January 25, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Dear Ms. Murphy and Mr. Stawick:

The Loan Syndications and Trading Association (the "LSTA")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC"; and together with the CFTC, the "Commissions") to highlight (i) the importance of "loan participations" in the U.S. and global market for syndicated loans, and (ii) the disruption that would occur in that market if loan participations were regulated as "swaps" under the Wall Street Transparency and Accountability Act of 2010 ("Dodd-Frank").[2] We particularly appreciate the opportunity to provide these comments prior to the Commissions' proposed rulemaking in these areas, as we consider the certainty of the issues to be of critical importance to the U.S. syndicated loan market and its continued primacy in the global economy.

Syndicated loans provide $2.5 trillion of financing to U.S. businesses alone.[3] Borrowers of these loans are blue-chip companies, industrial companies, middle-market companies and new and emerging businesses. The syndicated loan market – a market that continued to provide critical financing to U.S. businesses without interruption in the recent economic downturn – is now a vital component of global corporate finance.

[1] The LSTA is a U.S. trade organization representing over 320 member firms that engage in loan syndication and trading activities. Its membership includes buy- and sell-side organizations, law firms, consultants, accounting firms and vendors. The LSTA's mission is to promote a fair, orderly, efficient and growing loan market and provide leadership in advancing and balancing the interests of all market participants.
[2] Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Pub. L. 111-203 (July 21, 2010).
[3] Report of The Shared National Credit Review, September 2010. The Shared National Credit Review is jointly run by the U.S. Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision. It reviews and classifies any loan or loan commitment of $20 million or more, held by three or more federally supervised institutions.

366 Madison Avenue, 15th Floor, New York, NY 10017
Tel: 212.880.3000 Fax. 212.880.3040 www.lsta.org.

The banks that originate syndicated loans typically sell a portion of those loans to other banks and non-bank financial institutions. For decades, the originators, sellers and buyers of these loans have relied on a simple and ubiquitous transfer structure – the traditional "loan participation" – as an efficient alternative to assignments in the well-established primary and secondary bank loan market. Loan participations facilitate a lender's diversification of its portfolio holdings, provide a key component of the efficient settlement process, and enhance liquidity in the global syndicated loan market.

We believe Dodd-Frank did not intend to regulate this vital loan transfer structure as a "swap," and we urge the Commissions to confirm our understanding by explicitly excluding loan participations from the definition of "swap," "security-based swap," and "mixed swap."[4] Without such action, the unintended consequences of Dodd-Frank would include (1) diminished utility and function of the loan participation as a transfer structure in the syndicated loan market, (2) decreased liquidity in that stable and robust market, (3) constrained bank lending activities, and (4) decreased flow of new capital for existing businesses.

This letter (1) outlines the definitional provisions of Dodd-Frank giving rise to the concern that loan participations may be regulated as swaps, (2) describes the essential structure of loan participations used in the global syndicated loan market, (3) identifies the negative impact that regulation of loan participations as swaps would have on the syndicated loan market, and (4) demonstrates why the Commissions should exclude loan participations from the products intended to be covered by Dodd-Frank, thereby providing legal certainty under Dodd-Frank and preserving the utility of the loan participation in the loan market.

Loan participations should not be swept up within the "swap" definition under Dodd-Frank

There is concern in the global syndicated loan market that loan participations may be swept up within Dodd-Frank's broadly-drafted definitions of "swap," "security-based swap," and "mixed swap." We think the better argument is that they are not, and we urge the regulators to confirm our view.

In relevant part, the new definition of "swap" includes:

> "any agreement, contract, or transaction … that provides … for the exchange … of 1 or more payments based on the value … of 1 or more interest or other rates, … instruments of indebtedness, … or other financial or economic interests or property of any kind, … and that transfers … in whole or in part, the financial risk associated with a future change in any such value … without also conveying a current or future direct or indirect ownership interest in an

[4] Sections 712(d) of Dodd-Frank requires the Commissions, in consultation with the Federal Reserve Board, jointly to define further the terms "swap" and "security-based swap." Sections 721(c) and 761(b) also require the Commissions to define these terms further. For the purpose of brevity, we sometimes use "swap" to refer to "swap," "security-based swap," and "mixed swap."

