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THE STATE OF THE LOAN SUB-PARTICIPATION

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The common practice of selling sub-participations in commercial bank loans has received attention in the light of recent domestic bank failures and the many sovereign debt renegotiations currently in progress. Under regulatory pressure to improve capital ratios, or in an effort to adjust loan portfolios to achieve other goals, commercial banks are increasingly resorting to the sub-participation market notwithstanding the troublesome legal questions posed by these transactions. Moreover, many of the more important legal questions raised by the sale of a sub-participation do not have definitive answers. This article explores the nature of these legal risks from the perspective of both the seller and the buyer of the loan sub-participation. The article also discusses how the traditional legal analysis of these instruments has changed, and is changing, in light of heightened regulatory scrutiny and the altered nature of the sub-participation market itself.

1. Introduction

Until recent events forced its reappraisal, the unspoken major premise of many bank-to-bank financial transactions was that all reputable and right-thinking bankers, if confronted by a situation calling for an important decision regarding the management of a loan, will act in a similar fashion. According to this theory, an identical goal – to maximize the likelihood that their bank's credits will be repaid on a timely basis – motivates all loan officers in all banks in all parts of the world. Thus, when one lender in a multi-bank transaction surrendered its discretion to manage the loan to a fellow lender, this decision reflected a confidence that any such decision would be acceptable to all the lenders.

The loan sub-participation [1] is a classic embodiment of this belief in the family of bankers. The salient feature of a sub-participation is that the bank originating the loan (lead) will remain in its role as the nominal lender and will continue to manage the loan notwithstanding the fact that it may have sold off most or even all of its credit exposure [2]. Many forms of sub-participation agreements widely used in the market during the late 1970's and early 1980's effectively consigned the purchaser of the sub-participation to an impassive position [3]. The sub-participant was expected to await receipt of a pro-

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portionate share of any recovery under the loan [4]. The sub-participant had no right to pursue any independent action, legal or otherwise, to protect its interests vis-à-vis the borrower and often was not even entitled to communicate with the borrower [5]. In addition, the sub-participant frequently had no right to comment on or even approve amendments to the loan agreement or waivers of payments that the lead bank might grant to the borrower [6]. One may, therefore, regard the quiet but steady growth of the loan sub-participation market over the last ten years as a testament to the widespread belief that lenders generally share a community of interests in managing their assets. Moreover, this community of interests justified a sub-participant in assuming that the lead would not act in a manner that the sub-participant would find objectionable.

Much of the recent attention directed to the subject of loan sub-participations probably reflects a recognition that this assumed community of interests among bankers is no longer supportable, if indeed it ever was. Moreover, in the wake of disturbances such as the Penn Square Bank failure, bankers seem less eager to presume a level of competence and straightforwardness on the part of their fellow bankers [7]. In addition, bank regulators have affirmatively warned sub-participants *not* to base their business dealings with other banks on this presumption.

The series of events leading to the banking community's loss of innocence in this regard are well known. For example, when President Carter imposed a freeze order on Iranian assets in 1979, some lending syndicates, composed of both U.S. and non-U.S. banks found themselves engaged in bitter and unseemly squabbles as to whether their Iranian loans should be declared in default and accelerated [8]. This situation was repeated several years later in the wake of the United Kingdom–Argentina dispute over the Falklands [9]. The differing political pressures on individual banks, usually resulting from their geographical alignment, prompted banks to adopt polarized views on such fundamental choices as whether to accelerate a loan or to pursue legal remedies [10]. For example, U.S. banks led the Mexican and Latin American reschedulings, while German banks led the Polish restructuring [11].

More recently, the sovereign debt restructuring process has dispelled any lingering beliefs that all right-thinking bankers will always agree on how to manage their assets. A bank's level of exposure in a country that has announced a general debt restructuring, the degree to which that bank can write down assets in the country without doing major violence to its balance sheet, and the level of political and regulatory pressure that the bank must endure should it refuse to accept the restructuring program, will all affect how a particular bank may respond to a borrower's request for restructuring. These factors will obviously have a different impact on individual banks. There can be no assurance that each bank in a syndicate, or each sub-participant of a lead bank, will perceive things in the same way. In short, perfectly reputable and sensible bankers are capable of forming radically opposing views on fundamental questions regarding the management of their loans as a result of factors that may have little to do with a simple desire to maximize the chances for repayment of the loan.

