

**BEFORE THE EXTERNAL REVIEW PANEL OF THE
DETERMINATIONS COMMITTEE OF
THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION INC.**

DC ISSUE NO: 2018101502

**Do the following obligations satisfy the Consent Required Loan
Deliverable Obligation Characteristic for purposes of the
Auction to be held with respect to SRAC?**

**FIGI BBG00DX35360 2LL: PIK Term Loan -
The Term Loan, as defined in the Fifth
Amendment to the Second Lien Credit
Agreement dated as of July 5, 2018.**

**FIGI BBG00DX35360 2L: Line of Credit Loans
(\$525.0m) - The Line of Credit Loans, as the
Fifth Amendment to the Second Lien Credit
Agreement dated as of July 5, 2018.**

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INTRODUCTION

Amici, a group of global asset and alternative asset managers who collectively have over \$150 billion of assets under management, are ISDA Members¹ who regularly participate in the Credit Default Swap (“CDS”) market. *Amici* submit this brief to assist the External Review Panel in articulating a predictable rule with respect to the Consent Required Loan Deliverable Obligation Characteristic that affects the commercial reality of the secondary loan market in transferring these Loans.

Amici support a broad interpretation of “Consent Required Loan.” Their support is based on the plain words used to define “Consent Required Loan” in the 2014 Definitions, which indicate that a Loan is a “Consent Required Loan” so long as it is capable of assignment with consent to at least one party. And their support is based on the commercial reality that participations are readily available in the loan market whether or not a Loan is assignable.

Like many market participants, *Amici* have a strong interest in the success and smooth functioning of the CDS market and significant experience in CDS and credit markets in general. Should the External Review Panel find it helpful, *Amici* would welcome an opportunity to provide more information to the External Review Panel regarding the issues discussed in this brief as well as those relevant to the Reviewable Question in general, by participating in the Oral Argument or otherwise.

¹ Capitalized terms used but not otherwise defined herein have the meaning assigned to them under the 2014 ISDA Credit Derivatives Definitions (the “2014 Definitions” or “Definitions”), or the 2018 ISDA Credit Derivatives Determinations Committee Rules, as the case may be.

DISCUSSION

I. A LOAN SHOULD BE A “CONSENT REQUIRED LOAN” SO LONG AS IT IS CAPABLE OF ASSIGNMENT WITH CONSENT, NOTWITHSTANDING ASSIGNEE ELIGIBILITY CRITERIA.

The CDS market would benefit from the clarity around one of the most important Definitions affecting the value of the product. That clarity is attainable by reading the “Consent Required Loan” Definition exactly as it is written, without supplying more words.

Under New York law, which is the Relevant Governing Law for purposes of the Reviewable Question, the literal words of a contract should be enforced as written absent extraordinary circumstances. As the New York Court of Appeals has made clear, “courts may not by construction add . . . terms . . . and thereby make a new contract for the parties under the guise of interpreting the writing.” *Reiss v. Financial Performance Corp.*, 97 N.Y.2d 195, 199 (2001) (internal quotation marks and citations omitted). Although “courts may as a matter of interpretation carry out the intention of a contract by . . . supplying words to make the meaning of the contract more clear . . . such an approach is appropriate *only* in those limited instances where some absurdity has been identified or the contract would otherwise be unenforceable.” *Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 547 (1995) (emphasis added). When interpreting a contract, words and phrases used by the parties should be given their plain meaning. *DDS Partners, LLC v. Celenza*, 6 A.D.3d 347, 348 (1st Dep’t 2004).

Here, the relevant words the drafters used in the 2014 Definitions are plain and unambiguous. A “Consent Required Loan” is a Loan which is “capable of being assigned or novated with the consent of the Reference Entity . . . or any agent.” The word “capable” here should be given its ordinary meaning, namely, “[s]usceptible; competent; qualified; fitting; possessing legal power or capacity. Able, fit or adapted for.” Black’s Law Dictionary (6th ed. 1990). The Definition includes no scope limitation regarding the number of assignees to whom

the Loan could be assigned (assuming consent). As literally drafted, provided that the Loan can be assigned to at least one person, the requirement is satisfied.

By contrast, the First Interpretation requires the addition of words to this unambiguous text. Specifically, the First Interpretation requires adding the words “generally to all persons” to modify the unambiguous words “capable of being assigned.” Determinations Committee Decision Issue No. 2018101502 at 2 (Nov. 7, 2018) (“DC Decision”). Such an approach is inconsistent with applicable New York law.

The drafters of the 2014 Definitions knew how to define a minimum or required scope of assignees under the Deliverable Obligation Characteristics, as they did exactly that in the Definitions of “Assignable Loan” and “Transferable.” If the drafters had intended to require a minimum scope for “Consent Required Loan,” they would and could have done so explicitly. They did not do so and their decision should be respected. If restrictions are to be imposed on the deliverability of a Loan, such restrictions should have been explicitly stated in the provision in a format that would give market participants fair warning. They cannot be sprung on market participants after the fact.

The addition of the *de minimis* exception, as suggested by some DC Members, would fail to provide clarity to the market. *See* DC Decision at 3. It would be subject to interpretation on a case-by-case basis, thus still leaving the market without clarity absent a specific DC determination on the issue. Moreover, only a small minority of Loans contain eligibility criteria that are as non-consequential as “non-natural person.” Hence, a *de minimis* exception, if applied too narrowly, would not adequately recognize the reality of this asset class. The market’s desire for predictability is therefore best served by a plain reading of the words of the “Consent Required Loan” definition rather than adding words to the text.

