Brexit and the LMA English Law Participation

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Introduction

Notwithstanding the current pandemic, the 31 December 2020 Brexit is rapidly disappearing into the rear-view mirror. That said, there are still some *judder bars* (speed bumps for my northern hemisphere colleagues) ahead for the LMA's English law participation agreement. These speed bumps aren't necessarily driven by the participation agreement itself, but by the current trend of grantors being positioned in jurisdictions other than England, i.e. continental Europe.

This article presents a number of questions that grantors and participants should be asking themselves as they implement structural changes. It may be by no means complete, nor seek to answer those questions given the inherent subjectivity.

What is the nature of the new structure?

Initial observations of the market would suggest that two broad structures are being adopted. Both involve the lender of record being positioned in continental Europe – Ireland and Germany being popular choices. The first structure involves a continental grantor (as lender of record) directly participating to the participant (referred to herein as the direct participation structure). The second structure involves an internal participation from a continental grantor (as lender of record) to (UK grantor) to the participant (referred to herein as the double grantor structure).

Implementation

It is assumed (perhaps riskily) that grantors will have the operational ability and capacity to administer participation from their continental grantor. Whether this ability has to be jurisdictionally local is a question that will need to be asked and answered.

Additionally, grantors and participants will need to consider whether positions can remain where they are, or whether they need to be moved to the new structure. If the latter, and assuming that was meant to occur on 1 January 2021, what is the effect of the interregnum?

Regulatory requirements / banking monopoly

Paramount to consider is whether or not the new continental grantor is able to meet all the regulatory and *banking monopoly* requirements of operating in Europe. Whilst it is easy to suggest this investigation is a given, it should be undertaken by the grantor with due care and process, and not merely considered a *fait accompli*.

Off balance sheet treatment

Likewise, if a grantor has been enjoying off-balance sheet treatment due to an English law charge and security trust deed arrangement (or one akin to it), it should be considered whether that accounting treatment still holds.

KYC

As part of the implementation of any new structure, the grantor and participant will need to consider whether fresh KYC obligations arise upon implementation. For instance, if there is a new grantor entity, does the participant feel it needs to KYC that entity? Conversely, does the new grantor need to perform KYC on its participants and, are the KYC requirements of the new grantor different to those of the previous?

Process Agents

With grantors now being in continental Europe, as opposed to the UK, a participant should consider whether the grantor needs to appoint a process agent (see Condition 33.3 of the Standard Terms and Conditions). Historically, neither grantor nor non-UK participant has generally appointed a process agent, so it is questionable whether any change will manifest itself in this regard.

Ongoing questions

Tax

Probably the most important question facing the grantor / participation relationship in 2021 is what effect, if any, does it have on the withholding tax position of the participant. Does the change of jurisdiction of the grantor in the direct participation structure or the utilisation of the double grantor structure alter the withholding tax treatment ultimately borne by the participant? Up to now, most participation agreements have mitigated the imposition of any withholding tax, but that may change. Grantors and participants would be minded to consider the withholding tax treatment and, in line with section 4.3(b) of the Funded Participation Agreement, work together to eliminate the need to make withholding tax deductions.

Credit risk

It is widely accepted that the LMA English law participation results in the participant taking credit risk with respect to both the borrower and the grantor. Technically, the double grantor structure amplifies that risk given the interposition of two grantors between the participant and the borrower. Practically, however, the view could be taken that the credit risk is on the institution as a whole and not its individual entities.

Conclusion

There are probably many more questions that have been asked and answered within individual institutions, and this article is by no means complete. However, it should serve to illustrate the broad issues and questions that should be considered.

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About McCarthy Denning

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The firm operates a flat structure (eschewing the pyramid structure traditionally adopted by larger law firms) with highly experienced lawyers operating within a vastly-reduced-overhead environment. The firm has a high-tech approach at its core to provide greater efficiency through flexible working.

McCarthy Denning recruits highly experienced lawyers (both partners and associates) selecting only those with the appropriate pedigree and credentials. The firm benefits from an agile working culture affording the team the opportunity to either work remotely or utilise the firm's city office which houses our administration/marketing team, bespoke meeting rooms and dedicated desk space. It also boasts a sophisticated technology platform which facilitates simplicity of working even in very large teams where required for significant transactions.

About Justin Conway

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Justin is a commercially minded pan-European special situations and credit trading lawyer. Prior to spending eight years as a partner at both DLA Piper and Jones Day, Justin was an Executive Director and Senior Counsel at Goldman Sachs, sitting on its credit trading desk.

He has extensive experience in debt, claims, and loan portfolio trading and investment as well as in credit default swaps, bankruptcy, and restructuring. In addition, he counsels clients on compliance and public/private issues, due diligence, and loan agency matters.

Justin has advised on more than $50 billion of debt, claims, and loan trades, most recently involving Celsa, Deoleo, Eroski, HETA, Spanish toll roads, and instruments across the Steinhoff structure. Justin's real strength lies in providing advice with respect to off-the-run investments, including: structured debt and equity investments; performing, non-performing, shipping and real estate portfolios; and expropriation / liquidation claims.