Section 2 will summarize some of the traditional legal concerns with loan sub-participations. These worries were present even in "innocent" days of this market. In practice, these traditional problems recur with a frequency that is sufficient to make their oversight by lawyers hazardous. Section 3 will address some of the more recent market and regulatory events that are likely to influence the future development of the loan sub-participation market and associated legal documentation.

2. Conventional Legal Concerns

Sub-participations have always raised troublesome legal problems both for purchasers and sellers. As a practical matter, however, these potential worries do not seem to have dampened bankers' enthusiasm for this kind of transaction nor have they, at least until recently, had a discernable impact upon the standard form of documentation for sub-participations. The following is a summary of some of the more important legal concerns.

2.1. Consequence of the Sub-participant's Lack of a Debtor/Creditor Relationship with the Borrower

The sale of a typical loan sub-participation does not, as a legal matter, transfer the lead's interest in the loan to the sub-participant [12]. As a consequence, only the lead stands in a direct debtor/creditor relationship with the borrower. Thus, the sub-participant will be forced to rely on the lead in all matters relating to the management of the loan or the enforcement of the loan obligations against the borrower. The principal legal issues that concern purchasers of sub-participations derive from this lack of contractual privity between the sub-participant and the borrower, as well as the risks inherent in relying on the lead to manage and receive payments under the loan [13].

2.1.1. Inability to Enforce the Borrower's Obligations

A sub-participant is not in a position to take any direct legal action against the borrower for recovery of amounts due under the loan agreement or other credit instrument. Consequently, a sub-participant cannot sue the borrower for recovery of the loan or take appropriate action with respect to any collateral for the loan. If the lead deliberately or negligently fails to take effective action to enforce the borrower's obligations, the sub-participant's remedies are limited. It could try to persuade the lead to transform the sub-participation into a formal assignment of the lead's interest in the loan, which would permit independent action by the sub-participant. A sub-participant could argue that the lead is subject to fiduciary responsibilities in its administration of the loan [14] or that the lead has responsibilities to the sub-participant under relevant securities laws [15]. In the typical case such contentions would conflict with the terms of the sub-participation agreement which generally disavow any such responsibilities. These concerns may be particularly acute if the lead has sold off its entire interest in the loan, leaving it little economic incentive to pursue aggressive enforcement actions against the borrower.

2.1.2. Inability to Benefit from Protective Clauses

Eurocurrency loan agreements typically provide lenders with certain protections in connection with their maintenance and funding of the loan [16]. For example, the substitute London interbank offered rate (LIBOR) clause allows lenders to renegotiate the interest rate basis of their loans if the interest rate specified in the loan documentation no longer adequately reflects the cost to the banks of funding their advances in the London interbank market [17]. Similarly, the "Eurodollar disaster" clause will allow a bank to terminate its commitment under the loan agreement if circumstances affecting the Euromarket generally make it impossible for the bank to continue funding the loan in that market [18]. Finally, banks are usually permitted to pass on increased costs that may result from changes in the laws or regulations affecting the bank's lending practices to the borrower [19].

Because a sub-participant is not a party to the underlying loan agreement, it cannot avail itself of the protective clauses described above without the borrower's express consent. Thus, for example, if a sub-participant becomes subject to the kind of increased costs referred to above, the borrower would be under no obligation to indemnify the sub-participant for these increased costs.

2.1.3. Set-off Rights

Under the laws of most jurisdictions, before a bank can exercise a banker's lien or set-off right against the debtor's deposits, there must be mutuality between the bank exercising the right of set-off and the bank extending the credit whose nonpayment gives rise to the right of set-off [20]. No such mutuality would exist where a loan is extended by a lead bank. Thus, the sub-participant may be frustrated in an attempt to set off amounts due under its sub-participation against the deposits it is holding.

