**INSIGHT**
MAY
2020

## Instituting Primary Delayed Compensation Amid Covid-19

In order to shorten trade settlement, the Primary Delayed Compensation Protocol was approved by the LSTA Board of Directors in October 2018. The protocol went live on March 16, 2020.

*The Primary Delayed Compensation ("PDC") Protocol revises the definition of Trigger Date & Early Day Trade. It also adds the definition of 2 new types of trades: Pre-Trigger Trade and Post-Trigger Trade.*

## What is the Trigger Date?

**"**Trigger Date**"** refers to the Effective Date; provided, however, if (a) there is no funding of any Facility on the Effective Date and (b) prior to the Settlement Date any Facility subsequently funds; then under such circumstances, the "Trigger Date" shall be deemed the first date on which any Facility subsequently funds.

The PDC protocol applies to the allocation of a new/or additional funded or unfunded money commitment provided to lenders as per the credit agreement. This includes without limitation, an Amendment Agreement and/or any add-on or incremental component of the Facility.

## What is the Ready Date?

The Ready Date will usually occur three business days after the Trigger Date (when allocations are given on/or before the Trigger Date) or three business days after the allocations are given (when they are given after the Trigger Date).

## What are the two types of Allocations?

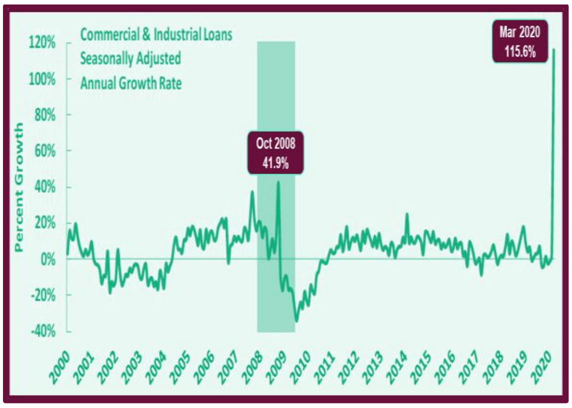
"Pre-Trigger Allocation" refers to any allocation that is made and communicated by the Seller (or an Affiliate of the Seller) to the Buyer on or before the Trigger Date.

"Post-Trigger Allocation" refers to any allocation that is made and communicated by the Seller (or an Affiliate of the Seller) to the Buyer after the Trigger Date.

## *What does Delayed Compensation mean?*

Delayed compensation is a pricing adjustment that puts the parties in the economic position that they would have been had the trade settled within the predetermined time period set by the LSTA (Loan Syndications and Trading Association).

In a regular secondary trade which has not settled by Trade Date + 7 Business Days, delayed compensation begins to accrue. This calculation includes the interest and fees that would have been received on the asset if the pending trade had settled by this date. The seller typically pays the total calculated delayed compensation less the cost of carry, which they are credited, for holding the asset on its books. Delayed compensation had only been used in secondary loan trading, on March 16th, 2020, this was extended to primary allocations.

