

Mr. David A. Stawick  
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Commodity Futures Trading  
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Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

23 February 2011

Dear Ms. Murphy and Mr. Stawick,

**Comments in relation to the definition of "swaps" under the Wall Street Transparency and Accountability Act of 2010 ("Dodd Frank")**

The Loan Market Association ("LMA") welcomes 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") in relation to the provisions of Dodd Frank, and in particular, to discuss the manner in which the current definitions of "swaps", "security-based swap" and "mixed swap" could have a severe and detrimental impact on loan participations in Europe. We hope that our comments will be useful in the Commissions' rulemaking process.

The LMA is the trade body for the European syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at 438 across Europe and consists of banks, non-bank investors, law firms, rating agencies and service providers. The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the European loan market in Europe vis à vis lenders, borrowers, regulators and other interested parties.

## **Background to loan participations**

In both the US and Europe, the loan market uses a "participation agreement" to transfer the economic benefit and risk of a bank loan from a seller (the "**grantor**") to a buyer (the "**participant**"). Under the participation agreement, the grantor remains the "lender of record" under the loan agreement, passing all loan payments which it receives to the participant. In return, the participant advances to the grantor any sums required to satisfy drawing requests made by the borrower under the loan agreement. Unlike a loan assignment, under a loan participation the participant does not have any form of contractual relationship with the borrower but rather a participation creates a contractual relationship between the grantor and the participant. It has been argued therefore that such a loan participation could fall within the definition of "swap", "security-based swap" and/or "mixed swap" under the Dodd Frank Act.

## **Why loan participations should not be classified as swaps**

In Europe and the United States, loan participations are an alternative form of transfer structure to the conventional loan assignment and essentially serve the same function in the market. Loan assignments are not, however, covered by Dodd-Frank and it therefore seems illogical to suggest that loan participations should be more heavily regulated. Any other conclusion would be difficult to reconcile.

We would also argue that U.S. Congress did not intend loan participations to be caught by this definition, particularly as Section 725(g)(2) of Dodd-Frank (which amends the Legal Certainty for Bank Products Act 2000 (7 U.S.C 27a) specifically excludes "identified banking products" from the definition of "security-based swaps" and the provisions of the Commodity Exchange Act ("**CEA**") and the jurisdiction of the CFTC, and the list of exclusions extends to "a participation in a loan". It is our understanding, based on our interpretation of the full text, as well as the legislative history of the Gramm-Leach-Bliley Act (which explains that "identified banking products" are exempt from certain regulation "to facilitate certain activities in which banks have traditionally engaged") that European loan participations, at least when granted by banks, should be included as "participations in a loan" for the purposes of the definition of "identified banking product". This would suggest that legislators did not envisage including loan participations as "security based swaps" or subjecting loan participations to the provisions of the CEA and the jurisdiction of the CFTC.

## **Participations as swaps - potential impact on the syndicated loan market**

Loan participations are a vital element of the European and United States syndicated loan markets and a significant proportion of all trades are currently settled by means of a participation, rather than a traditional assignment. Participations are particularly advantageous in those instances where, for example, the original lenders want to spread their risk exposure to a particular loan, but at the same time maintain a direct commercial relationship with the borrower.

Regulating loan participations on the basis that they are swaps would undoubtedly have a massively damaging effect on the global secondary loan market, particularly because the requirements of Dodd-Frank in relation to swaps, are fairly extensive. The expense and administrative burden of ensuring compliance would result in a large number of market

participants exiting the market entirely. It would also remove flexibility for lenders and raise the barrier to entry for new investors.

It should also be mentioned that the impact imposed on European investors by Dodd Frank would also have a detrimental effect on liquidity in the U.S market. European banks and institutional investors enter into participations with U.S. domiciled counterparties as readily as they do with non-U.S. counterparties (and vice versa). The syndicated loan market, of which participations are a vital component, is very much an integrated global market and therefore we feel it important to stress that regulating loan participations as swaps, whether they be based out of Europe, the U.S. or otherwise would have a damaging effect on all investors generally, and that such impact would be felt on a global scale.

## **Conclusion**

We firmly believe that any restrictions placed by US regulators on European loan participations would not only generate massive confusion and disruption in what is currently a smoothly operating market, but would also result in a marked reduction in liquidity and the number of participants entering that market. This reduction in funding sources, in turn, could lead to borrowers finding it increasingly difficult to access the syndicated loan markets. We do not consider that any of these outcomes are intended by either U.S. Congress or the regulators. On this basis, we would request that loan participations are specifically excluded from the various swap definitions. This will provide the market with the degree of certainty it requires to prevent any disruption and avoid any adverse consequences.

We would be happy to discuss any aspect of this letter with you in more detail. If we can be of any further assistance, please do not hesitate to contact me via email at [clare.dawson@lma.eu.com](mailto:clare.dawson@lma.eu.com) or by telephone on 020 7006 2216. Alternatively my colleague Mike Johnstone may be contacted by email at [mike.johnstone@lma.eu.com](mailto:mike.johnstone@lma.eu.com) or by telephone on 020 7006 2267.

Yours faithfully



**Clare Dawson**

**Managing Director**

Loan Market Association