2.2. Risks Associated with the Lead / Sub-participant Relationship

2.2.1. Bankruptcy of the Lead

Although the sub-participant is not in a direct debtor/creditor relationship with the borrower, its relationship with the lead bank may be so characterized if the lead bank declares bankruptcy [21]. Unless the sub-participant has taken some action to perfect a security interest in the underlying loan [22], the sub-participant may be relegated to the position of an unsecured creditor in the event the lead declares bankruptcy [23]. The lead's trustee or receiver in bankruptcy may treat the sub-participant as having made a general unsecured loan to the lead. As a result, the sub-participant's interest in any payments received from the borrower [24], or in any set-offs against deposits of such borrower held by the lead may not be recognized [25].

In certain circumstances, the sub-participant may be able to demonstrate that the lead was acting as a fiduciary and that it received funds in trust for the sub-participant [26]. The sub-participant could then rely on the well-settled rule that a trustee in bankruptcy acquires no rights in property to which the bankrupt held legal title in trust for the benefit of another [27]. Despite references in the sub-participation agreement to payments by the borrower being held in trust for the benefit of the sub-participant, the courts have not been consistent in finding that valid trust relationships are created in these transactions [28].

2.2.2. Claims by Third party Creditors of the Lead

Concerns similar to those surrounding the bankruptcy of the lead also arise when a third party creditor of the lead seeks to levy upon amounts payable by the borrower to the lead under the loan. The ability of a third party creditor to take priority over the sub-participant depends on a number of factors including whether the granting of the sub-participation is characterized as a loan to the lead by the sub-participant which is secured by the right to receive a portion of the payments made by the borrower [29], and whether the underlying loan is evidenced by a negotiable instrument that may be sold by the lead to a holder in due course [30].

2.2.3. Deliberate Misconduct of the Lead

The lead could take a number of deliberate actions that would prejudice the sub-participant's interest in the loan. For example, the lead could resell to another party the loan in which the participant has an interest; pledge in favor of a third party the asset represented by the loan as security for a debt contracted by the lead without informing the third party of the existence of the sub-participant's interest; release collateral for the loan without the sub-participant's consent; or fail to pass on payments received from the borrower.

These actions could constitute gross negligence or willful misconduct on the part of the lead and may therefore be actionable under the relevant sub-participation agreement or generally applicable legal principles.

2.2.4. Transfer Risk

Because the lead will act as the receiving agent for payments from the borrower, and will be required to pass on such payments to the sub-participant to the extent of the latter's proportionate interest in the loan, there is some chance that governmental restrictions could interfere with the normal flow of payments to the sub-participant when the lead and the sub-participant are located in different jurisdictions [31]. This so-called transfer risk materialized in 1979 as a result of President Carter's freeze of Iranian assets [32], and in 1982 when the United Kingdom blocked Argentine assets in response to the Falklands dispute [33]. Where the lead bank is located in the country imposing the freeze or blocking measures, and the sub-participant is located in the country against which such measures are taken, the practical effect of such a freeze or blocking order would be to prevent the borrower's payment from flowing through to the sub-participant [34]. In most cases, this risk is thought to be remote and the subject does not appear to have attracted the attention of draftsmen of conventional loan sub-participation agreements.

Another problem can arise if the lead attempts to set-off against payments due to the sub-participant amounts that are the subject of a dispute between the lead and the sub-participant under an unrelated transaction [35]. This problem is typically addressed in the sub-participation agreement by a covenant requiring the lead to pay all amounts free from set-off, deduction, or counterclaim [36].

2.2.5. Management of the Loan

One traditional area of conflict in sub-participation arrangements involves the extent to which the sub-participant will be entitled to consult with or instruct the lead in connection with the management of the loan [37]. Most standardized sub-participation agreements give the sub-participant very few rights in this regard. The principal exception in recent agreements is the right to approve any proposed amendments to the payment terms of the underlying loan.

A lead is subject to conflicting pressures in deciding whether to grant rights to the sub-participant in the management of the loan. On the one hand, a greater level of permitted participation in managing the loan may lessen the lead's potential legal exposure under both securities laws and other bases of legal liability to the sub-participant [38]. However, granting sub-participants a say in the management of a loan may be administratively difficult, particularly if the lead sells more than one sub-participation in the same loan. Giving sub-participants a voice in managing the loan is also problematic for a lead who wishes to retain flexibility in making decisions for political reasons [39].