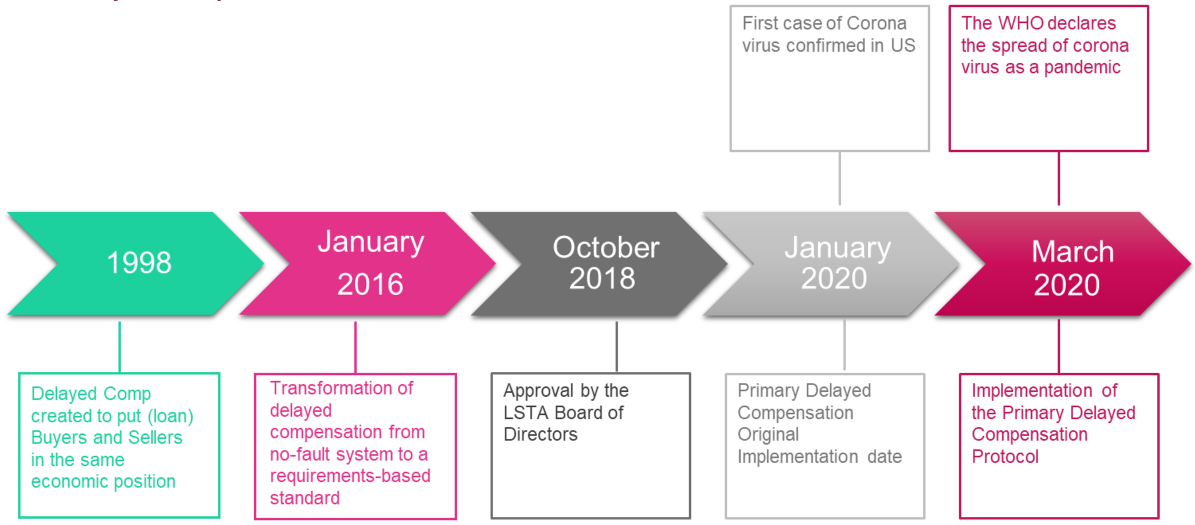



## *The Evolution of PDC*

From its inception in 1998 to 2016, delayed compensation was based on a no-fault system that entitled the Buyer to delayed compensation regardless of the root cause of the delay. However, to shorten settlement times, the LSTA board voted to transform delayed compensation to a requirements-based system. For most secondary trades, the Buyer is now obligated to sign all documentation by T+5 and agree to a settlement date no later than T+7 and must persist on settlement through the electronic platform until the actual settlement date.

This was agreed to by the buy-side investors with the understanding that the banks would implement delayed compensation on primary allocations.

***Delayed Compensation Timeline***




Therefore, buyers would be paid for their exposure in the primary market.

This protocol is now known as PDC, which was approved by the LSTA Board in October 2018 with an intended implementation date of January 2020. There was a slight delay in the release of the PDC protocol until the 16$^{th}$ of March 2020. This happened to be one week after the World Health Organization made the assessment that COVID-19 can be characterized as a pandemic, due to the alarming levels of spread and severity and the disturbing levels of inaction.

## *Timeline for Delayed Compensation*

Depending on the type of trade, delayed compensation will kick in at a different date. In the case of a distressed trade, delayed compensation is payable beginning 20 business days post the trade date (T+20). For par/near par trades that settle on LSTA documents, it is payable beginning 7 business days post-trade date (T+7), except for Early Day Trades when compensation commences on the Trigger Date + 14 Business Days (T+14). Delayed Compensation for par/near par trades done on LMA documents is payable beginning 10 business days post-trade date (T+10).

The number of days to get documentation complete where T stands for Trade date.

| ***Distress*** | ***LMA*** | ***LSTA*** |
|---|---|---|
| ***T+20*** | ***T+10*** | ***T+7*** |

## *What is PDC?*

PDC is a Protocol that applies to a "Primary Allocation," which is an allocation of new money by a syndicate desk in connection with either a new issue syndication or an amendment of an existing Credit Agreement.

## *Purpose of the PDC Protocol and how it can be helpful to the Loan Market*

- Produce faster settlement times for both primary and secondary trades.
- Provide liquidity as banks will be able to get fronted balances off their books quicker.
- Buy-side will be able to begin recognizing the interest accrual on their primary allocation.
- Comply with the mission of the LSTA, which is to promote a fair, orderly, efficient, and growing corporate loan market.
- Balance the interests of all market participants.
- Demonstrate to regulators that the secondary loan market possesses the ability to effectively self-regulate itself.

PDC will begin to accrue, on an unsettled trade, on the sixth Business Day after the Ready Date, provided that the Buyer has adhered to all of the requirements per the PDC protocol.

## *Two types of Primary Allocations:*

- "Pre-Trigger Allocation" is made and communicated by the Seller (or an Affiliate of the Seller) to the Buyer on or before the Trigger Date.

- "Post-Trigger Allocation" is made and communicated by the Seller (or an Affiliate of the Seller) to the Buyer after the Trigger Date.