> asset … or liability that incorporates the risk so transferred ….” (emphasis supplied)

This facet of the “swap” definition focuses on an exchange of payments based on the value of a financial instrument that has the effect of transferring the financial risk without an associated transfer of the ownership interest in, or liability incorporating the financial risk under, such instrument.

A “security-based swap,” under Dodd-Frank, is a transaction that is a “swap” and “is based on … a single security or loan, including any interest therein or on the value thereof ….” Dodd-Frank also provides for a third category of regulated products, the “mixed swap,” which is a security-based swap that is also based on “the value of 1 or more interest or other rates….”

As discussed below, loan participations do convey a current or future ownership interest in the loan, and as such should not fall within the definition of “swap.” As a corollary, loan participations should not be a “security-based swap” or a “mixed swap,” either.

The Legal Certainty for Bank Products Act, as amended by Dodd-Frank, evidences a legislative intent to exclude loan participations from the definition of swaps

Section 725(g)(2) of Dodd-Frank amends the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27a) by excluding “identified banking products” from the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act and from the definition of “security-based swap” (and therefore the provisions of Dodd-Frank that relate to security-based swaps). An “identified banking product,” as defined in the Gramm-Leach-Bliley Act – which definition was incorporated in the Legal Certainty for Bank Products Act – includes

> “a participation in a loan which the bank[5] or an affiliate of the bank (other than a broker or dealer) funds, participates in, or owns that is sold—
>
> > (A) to qualified investors; or
> >
> > (B) to other persons that—
> >
> > > (i) have the opportunity to review and assess any material information, including information regarding the borrower’s creditworthiness; and
> > >
> > > (ii) based on such factors as financial sophistication, net worth, and knowledge and experience in financial

[5] “Bank,” for these purposes, includes an FDIC-insured U.S. bank, a non-U.S. bank, and certain subsidiaries of either type of entity.

matters, have the capability to evaluate the information available, as determined under generally applicable banking standards or guidelines ….”

The Legal Certainty for Bank Products Act, as amended by Dodd-Frank, clearly demonstrates the legislative intent to exclude loan participations from the purview of the swaps regulations. While the statutory exclusion is technically limited to bank-granted participations, we believe that Congress intended to exclude all loan participations, even if not granted by banks. Not doing so would result in application of different regulatory regimes to substantially identical products (bank-granted participations as opposed to non-bank-granted participations), with a result that would be chaotic, unwieldy and certainly detrimental to the syndicated loan market.[6]

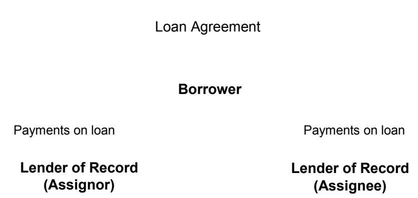
Loan participations are an important loan transfer structure

Syndicated loan agreements almost universally permit lenders to sell either assignments or participations in the loans, and permit participants to vote -- through the grantor as the lender of record -- on important matters under the loan agreements. Borrowers recognize that participations help effect transfers of interest in the loan and ensure access to the syndicated loan market.

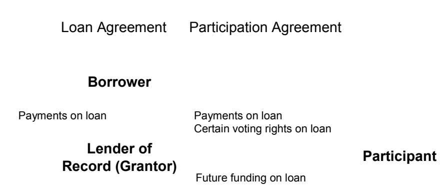
An assignment effects the transfer of legal and beneficial ownership of the loan, and substitutes the assignee for the assignor as a “lender of record” under the relevant loan agreement. Loan participations are used to transfer the economic benefits and risks of a bank loan from a seller (the “grantor”) to a buyer (the “participant”).

The following diagrams depict the structural similarities and differences of an assignment and a participation.