2.3. Sub-participant's Liability

In certain circumstances, a sub-participant may find itself liable to the lead bank if it fails to perform any continuing obligation under the sub-participation agreement. This failure to perform is most troublesome where the underlying agreement with the borrower involves a revolving line of credit or where the sub-participant obligates itself to fund the lead's periodic advances to the borrower in proportion to its interest in the loan. If the sub-participant wrongly refuses to participate in future advances, it may be subject to legal action by the lead to recover the sub-participant's pro rata share of those advances [40], or even to recover punitive or consequential damages [41].

In the extreme case, a sub-participant's conduct in failing to fund its portion of future advances to the borrower, or the sub-participant's refusal to consent to actions necessary to preserve the value of the loan or any associated collateral, may subject it to claims by other sub-participants in the same transaction [42]. One theory advanced to support this contention holds that each sub-participant in a transaction is a joint venture partner who is legally bound "to act in the utmost good faith toward its co-venturers" [43], and is accordingly liable to the other sub-participants for a breach of this duty [44].

2.4. The Lead Bank's Worries

2.4.1. Legal Liability under the Securities Laws

Lead banks have traditionally worried that sale of a loan sub-participation may constitute a sale of a security within the meaning of federal or state securities laws [45]. One consequence of selling a security is the possibility of having to comply with SEC registration and prospectus requirements [46]. In addition, the sub-participant may attempt to invoke the antifraud protections of these laws [47]. There has never been a definitive judicial interpretation of whether a conventional loan sub-participation is a security for these purposes [48].

Both the Securities Act of 1933 [49] and the Securities Exchange Act of 1934 [50] define a security. The 1933 Act states that "unless the context otherwise requires [a security is] a note ... evidence of indebtedness ... investment contract ... or any certificate of interest or participation in ... any of the foregoing" [51]. This language expressly states that a participation in a security is itself liable to be classified as a security. The definition of a security in the 1934 Act is similar, but excludes notes that mature in nine months or less [52]. The Supreme Court has indicated that the definitions of a security in both Acts are virtually identical and should be interpreted similarly [53].

Under these statutory definitions, sub-participations may qualify as securities in any of three ways: the underlying loan agreement, a promissory note or other evidence of indebtedness is regarded as a security [54]; where the loan agreement constitutes an investment contract [55]; or the loan sub-participation instrument is deemed to be an investment contract, regardless of whether the underlying loan transaction is defined as a security [56].

As indicated above, there has been no uniform judicial treatment of whether a conventional loan sub-participation agreement constitutes a security [57]. In *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville* [58], a federal appeals court applied a literal interpretation of the statutory definition of a security in a loan sub-participation context. In that case, the sub-participant, Lehigh Valley, sued the lead bank, Central, for alleged misstatements and omissions of facts in violation of SEC Rule 10b-5 and the 1934 Act [59]. In rejecting Central's argument that the loan sub-participation agreement was not a security, the court held that the borrower's note representing the underlying loan fit within the statute's specific reference to "any note" [60]. Thus, the sub-participation agreement itself also constituted a security because it was a participation in a security – the borrower's note [61].

The literal approach to interpreting the definition of a security used by the *Lehigh Valley* court has not generally been followed [62]. Most courts have relied on the prefatory words in the statutory definitions in both Acts – "unless the context requires" [63] – to restrict the definition of a security. In this regard, courts have employed several tests to decide whether an underlying loan agreement or promissory note is a security. Among these are tests which attempt:

- to distinguish between "commercial" and "investment" transactions (with only investment notes being classifiable as securities) [64];
- to discern whether the loan represents "risk capital" (whose repayment depends on the success of the borrower's business) rather than a conventional loan made on the reasonable assumption that the indebtedness will be repaid [65]; and
- to determine whether the literal definition of a security should be ignored in a particular case because the purpose of the securities laws requires such an interpretation [66].

A separate question is under what circumstances an underlying load agreement or the sub-participation agreement constitutes an investment contract. In the absence of any statutory definition of investment contract, courts have indicated that an investment contract is "a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party" [67]. In some respects, a loan sub-participation meets these criteria. It is an investment of money in a common enterprise. The critical issue is whether the sub-participant expects to make profits solely from the efforts of others. Although most courts have rejected the notion that a loan sub-participation satisfies these latter criteria [68], the lead increases the chance that a particular transaction will be deemed to constitute an investment contract if the sub-participation agreement gives the purchaser little or no voice in the administration of the loan [69]. To the extent that a sub-participant can participate in the management of the loan, however, it is less able to argue that it was relying *solely* on the efforts of the lead and the borrower to give value to the sub-participation interest.

