

Illustrative regulatory text

Financial collateral means collateral:

...
(3) For purposes of 12 C.F.R. § 132(c), financial collateral includes the effective notional amount of a qualifying letter of credit, as that term is defined in 12 C.F.R. § 132(c)(2).

12 C.F.R. § 132(c)(2).

...
(2) *Definitions.* For purposes of this paragraph (c), the following definitions apply:

...
(iv) *Qualifying letter of credit* means a letter of credit:

- (A) That is an eligible guarantee;
- (B) That is provided by an eligible guarantor;
- (C) In which the reference exposure is a derivative contract;
- (D) In which the obligated party is not a “financial end user,” as that term is defined in 12 C.F.R. § [PRUDENTIAL MARGIN RULE] 1.2; and
- (E) With respect to which the [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintained sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from a default or receivership, insolvency, liquidation, or similar proceeding of the obligated party) the relevant court and administrative authorities would find a claim by the [BANK], as the beneficiary, to enforce the effective notional amount of the letter of credit to be legal, valid, binding and enforceable under the law of the relevant jurisdictions.

Illustrative regulatory text

12 C.F.R. § .132(c)(2).

...

(2) *Definitions.* For purposes of this paragraph (c), the following definitions apply:

...

(v) *Qualifying derivative contract lien* means an arrangement:

- (A) In which a [BANK] has a perfected, first-priority security interest or lien or, outside of the United States, the legal equivalent thereof in collateral that is not financial collateral;
- (B) In which the collateral secures the [BANK]'s credit exposure in a derivative contract with a counterparty that is not a "financial end user," as that term is defined in 12 C.F.R. § [PRUDENTIAL MARGIN RULES] .2;
- (C) With respect to which the [BANK] has conducted sufficient legal review to conclude with a well-founded basis (and maintained sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from a default or receivership, insolvency, liquidation, or similar proceeding of the derivative contract counterparty) the relevant court and administrative authorities would find the first-priority security interest or lien of the [BANK] to be legal, valid, binding and enforceable under the law of the relevant jurisdictions;
- (D) In which the value of the collateral is not positively correlated with the [BANK]'s credit risk exposure to the derivative contract counterparty; and
- (E) With respect to which collateral, if acquired in the future by the [BANK], would be held as, and in conformance with the conditions applicable to, either:
 - (i) assets acquired, by foreclosure or otherwise, in the ordinary course of securing or collecting a debt previously contracted in good faith; or
 - (ii) a merchant banking investment as permitted for financial holding companies under section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)).

Illustrative letter of credit contractual language

IRREVOCABLE STANDBY LETTER OF CREDIT FORMAT

DATE OF ISSUANCE: _____

[ADDRESSEE]

Re: Credit No. _____

We hereby establish our Irrevocable¹ Standby Letter of Credit in your favor for the account of _____ (the "Applicant"), for the aggregate amount not exceeding _____ United States Dollars (\$ _____), available to you at sight upon demand at our counters at (Location in New York City) on or before the expiration hereof against presentation to us of one or more of the following statements, dated and signed by a representative of the beneficiary:

["Applicant has failed to make a payment, delivery or transfer of collateral (each such failure, an "Owed Amount") pursuant to the [ISDA Master] Agreement dated as of _____, between beneficiary and Applicant, as the same may be amended and such Owed Amount remains outstanding at the time of drawing hereunder. Wherefore, the undersigned does hereby demand payment of the Owed Amount under the Letter of Credit in the amount of \$[•]."]

["A Letter of Credit Default (as defined in the [ISDA Master] Agreement dated as of _____, between beneficiary and Applicant, as the same may be amended, the "Agreement")² has occurred and is continuing with respect to the Letter of Credit or the Letter of Credit no longer constitutes an Eligible Letter of Credit (as defined in the Agreement)³. Wherefore, the undersigned does hereby demand payment of the entire undrawn amount of the Letter of Credit."]

["The Letter of Credit has fewer than 30 days remaining prior to the date of expiration and beneficiary has not received either (i) a replacement letter of credit in an equal amount and in form and from an issuer acceptable to it or (ii) US dollars in an amount equal to the undrawn amount of the Letter of Credit. Wherefore, the undersigned does hereby demand payment of the entire undrawn amount of the Letter of Credit."]