### *New types of Secondary Trades:*

- The determination of whether a Trade is a Pre-Trigger Trade, a Post-Trigger Trade, or an Early Day Trade is not dependent upon whether or not an upstream seller received an Allocation, either a Pre-Trigger Allocation, a Post-Trigger Allocation or an Allocation for which this Protocol does not apply.
- "Pre-Trigger Trade" refers to a trade in which the Trade Date is a date on or before the first (1st) Business Day following the Trigger Date. The trade needs to be part of a Facility previously allocated to prospective lenders by means of a Pre-Trigger Allocation. Additionally, the potential lender would typically be receiving the economic benefit of interest and accruing ordinary course fees under the standard terms and conditions of a Primary Allocation Confirmation.
- "Post-Trigger Trade" refers to a trade in which the Trade Date occurs either on the Post-Trigger Allocation Date or the Business Day immediately following the Post-Trigger Allocation Date of a Facility previously allocated to prospective lender by means of a Post-Trigger Allocation and in connection therewith; a prospective lender would have been capable of receiving the economic benefit of interest and accruing ordinary course fees under the standard terms and conditions of a Primary Allocation Confirmation.
- "Early Day Trade" refers to a trade in which the Trade Date is a date on or before the sixth (6th) Business Day following the Trigger Date in a Facility originally syndicated pursuant to an Allocation whereby a buyer would not have been capable of receiving the economic benefit of interest and accruing ordinary course fees under the standard terms and conditions of a Primary Allocation Confirmation.

### *Delayed Compensation does not apply in connection with an allocation:*

- When the Seller and the Administrative Agent (the "Admin Agent") and any other Entity (other than the Borrower and any Affiliate of the Borrower) that has a consent right under the Credit Agreement in connection with an assignment of a Facility to which the Transaction relates (such as an issuing bank, a swingline lender or a collateral agent) are neither the same Entity nor Affiliates.
- When the Buyer is not onboarded and approved as a counterparty by both the Seller and the Administrative Agent on the Ready Date (as hereinafter defined), including, without limitation, in circumstances whereby the Buyer has not satisfied the know your customer ("KYC") requirements or other diligence requirements, as determined in the sole discretion of the Seller and the Administrative Agent (each acting in good faith) pursuant to applicable regulatory requirements and each of their respective internal guidelines and procedures.
- If the Allocation is settling on an Electronic Settlement Platform ("ESP"), and Buyer was not identified with a unique Markit Entity Identifier ("MEI") by the Ready Date.
- If an Allocation settles by participation and not by assignment.
- Note further that the CLO Black Period Exception remains applicable for Pre-Trigger, Post-Trigger, Early Day, and Secondary Trades; however, it does not apply to Primary Allocations.

### *Primary Allocation Date:*

- Allocation Date refers to the Pre-Trigger Allocation Date or the Post-Trigger Allocation Date, as specified in the primary allocation Confirmation.
- Pre-Trigger Allocation Date" refers to the date on which an Allocation is made and communicated by the Seller (or an Affiliate of the Seller) to the Buyer when such a date occurs on or before the Trigger Date.
- "Post-Trigger Allocation Date" refers to the date on which an Allocation is made and communicated by the Seller (or an Affiliate of Seller) to the Buyer when such a date occurs after the Trigger Date.
- To receive delayed compensation, the Buyer must be ready to settle the Allocation by the Ready Date.
- In the case of a Pre-Trigger Allocation, the "Pre-Trigger Allocation Ready Date" refers to the date that is three (3) Business Days after the Trigger Date.
- In the case of a Post-Trigger Allocation, the "Post-Trigger Allocation Ready Date" refers

to the date that is three (3) Business Days after the Post-Trigger Allocation Date.

- Provided that requirements are met, delayed compensation for Pre-Trigger Allocations and Post-Trigger Allocations begins on the following respective dates:
- "Pre-Trigger Commencement Date" refers to the six (6) Business Days after the Pre-Trigger Allocation Ready Date.
- "Post-Trigger Commencement Date" refers to the six (6) Business Days after the Post-Trigger Allocation Ready Date.

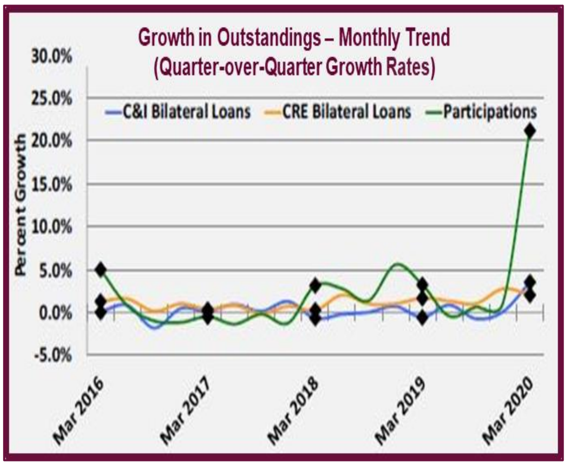
## Early Market Adoption and Feedback

- Banks have seen a significant rise in onboarding requests as buy-side is putting in requests for every fund regardless of relationships.
- Banks having to add onboarding, tax and credit support to accommodate the requests, which come at a cost to the banks.
- Trade clearing vendors have invested a lot of time and money to develop this functionality with limited use since inception to this point.

