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Sponsors seek unique revolver control

By Kristen Haunss

NEW YORK, Mar 28 (LPC) - Private equity sponsors are seeking greater control over who participates in revolving lines of credit extended to their portfolio companies, which may alter how banks compete for business.

Financing to back the acquisition of the remaining 80% stake in Truist Insurance Holdings by investors led by Stone Point Capital and Clayton, Dubilier & Rice from Truist Financial Corp sought borrower consent language for revolver participation agreements, a unique right, according to two sources.

Private equity firms want to ensure they know who will vote on amendments for their portfolio companies if a borrower runs into trouble. They are expected to try to adopt similar participation consent language in future credit agreements. While borrower consent, which allows a company to approve who buys its loan, is standard in a typical loan trade, it is not common in a participation agreement, which allows banks to sell their rights and obligations under the loan while remaining the lender of record. These transactions can enable banks to address capital requirements as regulators ramp up pressure to ensure lenders have adequate liquidity following last year's regional banking crisis.

Under some credit agreements, banks may sell a participation, and the borrower and its sponsor would be none the wiser – which some lenders value to curry favor and maintain relationships. These agreements have allowed some banks to put in larger revolver commitments to win business, knowing they could sell a participation once the deal closed. If this language is widely adopted, some lenders may change how they commit to revolvers, one of the sources and a third source said.

PARTICIPATION RIGHTS

Revolvers are typically provided by banks that receive a nominal fee for lending and a margin plus a lending benchmark when the loan is drawn.

Banks view these lines of credit as a relationship tool but may not want to hold onto their entire allotted portion, whether for internal or regulatory reasons. In that case, lenders can assign the loan in a traditional trade or sell a participation.

In an assignment, the loan holder sells all or a portion of the investment to a buyer, or assignee, who becomes a lender of record with direct rights and obligations to the borrower. In a participation, the loan holder sells its rights and obligations under the loan agreement—known as a participation interest—but remains the lender of record. The buyer of the participation would take on substantially all of the economics of that participation interest, including interest payments.

Because the buyer of a participation is not the lender of record, it can heavily negotiate terms.

The buyer can determine how the seller will vote – telling the seller it wants to be very involved in every vote or be more passive, telling the seller to only reach out on big issues, according to Angie Batterson, a partner at law firm Cadwalader, Wickersham & Taft.

"This gives [the buyer] more wiggle room to negotiate the terms, and it's an interesting reason why people do it," she said. "Sometimes the buying bank doesn't want to be that involved; they don't want to be the lender of record; they just want to get the economics. And sometimes the selling lender has a relationship with the borrower, and they don't want the borrower to think they are offloading a bunch of these loans."

CAPITAL REQUIREMENTS

A bank may want to sell a loan or sell a participation to manage internal and external capital and exposure requirements, which has driven the recent uptick in these bespoke participations, according to Ryan Leverone, an associate at Cadwalader.

After the regional banking crisis, along with Basel proposals and other new rules, regulators ratcheted up capital requirements, forcing banks to boost their capital or reduce their loan holdings to hit targets, he said. With an assignment, the bank can sell their position and free up capital, while a participation can have a similar benefit.

"The seller [of a participation], while they retain the bare title, sold a beneficial interest to a third party and, provided they've structured the transaction to be a 'true participation' under New York law, can move that participated amount off of their balance sheet under GAAP for regulatory capital purposes," Leverone said. "And that is a hot topic right now."

CONSENTS

Assignments typically require consent from the borrower, which in some situations may be tough to achieve, leading to a participation.

"You will do a trade that you want to settle via assignment but you can't get one of those consents; maybe the borrower or administrative agent doesn't want an activist hedge fund to buy into the lender group so you'll need to settle by participation," Leverone said. "You can do that because participations, unlike assignments, usually don't have very many consent requirements, if any. Usually no one but the seller needs to know a participation has happened."

Borrower consent for participations will take on increased importance as defaults rise. Private equity firms want to ensure they know who they will be dealing with if revolver lender approval is needed for an amendment.

It is anticipated more companies may try to include borrower consent for participations in future credit agreements.

"Once something like this gets done, everyone latches onto it," the first source said. "News travels fast and this will be on the list of every sponsor."

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