¹ The Letter of Credit must be irrevocable and unconditional and contain no provision (outside of the direct control of the beneficiary) that could prevent the issuing bank from being obliged to pay out in a timely manner upon presentation that appears on its face to comply with the terms and conditions of the Letter of Credit.

² The definition of "Letter of Credit Default" in the underlying master agreement is negotiated between the parties. For example, it may include a failure to perform by the letter of credit's issuing bank pursuant to the terms of the letter of credit.

³ The definition of "Eligible Letter of Credit" in the underlying master agreement is negotiated between the parties. It may include eligibility standards that require the issuing bank to maintain minimum capital and credit-ratings requirements.

["An Event of Default [or Termination Event]⁴ (as defined in the [ISDA Master] Agreement dated as of _____ between beneficiary and Applicant, as the same may be amended) has occurred and is continuing with respect to Applicant. Wherefore, the undersigned does hereby demand payment of the entire undrawn amount of the Letter of Credit."]

This Letter of Credit shall expire at our counters on _____ at 5 pm New York time.

Partial and multiple drawings are permitted hereunder.

The amount which may be drawn by you under this Letter of Credit shall be automatically reduced by the amount of any drawings paid by us under this Letter of Credit.

All costs and banking charges pertaining to this Letter of Credit are for the account of the Applicant. Failure of the Applicant to pay any such amounts shall not affect your rights to make drawings under this Letter of Credit.

As used herein the term "**Business Day**" means (a) a day on which we (at our above address) are open for the purpose of conducting a commercial banking business and (b) a day on which banking institutions in New York, New York, generally are open for the purpose of conducting a commercial banking business. If demand for payment is made by you hereunder on a Business Day on or prior to 4:00 p.m., New York time, and your drawing certificate conforms to the terms and conditions hereof, payment shall be made to you on the next immediately succeeding Business Day. If demand for payment is made by you hereunder on a Business Day after 4:00 p.m., New York time, and your drawing certificate conforms to the terms and conditions hereof, payment shall be made to you on the second immediately succeeding Business Day.

Any notice, demand, draw request or other communication hereunder shall be delivered by hand, by nationally recognized overnight courier, or by facsimile to:

Attention: _____

Facsimile No.: _____

⁴ Reference should be made to the term, if any, used in the underlying master agreement for an early termination that is other than an Event of Default.

We hereby agree with you that documents drawn under and in compliance with the terms of this Letter of Credit shall be duly honored, payable in immediately available US Dollars upon presentation as specified herein.

This Letter of Credit shall be governed by the International Standby Practices (ISP98), International Chamber of Commerce Publication No. 590 ("ISP")⁵, except to the extent that the terms hereof are inconsistent with the provisions of the ISP, in which case the terms of this Letter of Credit shall govern. As to matters not covered by the ISP and to the extent not inconsistent with the ISP or the terms hereof, this Letter of Credit shall be governed by and construed in accordance with the law of the State of New York, including Article 5 of the Uniform Commercial Code as in effect in that State.

[BANK SIGNATURE]

⁵ ISP adopts international banking standards for interpretation and application of its rules and is drafted expressly for the standby letter of credit practice as separate and apart from the commercial letter of credit practice. It is the set of rules governing the majority of standby letter of credits issued by financial institutions.

Illustrative lien contractual language

Often when entering into a secured credit facility with one or more lenders, the commercial end user/borrower (“hedge counterparty”) will be required to hedge certain risks associated with the transaction linked to the relevant loan, or the hedge counterparty seeks to generally hedge against risks associated with its operations. In any such cases, a banking organization may be asked to become a hedge provider, regardless of whether it or one of its affiliates is included as a lender in the secured credit facility, having the hedges secured by the facility’s collateral as credit support. Prior to accepting a security interest in or lien on assets as security for such hedging transactions with a hedge counterparty, a diligence by hedge provider’s counsel of the relevant loan documents is warranted, whereby each of the below-listed points is verified and other salient issues relating to the security of hedges are identified.⁶

- Review of any relevant Credit Agreement and/or Intercreditor Agreement to confirm:
 - if incurring debt under hedges is permitted and if any restrictions apply;
 - if permitted hedges may be secured by liens on or a security interest in the collateral under the loan’s collateral/security documents and the criteria such hedges must satisfy to be secured as such (e.g., hedge provider must be a lender or an affiliate of a lender, satisfy a rating requirement, or execute a joinder to an intercreditor agreement); and
 - if obligations under secured hedges rank *pari passu* and ratably with the credit agreement’s (most senior) loan obligations for payments from proceeds of the collateral following an event of default.
- Review of any relevant Collateral/Security Documents to confirm:
 - the relevant liens and/or security interests have been granted/perfected, and
 - coverage expressly includes obligations under secured hedges and when such coverage terminates.

