a list of specifically disqualified institutions which are blocked from acquiring a credit exposure thereunder. In contrast to the European credit market’s use of “white lists”, the incorporation of a “DQ list” is an approach which is more favored in the US loan market. Any entity included on a “DQ list” is typically prohibited, unconditionally, from becoming a lender under the credit agreement, even if the borrower has otherwise lost its consent rights upon the occurrence of a default thereunder.

If a credit agreement incorporates a “white list” or a “DQ list”, the language around the availability of the list should be reviewed. Unless the agent is able to share the list with lenders in advance, trading in the loan exposures under the credit agreement could be negatively impacted – with lenders (and brokers) forced to work out in piecemeal fashion which parties fall within the universe of potential trading counterparties for the credit exposures.

(D) Consultation or Notification Requirements: Transfer provisions may also give a borrower, its parent or the sponsor consultation or notification requirements, as opposed to consent rights. In prior years it was more standard to incorporate consultation or notification rights than consent rights as a precondition for the transfer of loans in the European credit market. Viewed by some as more of an administrative procedure rather than a hard requirement, these provisions have the potential to hold up the efficient trading of loans in the market for those who gloss over their requirements (particularly in situations where the borrower is more inclined to be particular about the observance thereof).

Note also that if a transfer is effected without strict compliance of such consultation or notification requirements (or, in fact, any requirement included in the transfer provisions), then the effectiveness of such transfer could be jeopardized if the credit agreement provides that non-complying transfers are void.

(E) Participations: If an assignment is not possible, the trade documentation will generally provide a fall-back to settlement by way of a participation. Participations have historically not been subject to the same level of transfer restrictions applicable to assignments. However, borrowers have begun scrutinizing the provisions in credit agreements allowing for participations, pushing for more controls over participation arrangements which carry voting privileges or rights—and at times demanding additional controls over all lender participation arrangements. For instance, a lender may be required by the credit agreement to give the borrower notice prior to entering into a participation agreement with a third party, or to maintain a register of all third-party participation arrangements into which it has entered under the credit agreement. More crucially, though, many credit agreements extend to participations (and, in particular,

³ In some instances, these definitions may wrap in the sponsor and/or affiliated funds, though more “bona fide” debt fund affiliates may be excluded.

voting participations) the same borrower consent rights and DQ lists applicable to assignments.

(F) Minimum Transfer Amounts / Minimum Hold Amounts: Credit agreements typically require transfers to be of at least a certain minimum amount, often in the range of \$1 - \$5 million (and sometimes more) depending on the size of the facility, which forestalls the potential administrative headache associated with multiple trades in smaller amounts. Potential purchasers should confirm the minimum transfer amount when reviewing a credit agreement to ensure the prospective amount of debt to be purchased is in excess of this threshold (or, if below, there is an exception allowing a transfer representing the entirety of the seller's current holding (if applicable)).

Credit agreement minimum hold requirements prevent existing lenders from selling down all but a minimal amount of their credit exposure. As with the minimum transfer amount requirement, the justification for these types of requirements is ease of administration. However, where a minimum hold requirement is set at a burdensome level it could act as a restraint on the transferability of the loan.

(G) Pro Rata Slice: Where there are two or more loan facilities or tranches documented under a credit agreement, a lender could be required to transfer *pro rata* portions of each exposure. Although not a common feature, it is worth considering when carrying out an initial review of a credit agreement.

(H) Other Related Considerations: Though not usually included in a credit agreement's transfer provisions, there are typically other "back-of-the-agreement" provisions that can impact the transferability of credit exposures and, as such, warrant consideration in connection with an initial documentary review.

- a. Confidentiality Provisions:** Although the confidentiality provisions in credit agreements typically permit lenders to share syndicate level information with potential transferees and participants (and their advisors), it should be confirmed as a part of a credit review as a matter of good practice. It is possible that sharing confidential information under a credit agreement outside the lending syndicate could be conditioned on borrower consent or notification.
- b. Information Provisions:** As more of a forward-looking consideration, a prospective purchaser of credit exposure should confirm in advance what information the borrower has agreed to provide to lenders under the credit agreement and the timing for those reporting deliverables. Annual and quarterly financial statements can usually be expected, but there may be other information which the borrower has agreed to provide (*e.g.*, monthly financial statements, annual budgets and possibly periodic lender calls). While less important for the actual trading of credit exposures, this information can be crucial for managing and monitoring a post-trade position.
- c. Voting Provisions:** Again, though the voting provisions (namely, the percentages of the lending syndicate required to agree for different amendments to be effected) will not technically affect the transferability with respect to a credit agreement, a potential purchaser should be aware of the changes which could be

made by the other lenders acting as a majority within the syndicate. This is especially true where a potential purchaser is considering the acquisition of less than a “blocking stake” in a stressed or distressed situation. Recent examples of aggressive majority behavior (eg, Serta Simmons) should provide enough of a cautionary tale for market participants in this regard.

