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MCAPs: Capping Off Lessons From the Credit Crisis

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The Loan Syndications and Trading Association (LSTA), the primary domestic trade association for the corporate loan market, has been advocating for the U.S. syndicated loan market since 1995. In addition to promoting corporate loans as an asset class to U.S. and overseas investors, one of the core functions of the association is to standardize primary and secondary market loan documentation.

The primary and secondary corporate loan markets in the U.S. have increased exponentially over the past 10 years. The LSTA reported that at the current trajectory, 2014 could be a record year for trading, with annualized trading standing at $628 billion, which would eclipse the market's standing record of $520 billion in 2007.[1]

As the corporate loan market has continued to expand, market participants have looked to the LSTA for leadership in generating forms that increase the efficiency and transparency of market trades. The LSTA first published its Model Credit Agreement Provisions (MCAPs) about 10 years ago; they have undergone significant revisions since then. As more and more market participants use the MCAPs for their transactions, the LSTA is becoming the standard-setter for credit agreement provisions, even when LSTA trades are not involved.

On Aug. 8, 2014, the LSTA published its latest iteration of the MCAPs (2014 MCAPs). The 2014 MCAPs introduce standardized terms for several provisions that emerged in the wake of the 2008 credit crisis: (1) amend and extend, (2) buybacks, (3) cashless rolls, and (4) restrictions on disqualified institutions.

The first three items relate to what are often described as "sacred rights." The term "sacred rights" refers to provisions that cannot be modified without the unanimous consent of lenders. These typically cover the following: rate of interest, rate of amortization, maturity date and collateral. During the financial crisis, borrowers not surprisingly encountered difficulty achieving unanimous consent from lenders to credit facility amendments that would modify such provisions. The 2014 MCAPs contain mechanisms intended to allow such amendments to become effective for consenting lenders without prejudicing non-consenting lenders.

The last item, restrictions on disqualified institutions, addresses a continuing source of tension in the secondary market between, on the one hand, borrowers and sponsors, who seek to prevent assignee lenders from gaining access to confidential information, and, on the other hand, lenders and other market participants looking to preserve maximum debt liquidity.

Today we review each of these four new sets of provisions.

Amend and extend provisions in the 2014 MCAPs allow each individual lender the opportunity to extend the maturity date of its loans and commitments without forcing existing non-consenting lenders to exit the facility.

Amend and Extend

As noted above, since credit agreements typically require the unanimous consent of lenders to extend the maturity date of loans and commitments, during the financial crisis, borrowers were often unable to obtain refinancing on reasonable terms and accordingly defaulted on their loans when they failed to achieve unanimous support for an extension. As a result, amend and extend transactions became popular and, although refinancing is not the challenge it was, these provisions continue to appeal to borrowers, sponsors and lenders alike due to their ease of administration.

Amend and extend provisions in the 2014 MCAPs allow each individual lender the opportunity to extend the maturity date of its loans and commitments without forcing existing non-consenting lenders to exit the facility. Each lender of a particular class can participate in an extension on a pro rata basis on the same terms and conditions as each other lender of the same class.[2]

Under these provisions, the terms of the extended term loans or revolving credit commitments remain substantially identical to the existing loans, except that the extended portions can have different pricing (presumably higher), there is no scheduled amortization of the loans or reductions of commitments under any extended revolving credit commitments, and the average life to maturity of the extended term loans is no shorter than the remaining average life to maturity of the existing term loans. The extended loans benefit from the same guaranties, the same collateral and the same pro rata share of voluntary or mandatory prepayments or reductions (aside, of course, from the earlier maturity date of the non-extended loans).

The appeal of this structure is obvious: The extending lenders often get fees and better economic terms, the borrower, in turn can extend at least a portion of its facility without the cost and burden of refinancing, and the non-consenting lenders can exit the facility on schedule.

Borrower Buybacks

Borrower buybacks represent another vestige of the credit crisis. During that period, borrowers who wanted to de-lever often had to do so by buying back term loans trading below par in the secondary market.

U.S. credit agreements typically require prepayments to lenders to be made on a pro rata basis and contain sharing provisions which

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generally require lenders to share with other lenders any amounts received in excess of their pro rata share. The 2014 MCAP provisions allow the borrower, through a reverse "Dutch Auction," to offer to acquire term loans on a non-pro rata basis provided an offer is made on a pro rata basis to all term loan lenders.

Among the conditions to such purchase are that the borrower cannot use proceeds of any revolving loans (so it must use its own funds) and it must represent that neither it nor its affiliates has any material non-public information not already disclosed to the term lenders (other than to term lenders that don't wish to receive such information).

Affiliate Purchases

The 2014 MCAPs also contain provisions that permit lenders, through "open-market purchases" (which is not defined), to assign their term loans on a non-pro rata basis to an affiliate of the borrower or its subsidiaries (or the sponsor). However, affiliate assignees that do not qualify as "Debt Fund Affiliates"[3] are subject to several special conditions, including that they cannot receive information provided solely to lenders by the administrative agent or another lender, participate in lender-only meetings or vote on non-unanimous matters other than in proportion to the vote of other lenders, and that they can only vote on matters requiring unanimity if they would be more materially adversely affected than other lenders, and must covenant *not* to vote on any bankruptcy plan of reorganization or liquidation of the borrower.