If a sub-participation is deemed to constitute a security, its sale would entail the full registration and prospectus requirements of the 1933 Act, unless one of the specified exemptions from that Act is applicable [70]. The 1933 Act establishes a general exemption from the registration requirements for "transactions by an issuer not involving a public offering" [71], and this private placement exemption would appear to be the most likely candidate for exempting bank loans [72] and the sale of sub-participations in bank loans [73] from the scope of the Act. Moreover, if the sub-participation agreement is deemed to constitute a security, certain of the antifraud and civil liability provisions of the 1933 and 1934 Acts, and perhaps state securities laws as well, would be applicable to the offering and sale of the sub-participation interest [74], regardless of the fact that the transaction may be exempt from the registration requirements of the 1933 Act.

2.4.2. Other Bases of Liability

An aggrieved sub-participant determined to sue a lead bank that sold a sub-participation in a bad loan is unlikely to limit itself to claims based on federal or state securities laws. Lawsuits of this kind typically also seek relief under a variety of common law causes of action such as breach of fiduciary duty [75], common law fraud [76], deceit [77], negligent misrepresentation [78] and breach of contract [79]. If a court is unsympathetic to a claim based on the securities laws, the plaintiff may find these common law counts to be the only remaining basis on which relief can be granted [80].

A good example of these types of claims may be found in the series of lawsuits referred to collectively as the Colocotronis litigation [81]. European-American Banking Corporation made a series of loans to a group of commonly-controlled companies (the Colocotronis companies) [82]. European-American subsequently sold sub-participations in these loans to at least thirty banks [83]. When the Colocotronis companies defaulted under various loan agreements, some of the sub-participants filed lawsuits alleging that European-American had breached the terms of the sub-participation agreements, breached its fiduciary duty with respect to the sub-participants, and engaged in misrepresentation and omissions of material facts [84]. The plaintiffs based their lawsuits on a variety of theories including violations of various federal and state securities laws, common law fraud, breach of contract, and failure to fulfill fiduciary duties [85].

The allegations made in these cases provide an example of how these issues can be framed in the aftermath of a defaulted loan. It was, for instance, alleged that European-American had failed to investigate thoroughly the creditworthiness of the borrower, had not exercised sufficient care in its supervision of the loans, and had not taken adequate steps to determine all material facts regarding the loans and inform the sub-participants of these material facts [86]. All of the Colocotronis lawsuits were ultimately settled.

2.5. Effect of Disclaimers of Liability

Standard loan sub-participation agreements often contain provisions disclaiming any responsibility for the information furnished in connection with the sale of the sub-participation and for any action taken by the lead in the administration of the loan [87]. Such disclaimers are, as a general matter, notoriously ineffective to shield a defendant from all liability. However, in *NBI Mortgage Investment Corp. v. Chemical Bank* [88], the court was willing to give effect to such a disclaimer. This case involved an action by NBI to recover losses incurred after taking a 90% interest in a loan originated by Security National Bank. (Chemical had succeeded to the interest of Security National prior to the lawsuit) [89]. The sub-participation agreement contained the following clause:

> It is expressly understood that Security [National Bank] has not made any representations or warranty, express or implied, with respect to the execution, validity, enforcement or collectibility of the loan ... [90].

The court held that this clause *was* effective to bar NBI's allegations that Security National had misrepresented the quality of the loan [91].

3. Recent Developments

Major changes in the nature of domestic and international commercial bank lending over the last few years have dramatically affected the loan sub-participation market. Notable bank failures, involving institutions such as Penn Square Bank [92], have painfully demonstrated the interconnected fortunes of U.S. banks. One reason for this interdependence is the widespread use of loan sub-participations. In addition, when major sovereign borrowers routinely followed Mexico's lead in 1982 by seeking a generalized restructuring of their external debt [93], what initially appeared to be exercises involving specific borrowers and their identifiable bank creditors, turned out to have implications for hundreds of other banks holding silent sub-participations in the credits. These developments have changed the market for sub-participations as well as the legal documentation associated with these transactions.