Assignment



Participation



[6] Indeed, one of the purposes of Dodd-Frank is that regulators should treat functionally or economically similar products alike. See, e.g., Section 712(a)(7) of Dodd-Frank (CFTC and SEC to treat functionally or economically similar products or entities similarly).

Under participation agreements, a contractual relationship is established between the grantor and the participant, under which the grantor is required to retain legal ownership of the loan, and a current beneficial ownership interest and/or a future legal or beneficial ownership interest is conveyed from the grantor to the participant. Indicia of a current beneficial ownership interest include the participant's entitlement to direct the grantor's "acts and decisions" as a lender under the loan agreement. Indicia of a future ownership interest include either party's right to require the other party to make commercially reasonable efforts to effect an assignment in the loan at a later time.

Loan participations are a vital transfer structure in the global syndicated loan market and a significant percentage of all loan trades that settle both in the U.S. and in Europe settle by participation, as opposed to assignment. Among many other things, loan participations allow (1) an originating (lead) bank to quickly and efficiently fund a borrower while allowing a syndicate of lenders to simultaneously share in the risk of the loan; and (2) an original lender to maintain a direct business relationship with the borrower while actively managing (and downsizing) its own risk exposure.

In the U.S., loan participations are typically modeled on legal documentation created and published by the LSTA. In Europe and Asia, loan participations are typically modeled on legal documentation created and published by the Loan Market Association (the "LMA"),[7] the LSTA's European counterpart. An LSTA-style participation specifically provides that the participation is intended by the parties to be treated as a sale by the grantor and a purchase by the participant.[8] By contrast, an LMA-style participation, while not effecting a sale, creates a current debtor-creditor relationship between the grantor and the participant under which a future ownership interest is conveyed. U.S. bank and non-bank financial institutions typically rely on both LSTA and LMA forms of legal documentation as they transact in the global syndicated loan market. U.S.-domiciled loan participants may enter into loan participations with foreign grantors, and *vice versa*.

Loan participations should not be regulated as swaps

As discussed above, loan participations and loan assignments are alternative transfer structures. Loan participations serve primarily the same function as loan assignments in the syndicated loan market, and are often used as an essential settlement option by trading counterparties, banks and non-banks alike. Assignments of loans are certainly not covered by the Dodd-Frank swap regime, and there is no reason why any loan participation should be covered, either, whether or not they are bank-granted. The fact that loan assignments are not covered provides additional support for why all loan participations should be excluded. Any

[7] The LMA is a European trade association for the syndicated loan markets. Established in 1996, it has a corporate membership of over 420 members comprising banks, institutional investors, law firms, rating agencies and system providers, all actively engaged in the international syndicated loan markets.
[8] The LSTA-style participation is intended to effect a "true sale" of the loan from the grantor to the participant and put the participant's beneficial ownership interest in the loan beyond the reach of the grantor's bankruptcy estate. See LSTA Market Advisory – Accounting for the Sale of Participations, available to LSTA members at http://lsta.org/content.aspx?id=7398.

other result would be difficult to reconcile and would have a significantly adverse effect on the syndicated loan market.

The risk profile of loan participations in general does not warrant the extreme regulatory treatment that would follow from categorization as a "swap." Loan participations are not "synthetic" transactions – they are merely transfers of cash loan positions. The ratio of underlying loan to participation is always one-to-one, because the grantor continues to hold legal title to the loan as a lender of record and agrees to take certain action under the loan agreement as the participant instructs. There is no risk of an outsized bubble of loan participations that references a small pool of loans in the underlying cash loan market, and loan participations do not reduce transparency about the size of the loan market or the risks each party is exposed to. Loan participations do not create the kinds of systemic risk that Dodd-Frank seeks to address.

Further, the centerpiece of the derivatives regulation under Dodd-Frank, central clearing, is incompatible with loan participations. The risk profile of a loan participation is fundamentally at odds with the margin principles and models developed for the derivatives markets, which serve as the basis for centralized clearing. Participations do not create large counterparty risk that could be efficiently reduced by central clearing. Once a participation is granted, the grantor is exposed to the risk that the participant defaults and does not fund future draws, if any, and the participant is exposed to the risk that the grantor defaults and fails to make distributions of principal, interest and fees to the participant. Changes in market value of the underlying loan do not effect loan participations.