As a supplement to an initial review of the relevant credit documentation, prospective purchasers should attempt to inform themselves of both the composition of the existing lending syndicate and any prevailing dynamics or relationships among the entities in the lending syndicate and between the lending syndicate and the borrower or sponsor. This information will be useful for understanding the fuller context of the credit which the prospective purchaser may enter.

- d. Loan Party and Affiliated Lender Purchases:** A potential purchaser should make itself aware of whether, and how, a borrower, sponsor and/or their affiliates may acquire loans under the credit agreement and, if a loan is so acquired, the rights of the borrower, the sponsor and/or such affiliates in such loans. Loans acquired by a borrower, sponsor or their affiliates are typically retired upon purchase or, if not retired, denied the credit voting rights afforded other lenders. Also, in light of certain recent precedents, potential purchasers should understand whether a borrower, sponsor or their affiliates may acquire the loan exposures of some of the lenders exclusively without affording the other lenders in the syndicate a similar opportunity to sell.

Sample Credit Transferability Checklist

1. Consent Rights	
Agent	<input type="checkbox"/> Consent right <input type="checkbox"/> Not to be unreasonably withheld or delayed <input type="checkbox"/> Exclusion for existing lenders, affiliates, approved funds <input type="checkbox"/> Other: -----
Issuing Bank(s)	<input type="checkbox"/> Consent right <input type="checkbox"/> Not to be unreasonably withheld or delayed <input type="checkbox"/> Exclusion for existing revolving lenders, affiliates, approved funds <input type="checkbox"/> Other: -----
Borrower / Parent / Sponsor	<input type="checkbox"/> Consent right <input type="checkbox"/> Not to be unreasonably withheld or delayed <input type="checkbox"/> Consent deemed given within if no response within ----- <input type="checkbox"/> Notification or consultation right? <input type="checkbox"/> Exclusion for existing lenders, affiliates, approved funds <input type="checkbox"/> White list <input type="checkbox"/> DQ list <input type="checkbox"/> Other: -----
Other	<input type="checkbox"/> -----

2. Eligible Assignee Requirements	
Specific eligible assignee requirements?	<input type="checkbox"/> ----- <input type="checkbox"/> ----- <input type="checkbox"/> -----
3. Prohibited Assignees	
Ineligible Institutions	<input type="checkbox"/> Competitors <input type="checkbox"/> Disqualified Institution List: ----- <input type="checkbox"/> Other: -----
Defaulting Lenders	<input type="checkbox"/>
Borrower and its Affiliates	<input type="checkbox"/> <input type="checkbox"/> Exclusions from prohibition: -----
Sponsor and its Affiliates	<input type="checkbox"/> <input type="checkbox"/> Exclusion from prohibited assignment for affiliated institutional lenders? <input type="checkbox"/> Other exclusions from prohibition?
4. Participations	
	<input type="checkbox"/> Applicable Consent rights (Borrower/Parent/Sponsor/Agent/Other) <input type="checkbox"/> Applicable for All Participations/Voting Participations <input type="checkbox"/> Not to be unreasonably withheld or delayed <input type="checkbox"/> Consent deemed given within if no response within ----- <input type="checkbox"/> Notification or consultation right (All/Voting Participations)? <input type="checkbox"/> Other: -----
5. Minimum Assignments / Minimum Holds	
Minimum Assignment Amount	<input type="checkbox"/> \$-----
Minimum Hold Amount	<input type="checkbox"/> \$-----
6. Other	
Pro rata purchase requirement	<input type="checkbox"/>
Confidentiality provisions permit potential assignee / participant access?	<input type="checkbox"/>
Notable voting provisions	<input type="checkbox"/> ----- <input type="checkbox"/> ----- <input type="checkbox"/> -----
Borrower / Sponsor / Affiliate Purchases	<input type="checkbox"/> Permitted? <input type="checkbox"/> Lender consent rights? <input type="checkbox"/> Retired upon purchase? <input type="checkbox"/> Disenfranchised upon acquisition? <input type="checkbox"/> Required to offer purchase to all lenders? <input type="checkbox"/> Other -----

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