3.1. Regulatory Scrutiny

In December 1983, following the Penn Square crisis, the Comptroller of the Currency (OCC) announced policy guidelines relating to the sale and purchase of loan participations by national banks [94]. The OCC stated that "recent abuses have highlighted the need ... to remind banks of prudent banking practices" [95] in the area of loan sub-participations, and warned that "the absence of satisfactory controls over risk may constitute an unsafe or unsound banking practice" requiring remedial action by the OCC [96].

The OCC admonished both purchasers and sellers of these instruments to follow prudent banking practices [97]. The satisfactory controls sought by the OCC in the purchase of loan sub-participations included:

> [W]ritten lending policies and procedures of the purchasing bank governing these transactions; ... an independent analysis of credit quality by the purchasing bank; ... agreement by the obligor to make full credit information available to the selling bank; ... agreement by the selling bank to provide available information on the obligor to the purchaser; and ... written documentation of recourse arrangements outlining the rights and obligations of each party [98].

For its part, the seller of a loan sub-participation is directed by the OCC to provide complete and current credit information to the purchasing bank on the loan's accrual status, the status of principal and interest payments, collateral values, and information on a continuing basis regarding the borrower's credit worthiness [99].

3.2. The Sub-participation in Debt Restructuring

The widespread existence of sub-participation arrangements among commercial banks has created serious complications in the massive debt restructurings that are a predominant feature of the current banking scene [100].

3.2.1. The Lead's Perspective

In most sub-participations sold prior to 1982 the lead bank assumed that the underlying credit would be repaid, in which case the sub-participant would contentedly receive its proportionate share. If the credit were not repaid, the lead and the sub-participant would consult regarding their legal remedies to obtain a recovery. Neither the buyers nor sellers of most sub-participations contemplated a situation in which the borrower would propose *neither* to repay the debt *nor* default on it in the strict sense. In other words, the parties to conventional sub-participation agreements typically did not show any special awareness of, or provide in the documentation for, the possibility that the underlying loan would be swept up in a general restructuring program [101].

In late 1982 and 1983, when restructuring requests from many of the largest Lesser Developed Country (LDC) borrowers became the rule rather than the exception, bankers and their lawyers were forced to exhume from their files dusty sub-participation agreements in order to determine what the lead bank could and could not do without the consent of its sub-participant [102].

Frequently the relevant agreement omitted any reference to the necessity of the lead obtaining the sub-participant's consent before agreeing to reschedule payment dates or to change the interest rate applicable to the loan. Under these conditions, the lead had the flexibility of going along with the borrower's restructuring request without the sub-participant's consent. Even in the absence of a contractual restriction binding the lead, however, two factors suggested that the lead bank show restraint. First, the canons of bank-to-bank courtesy strongly suggested that the lead consult its sub-participant before going along with the borrower's request. Second, there were often nagging legal worries about the possibility that the lead's fiduciary or agency responsibilities may not have been effectively disclaimed in the sub-participation agreement [103].

If the relevant agreement did require the sub-participant's consent to any change in the loan's payment terms, however, the lead's position was at least clear, if not always pleasant. Friction would be avoided if the lead could persuade the sub-participant to see the matter its way. If the lead was disposed to grant the borrower's request for a restructuring but its sub-participant refused to consent, there were several choices facing the lead. The lead could refuse to grant the borrower's request, and thus act against its own interest. This position would be extremely unpopular with the borrower and could incur the opprobrium of other bankers and bank regulators for refusing to accept a restructuring proposal that is generally supported by the banking community. Alternatively, the lead could buy out the sub-participant. This is a costly proposition and one that would virtually guarantee that all sub-participants would withhold their needed consent. Finally, the lead could agree to the restructuring without the sub-participant's consent and risk a possible lawsuit by the sub-participant for breach of contract [104].

A number of banks are currently faced with this dilemma. Moreover, the very banks whose LDC exposure is the greatest, and who, therefore, are the most enthusiastic advocates of the restructuring process, are often the same institutions that have been most active in selling sub-participations. It is obviously difficult for a major money-center bank that sits on a country advisory committee to refuse to restructure one of its own loans when it is otherwise exhorting its fellow banks to accept the restructuring package.