Cashless Rolls

The recent low interest rate environment has prompted borrowers to seek to reduce their credit facility interest rates. Reduction of the rate of interest would fall within the "sacred rights" of a credit agreement voting structure, accordingly requiring the unanimous consent of lenders. The 2014 MCAPs seek to facilitate the re-pricing of a loan facility when unanimous consent is not available through what the LSTA refers to as a "cashless roll."

Without the unanimous consent of lenders, a borrower would typically be required to refinance its existing facility, with the associated administrative burdens. Pursuant to a cashless roll, loans under the existing facility from consenting lenders are "rolled" into an amended and restated credit agreement on a cashless basis. Although non-consenting lenders are repaid in full, importantly, there is no requirement to fund a repayment of the existing facility and or a reborrowing under the restated facility for consenting lenders. This structure has the obvious benefit of eliminating the delays (and sometimes associated difficulties) of cash settlements.

Disqualified Institutions

Probably the most significant additions to the MCAPs are the provisions addressing disqualified institutions. Disqualified institutions are institutions that the borrower wants to exclude from its lending group. Borrowers are required to provide confidential information to lenders and, from time to time, involve lenders in decisions affecting the borrower's capital structure. Borrowers fear that a potential or actual competitor or other party seeking to gain a strategic business advantage will become a member of its lending syndicate. The disqualified institution provisions attempt to balance such concerns of borrowers against the desire of lenders, agents and other market participants to preserve liquidity in the secondary market.

Under the 2014 MCAPs, the list of disqualified institutions is created by the borrower before the closing of the credit facility. After the closing, the borrower may update the list by adding "competitors." The exact definition of competitor is left for negotiation, but it is intended to be defined in reference to the particular borrower and its business.[4]

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These provisions do not have retroactive effect. If a lender enters into a trade with an institution that subsequently is added to the "DQ List," the trade can still be settled but the borrower has the right to "yank" the competitor by purchasing the loan or requiring the competitor to assign all of its interest, rights and obligations under the credit facility to an eligible assignee.[5]

The disqualified institution provisions apply to both assignments and participations. Notably, an assignment or participation in violation of these provisions is not void. Such a result would raise practical as well as legal issues. Instead, a disqualified institution (1) will not have the right to receive and/or access information provided to the other lenders, (2) will not have the right to attend meetings of the lenders, and (3) prior to and following a bankruptcy proceeding of the borrower, will not have voting rights as the other lenders do with respect to certain actions taken under the credit agreement.

Although the 2014 MCAPs do not attempt to invalidate a prohibited assignment or participation to a disqualified institution, an interesting question is whether the anti-assignment provisions of Article 9 of the Uniform Commercial Code would override the limitations imposed on a disqualified institution that takes an assignment in violation of such provisions. Article 9, by its terms, applies to sales of promissory notes and payment intangibles,[6] which would include a lender's primary rights under a credit agreement. Section 9-408(a) of the UCC renders ineffective contractual restrictions on transfers as they apply to sales of promissory notes and payment intangibles to the extent provided in such section and in UCC §9-408(d). Despite this override under the UCC, contractual anti-assignment provisions in credit agreements such as those in the MCAPs should still provide meaningful protection to borrowers. For example, a borrower would not be required to deliver confidential information to a lender that took an assignment in violation of the anti-assignment clause to the extent that the borrower otherwise had an obligation to deliver such information under the credit agreement.[7] In fact, the Official Comments to UCC §9-408 indicate that limitations that do not directly restrict assignment but constitute a practical impairment are not overridden.[8]

Finally, to avoid burdening administrative agents with added responsibility and liability for monitoring the list of disqualified institutions, the 2014 MCAPs include language that makes it clear that the agent will not be responsible or liable for its role with respect to such list.

Conclusion

Although significant bespoke negotiation will still be necessary when putting this model into practice, the 2014 MCAPs represent a solid step forward in the evolution of lending documentation. These provisions address some tail risks that surfaced as a result of the credit crisis, in particular refinancing risk. They provide needed flexibility for both lenders and borrowers, something that will likely prove important over time.

1. LSTA Secondary Trading & Settlement Monthly (Aug. 15, 2014), http://www.lsta.org/data-and-analysis/lsta-research#ui-accordion-yw5-header-3.

2. In fact, the 2012 MCAPs contained a version of this provision, although set forth in an appendix rather than the actual agreement. The appendix language referred solely to extensions of commitments and did not address term loans, and provided as well for a minimum percentage requirement of extending lenders, which the 2014 MCAPs do not.

3. A Debt Fund Affiliate is defined generally as a debt fund or investment vehicle that invests in commercial loans in the ordinary course of business and isn't controlled by the borrower, sponsor or any affiliate.

4. LSTA Model Credit Agreement Provisions, Disqualified Institutions, DQ Structure Memo (July 29, 2014), http://www.lsta.org/legal-and-documentation/primary-market.

5. LSTA Quarterly Review (July 25, 2014), http://www.lsta.org/news-and-resources/lsta-newsletter.

6. See UCC§9-109(a)(3). "Payment intangible" is defined in UCC§9-102(a) (61) to mean "a general intangible under which the account debtor's principal obligation is a monetary obligation." "Promissory note" is defined in UCC§9-102(a) (65) to mean "an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds."

7. See UCC §9-408(d)(5), which provides that an assignment effected pursuant to the override in UCC §9-408(a) "does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor."

8. See Official Comment 6 to UCC §9-408; See also Official Comment 5 to UCC §9-406.