II. APPLYING THE PLAIN WORDS OF THE “CONSENT REQUIRED LOAN” DEFINITION COMPORTS WITH MARKET EXPECTATIONS.

A literal reading best comports with the underlying commercial motivations for the broad language used in the “Consent Required Loan” Definition and results in no absurdities requiring the addition of words to the text. In particular, there is no need to add words to the “Consent Required Loan” Definition in order “to protect CDS market participants from the risk that a Loan is characterized as a Deliverable Obligation but is subsequently not capable of being transferred to another participant in that CDS market as part of the settlement of a CDS contract,” as some members of the DC had suggested. DC Decision at 3. That is because the transfer of a Loan in the secondary loan market can almost always be accomplished by means of participation even if the Loan is otherwise unassignable.²

Because eligibility criteria for assignments are common in loan agreements, and indeed because borrowers sometimes do withhold consent to assignments, the U.S. loan trading market has developed and now readily recognizes participation as an alternative method to transfer the economic benefits and risks of Loans. Under the framework used in that market, a participation is an industry standard arrangement under which a grantor grants a beneficial interest in the Loan to a participant. While the participant does not acquire legal title to the Loan, it does acquire all other indicia of ownership, including all economic rights and interests.

A conveyance of “equitable title” of a Loan via participation meets the requirements under the Definitions that the Loan be Delivered within the meaning of Section 8.12(a) in connection with a Physical Settlement. Holding an ownership interest in the form of participation is no different in principle from the holding structure of most DTC-eligible Bonds.

² The secondary loan market is the appropriate reference market here because Physical Settlement of a CDS necessarily involves transfer of the Loans as they would be transferred in the secondary loan market.

Such Bonds are typically registered in the name of Cede & Co., as nominee of The Depository Trust Company. DTC's records reflect only the identity of the DTC participants, directly or indirectly through whom an owner of the Bond owns, and transfers, its beneficial interest in the Bond. Similarly, a transfer of a Loan by participation in the U.S. is a transfer of beneficial interest in the Loan, and therefore should also be a conveyance of "equitable title" under Section 8.12(a) of the Definitions.³ The availability of such a transfer mechanism customary in the loan market alleviates the concern that a Loan may be categorized as a Deliverable Obligation but is not capable of being transferred to another participant in the CDS market as part of the settlement of a CDS contract. It therefore removes the only stated commercial reason offered in support of the First Interpretation.

The availability of transfer by participation also addresses the concern raised in the published written materials cited in support of the First Interpretation. *See* DC Decision at 3 n.6 (citing Simon Firth, *Derivatives: Law and Practice* Ch. 16 (2003 & Supp. 2018)). The author of those materials muses that a restriction in a Loan agreement would disqualify such Loan from satisfying the Consent Required Loan Deliverable Obligation Characteristic "if the restriction extends to persons to which a participant in the *secondary loan market* might reasonably wish to sell the Loan." Firth, *Derivatives: Law and Practice* § 16.174 (emphasis added). Participants in the secondary loan market routinely acquire Loans by participation, thus a set of assignee eligibility criteria should not be considered such a disqualifying restriction.

³ In other jurisdictions, loans may be transferred via equitable assignments or participations. The distinction, however, between those participations and a U.S.-style participation should not make a difference for purposes of the CDS deliverability analysis insofar as such non-U.S. participations are customary in the relevant local markets.

III. THE SCOPE OF “CONSENT REQUIRED LOAN,” WHILE BROAD, SHOULD NOT EXTEND TO LOANS WHERE PARTICIPATIONS ARE UNAVAILABLE.

Although *amici* support a broad interpretation of “Consent Required Loan,” it is desirable for the External Review Panel to clarify that its scope is not unbounded. Specifically, in the circumstance where a participation in a Loan is also limited to eligible entities or is otherwise prohibited and therefore unavailable as a form of transfer of the Loan, it *would* be commercially unreasonable to designate a Loan as a Consent Required Loan merely because it could be assigned to at least one person with consent. That is because economic benefits and risks could not be transferred in a participation to market participants. Although such circumstances are quite rare, *amici* recommend that the External Review Panel add such clarification as an outer limit on the scope of an otherwise broad interpretation of the “Consent Required Loan” Definition.

IV. THE EXTERNAL REVIEW PANEL HAS A UNIQUE OPPORTUNITY TO PROVIDE CLARITY TO THE MARKET ON ONE OF THE MOST IMPORTANT DEFINITIONS FOR THE CDS PRODUCT

As Loans may be “cheapest-to-deliver” Obligations or sometimes the only Obligations of a Reference Entity, the market needs to ensure that Loans do not fail to satisfy the Deliverable Obligation Characteristics for technical reasons. By adopting the clear, easy-to-apply rule of interpreting the “Consent Required Loan” Definition suggested here, the External Review Panel will minimize speculation, debate and transaction costs associated with similar issues arising from future Credit Events, and thereby promoting liquidity in the CDS product without sacrificing any substantive commercial needs.

CONCLUSION

The CDS market has long respected the conventions and practices of the bond market as the underlying market to which it relates. It should now do the same with respect to the robust,

well-developed secondary loan market.⁴ The loan market accepts participations as a form of transfer in ownership of Loans where a proposed assignee is not an eligible assignee under the loan agreement. This reality eliminates any commercial need to construe the Consent Required Loan Deliverable Obligation Characteristic narrowly in order to protect CDS market participants. Instead, "Consent Required Loan" should be read broadly wherever the economic benefits and risks of a Loan may be transferred through participation.

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⁴ Trading volume in the secondary loan market was \$670 billion over the last twelve months. *Secondary Trading Volumes Surge 22% in October*, The Loan Syndications and Trading Association (Nov. 29, 2018), <https://www.lsta.org/news-and-resources/news/secondary-trading-volumes-surge-22-in-october>.