In 1983, this situation became the subject of litigation in *Michigan National Bank of Detroit v. Citibank, N.A.* [105] Citibank had made a loan to Petroleos Mexicanos (Pemex) and sold a $5,000,000 sub-participation to Michigan National [106]. Pemex requested that the principal amounts due under the loan be rolled over pending a restructuring of the loan [107]. Citibank, the chair of the bank advisory group for Mexico, requested the consent of Michigan National as required by the terms of the sub-participation agreement [108]. Michigan National ultimately refused to consent to one of the requested roll-overs [109]. It then brought suit against Citibank for recovery of its $5,000,000 when Citibank allegedly agreed to the roll despite the absence of the required consent [110]. The case was settled before going to trial, but it focused a good deal of attention on the uncomfortable role of a lead bank in this situation [111].

The lead may also have problems if the restructuring takes the form of a refinancing of the borrower's debt, rather than a rescheduling of existing obligations [112]. In a refinancing, the existing loans are repaid with the proceeds of a new borrowing from the same lenders [113]. If the sub-participation agreement is strictly construed, however, such a repayment may require the lead to repay the sub-participant. Unless there is a corresponding requirement that the sub-participant renew its arrangement with respect to this replacement loan, this would have the effect of increasing the exposure of the lead [114].

3.2.2. The Sub-participant's Perspective

Apart from the issue of obtaining the sub-participant's consent to the restructuring, both the seller and the purchaser of a sub-participation will be concerned about the effect of a request from the borrower or from the borrower's government for new money [115]. In the normal case, the sovereign will direct a new money request to those banks that appear on the sovereign's records as having loans or other exposure outstanding in the country on the target date [116]. The problem, of course, is that the lead bank may not have retained the full credit risk of the loan if, for example, sub-participations had been sold [117].

This situation raises the issue of which party should be responsible for the new money commitment corresponding to a sub-participated loan. The lead bank may take the view that this responsibility follows the credit risk of the underlying loan and accordingly seek a proportionate contribution from the sub-participant. The sub-participant is likely to argue that it agreed to take only a limited exposure when it purchased the sub-participation and that the lead assumed the risk of acceding to new money requests. This matter is rarely addressed in the documentation for a sub-participation, although it is likely that drafters will direct their attention to it in the future.

3.2.3. The Borrower's Perspective

To the extent that the existence of sub-participations complicates a borrower's restructuring program, it is an undesirable fact of life. Borrowers normally attempt to ignore the presence of sub-participations and direct their requests for new money or restructuring to the nominal lenders [118], even though they realize that third party consents are sometimes necessary before these nominal lenders may accede to the borrower's request [119]. The practice of selling sub-participations means, however, that a borrower will have creditors whose identity may remain undisclosed. Their anonymity can sometimes shield sub-participants from the kind of pressure that is occasionally exerted by borrowers, other banks and bank regulators against intractable lenders that refuse to go along with a restructuring.

3.3. The Changing Sub-participation Market

At one time commercial banks sold sub-participations to each other when necessary to free up lending or country limit constraints [120], to obtain liquidity [121], or to adjust portfolios in a manner the banks thought desirable [122]. This traditional market is changing rapidly. Under pressure from long-term debt restructurings and increased bank capital requirements, some banks have embarked on full-scale programs to sell off or swap their existing assets; this has created a growing secondary market in loan sub-participations [123].

These changes in the marketplace are forcing a reassessment of the traditional legal analysis surrounding sub-participations. For example, whatever assurances lawyers were able to give their banking clients regarding the securities law treatment of sub-participations when sold bank-to-bank on an *ad hoc* basis, may no longer be applicable if the sub-participations are sold as part of a general asset liquidation program to non-banks pursuant to highly standardized participation agreement [124].

Moreover, the initiation of a wholesale program of selling loan sub-participations, particularly where originating banks put in place sub-participation arrangements covering all or a large part of their interest in a loan prior to the time the loan is actually disbursed [125], could raise questions under the U.S. Glass-Steagall Act [126]. This Act generally restricts U.S. banks from underwriting or dealing in securities [127]. To the extent that loan sub-participations may be classifiable as securities for this purpose, this opens the issue of whether these transactions would constitute an underwriting by the bank of an issue of such securities.