Once any relevant loan documentation has been reviewed and it has been ascertained, to the satisfaction of the hedge provider’s internal credit/risk officers, that hedging obligations can be secured obligations thereunder to the same extent as the (most senior) loan obligations, the hedging transactions may be entered into and documented under an ISDA Master Agreement (“ISDA”) containing the below protective provisions for the hedge provider.

- Termination rights triggered by the occurrence of any of the following “Additional Termination Events”⁷ (or any combination thereof):

⁶ The documentation should also be reviewed to determine the if the hedge provider of secured hedges has any voting rights under any relevant credit agreement and/or intercreditor agreement (e.g., voting with respect to any release of collateral, amendments to/waivers under the credit agreement or other loan documents).

⁷ The ISDA’s Additional Termination Events are subject to negotiation based on the terms of any relevant loan documents. For example, if such loan documents extend consent rights to hedge providers in respect of any material amendments thereto, the “Material Amendment” provision becomes less critical to include in the ISDA.

- (i) **Secured Party.** If at any time (1) with respect to any payments made under the Credit Agreement or distributions resulting from either the proceeds of any Collateral (whether by collection, sale, distribution or otherwise) or any guaranty issued for the benefit of the Secured Parties, [Hedge Provider] is not a Secured Party entitled to such payments or distributions under the Transactions on a *pro rata* and *pari passu* basis with the Lenders as to the repayment of principal under the Credit Agreement or (2) [Hedge Counterparty's] obligations or liabilities to [Hedge Provider] under this Agreement are unsecured.
- (ii) **Collateral Release.** If either (1) all or substantially all of the Collateral is released from the liens of the relevant Collateral Documents without the prior written consent of [Hedge Provider] or (2) Collateral is released or sold in one or more transactions which, individually or in the aggregate, is in an amount that would require the consent of the Lenders pursuant to the terms of the Credit Agreement.
- (iii) **Credit Agreement Termination.** If, at any time, the Credit Agreement is terminated, discharged or otherwise ceases to be in full force and effect.
- (iv) **Material Amendment.** If the Credit Agreement or any Collateral Document (as in effect on the date of this Agreement without giving effect to any waivers, amendments, supplements or other modifications after the date of this Agreement) is amended, supplemented or otherwise modified, or any term thereof is waived, in each case, without [Hedge Provider's] prior written consent, and such amendment, supplement, modification, or waiver, as applicable, has a material adverse effect (as determined by [Hedge Provider]) on [Hedge Provider's] rights and/or obligations under this Agreement or under any Collateral Document (as in effect on the date hereof).

The following definitions are included in the ISDA for the use of the above Additional Termination Events:

"Collateral" means any and all collateral pledged to the Secured Parties under, or pursuant to, the Collateral Documents.

"Collateral Documents" means the Credit Agreement, any intercreditor agreement, any depositary agreement and any security, pledge, guaranty or other collateral agreement related to the foregoing.

"Credit Agreement" means that certain Credit Agreement dated as of [____], made by and among Party B, as Borrower, [____], as Administrative Agent, [____], as Syndication Agent, [____], and the other Lenders party thereto, as the same may be amended, supplemented, [refinanced,] replaced or otherwise modified from time to time.

"Lender" means any lender under the Credit Agreement holding the most senior security interest in the Collateral relative to the other Secured Parties and making the most senior tranche of Loans (if multiple tranches of Loans exist under the Credit Agreement).

"Loan" means any loan made by a Lender under the Credit Agreement.

"Secured Party" means a secured party under the Collateral Documents.

- Specifying the relevant loan's collateral/security documents as "Credit Support Documents" under the ISDA with respect to the hedge counterparty and specifying each party that executes such documents as "Credit Support Providers" under the ISDA with respect to the hedge counterparty.⁸

⁸ Provides additional protection under the ISDA for the hedge provider in the form of an Event of Default if any party to the loan's collateral/security documents fails to perform, repudiates, or makes a misrepresentation thereunder or any of the specified Credit Support Providers triggers a Bankruptcy event under the ISDA.