Regulating loan participations as "swaps" would impair the smooth functioning of the syndicated loan market

Regulating loan participations as swaps would be detrimental to the syndicated loan market. The cost and burden of such regulation would deter counterparties from using loan participations and it would be difficult to envision how loan participations could be used if they were considered "swaps" under Dodd-Frank.

If regulated as a swap, loan participations would be subject to the extensive requirements imposed under Dodd-Frank. The new requirements would be both impractical as well as cost-prohibitive if applied to cash loan transactions. For example, since it is virtually impossible for loan participations to be centrally cleared, more expensive capital and margin requirements would be imposed on counterparties that use loan participations, increasing the transaction costs for the syndicated loan market. The new regulations would create an artificial and drastic distinction between participations and assignments, when no philosophical difference should exist, making participations significantly more costly and complex from the economic, operational and regulatory perspectives.

If loan participations were characterized as swaps, they would become a disfavored form of transfer structure and the syndicated loan market would move toward settlement of transactions by assignment only. This would remove flexibility and raise the barrier to entry into, and potentially freeze participants out of, the syndicated loan market. Market participants would be concerned about their ability to reduce risk by selling a loan participation while still maintaining a direct relationship with a borrower, and that concern may ultimately reduce their willingness to lend to borrowers.

A move away from loan participations as a settlement method would also create risk in the financial system by slowing the speed of settlement. For example, if participations were no longer used in the syndicated loan market, parties to a loan trade will lose the option of expediting settlement by way of a traditional participation and subsequently completing the formalities of transferring the loan by assignment.

Regulating loan participations as swaps has the potential to disrupt a smoothly functioning market by introducing uncertainty without any discernable benefits. Liquidity in the market would suffer at a time when the health of the credit market is crucial to the economic recovery in the United States and elsewhere in the world. Borrowers who do not obtain sufficient funds in the credit market (and otherwise lack access to the capital markets) may ultimately be more likely to default, costing America more jobs.

Regulatory clarification is needed to confirm the intent of Dodd-Frank and restore certainty

The syndicated loan market needs clarity that loan participations, in whatever form, are not “swaps,” “security-based swaps” or “mixed swaps,” and therefore are not subject to the provisions of or regulations promulgated under Dodd-Frank.

As we discussed above, this result is clearly consistent with the intent of Dodd-Frank. Loan participations are one of two fundamental cash loan transfer structures. Loan participations convey “a current or future direct or indirect ownership interest” in the loan, and therefore do not meet the definition of “swap.” Moreover, they are a traditional banking product to which Congress intended to afford legal certainty. In the absence of clarity, parties may be forced to self-regulate and eliminate participation as an alternative transfer structure. This result would hinder capital inflow to the syndicated loan market, impede prudent risk management, create substantial settlement risks, and disrupt the smooth functioning of the syndicated loan market.

Accordingly we request that the Commissions either include in their rules further defining “swap” and “security-based swap,” as required by Sections 712(d), 721(c), and 761(b) of Dodd-Frank, an exception from the definitions for loan participations or otherwise make clear that loan participations are not “swaps” or “security-based swaps.” For the same reasons, we also request that the Commissions make clear that loan participations are not “mixed swaps.” This will afford the syndicate loan market the level of certainty it needs in the understanding that loan participations will not be subject to swap regulation under Dodd-Frank.

We would be pleased to discuss any of the points addressed in this letter. I can be reached directly at 212.880.3001 or Elliot Ganz, our General Counsel, at 212.880.3003.

Very truly yours,

THE LOAN SYNDICATIONS AND
TRADING ASSOCIATION

R. Bram Smith
Executive Direcor
366 Madison Avenue, 15th Floor
New York, NY 10017
bsmith@lsta.org