## Impact of COVID-19 on the PDC Protocol

The protocol is directly tied to the Term Loan B Issuance Market. Below are some impacts of COVID-19 on Markets, which has subsequently slowed the adoption of the protocol:

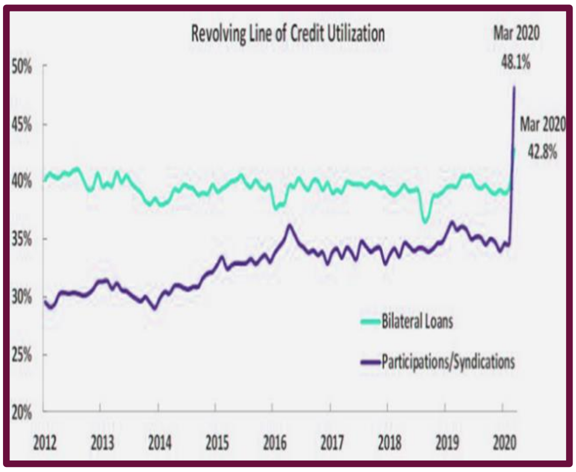
- A limited number of transactions have been launched due to COVID-19 and market conditions.
- Loan Mutual Funds continue to suffer significant outflows.
- The average loan bid has dropped to the low 90s.




- No expectation of an increase in loan defaults due to COVID-19.
- Companies are arranging new short-term lines and drawing down their loans to ensure continued liquidity.

## Insights & Guidance from the Loan Market Association ("LMA")

- Against a backdrop of significant traded volumes at levels well below par, primary leveraged loan issuance is largely on hold in Europe for now. Away from leveraged finance, Loan markets are very much open, as they are in the US. The leveraged loan market should begin to open slowly, especially secondary market & bigger deals in the upcoming months
- LMA has issued best practice & guidance over that past couple of years, such that if there is one mandated lead arranger, who is also the agent, PDC ought to be paid when certain milestones are met. (Detailed guidance available on the LMA website)
- The LMA believes that most of the delays in settlement times come from issues with KYC. They are focusing on simplifying that process over implementing standard terms and conditions for PDC at this time.
- The Joint Money Laundering Steering Group (JMLSG) guidance, in collaboration with the LMA worked to update guidance relating to the syndicated loan market, specifically Sector 17. The guidelines seek to set out where there is a customer relationship in syndicated lending and thus where KYC is relevant for AML purposes. The agent is not considered to have a customer relationship with incoming lenders in a primary or secondary transaction; thus, KYC does not necessarily need to be done.



And as such, there is no factual requirement for an agent to perform KYC on that incoming participant, which would greatly impact the timeline.

- KYC guidelines are set by JMLSG in the UK – refer to article 17 by LMA.
- The view is that the risk of money laundering is very low in the syndicated loan market.
- The LMA saw a good amount of pushback from both the sell-side & buy-side when initially looking to set guidelines on PDC.

## *How can Sia Partners help?*

- Our consultants have 300+ years of combined experience in loans, loan accounting systems & IT implementation experience.
- Entire group dedicated to expertise in the Syndicated Loan Market as well as Full understanding of the end to end life cycle of a loan.
- Sia Partners has expertise with 100+ lending service pack upgrades for top firms across the globe.
- Experience at large variety of institutions from large institutional banks, smaller regional banks and asset managers.
- We have best practices collated from our experience with many of the top institutions within the industry to improve current processes and technology, as well as tailor-fit solutions for each individual institution.
- Certified Project managers, Technical and Business Analysts who understand how changes to the market also affect the third-party vendor systems or in-house systems used to process commercial loan products.
- Our expertise, with AML/KYC regulatory compliance for banking clients, enables our clients to improve KYC and its due diligence on loan market participants with ease. We are highly proficient in customer onboarding and adhering to AML/KYC guidelines.
- Sia Partners expertise with APIs, data analytics, AI and Robotic Process Automation (RPA) enhances the end-to-end KYC onboarding process.

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