4. Conclusion

In summary, significant changes in the loan sub-participation market have resulted from two conflicting pressures. On the one hand, recent developments have virtually guaranteed the popularity of sub-participations as a means of adjusting loan portfolios, increasing liquidity and dealing with lending limit problems in the face of widespread restructurings and an altered bank regulatory environment. On the other hand, these same developments and, to some extent, the very growth of the market itself, has undermined the conventional legal wisdom regarding the status of sub-participations and increased the legal risks associated with these transactions. The likely consequence of this tension will be to focus the attention of lawyers and their banking clients on the structure and documentation of loan sub-participations with a view toward minimizing the legal exposure for both purchasers and sellers of these instruments.

Notes

[1] In U.S. banking parlance, these instruments are known simply as "participations". For descriptions of the nature and functions of loan sub-participations, see Hutchins, *What Exactly is a Loan Participation?*, 9 Rut.-Cam. L.J. 447 (1978); Ledwidge, *Loan Participations Among Commercial Banks*, 51 Tenn. L. Rev. 519 (1984); Szathmary, *The Participation Agreement as a Fundraising Vehicle*, 3(i) Int'l Bus. L. 75 (1975); Note, *Classification of Loan Participations Following the Insolvency of a Lead Bank*, 62 Tex. L. Rev. 1115, 1120, n.31 (1984).

[2] *See* Hutchins, *supra* note 1, at 448. *See generally* Szathmary, *supra* note 1.

[3] Szathmary, *supra* note 1, at 76.

[4] *Id.* at 76, 78.

[5] *See* Tompsett, *Interbank Relations in Loan Participation Agreements: From Structure to Workout*, 101 Banking L.J. 31, 32 (1984); Szathmary, *supra* note 1, at 77.

[6] *See generally* Szathmary, *supra* note 1, at 76, 77 (suggesting that the lead has total decision-making power over the loan and the participant is analogous to a limited partner; the participant joins in the profits and risks but cannot make decisions).

[7] The Penn Square Bank was declared bankrupt in 1982. For an in-depth look at the bank's failure and its repercussions, see Fisher & Muratif, *The Aftermath of Penn Square Bank: Protecting Loan Participants from Set-Offs*, 18 Tulsa L.J. 261 (1982); Note, *supra* note 1, at 116–20; Invenko & Stein, *Penn Square Bank Ruling – Loan Participant's Problems*, N.Y.L.J., Mar. 21, 1983, at 1, col. 3; *see also* Glaberson, *Is Chase Opening the Gates to Negligence Suits by the Boss?*, Bus. Wk., Nov. 5, 1984, at 39 (a discussion of the suit brought by the Chase Manhattan Bank against former senior officers for allegedly violating internal policies in relation to participations purchased from Penn Square Bank).

[8] *See generally* Youngblood, *1980 Survey of International Law in the Second Circuit*, 8 Syracuse J. Int'l Com. 159 (1980–81) (discussion of the Iranian assets litigation); *Iranians to Seek to Settle Loans Owed U.S. Banks*, Wall St. J., Dec. 13, 1982, at 34, col. 2; *The Banks' Squabble Over Iran's Assets*, Bus. Wk., Dec. 3, 1979, at 110.

[9] *See generally Argentine Loan of $1.5 Billion Encounters Snag as U.K. Banks Protest Curbs Over Their Funds*, Wall St. J., Aug. 8, 1983, at 21, col. 1; *Argentina Reaches Repayment Accord with British Banks*, Wall St. J., Nov. 9, 1982, at 40, col. 4.

[10] Szathmary, *supra* note 1, at 76; Tompsett, *supra* note 5, at 32. *See generally*, Wellons, *International Debt: The Behavior of Banks in a Politicized Environment*, 39 Int'l Org. 441, 470 ("In the case of Brazil a major conflict arose over the treatment of interbank deposits placed with Brazilian banks outside Brazil. The conflict split creditors along home-country lines. ... Swiss bank and the Swiss government actively opposed efforts that would have kept them in long-term rescheduling. The French government, having just nationalized many banks, felt too weak at home to oppose smaller French banks that wanted to pull out their interbank loans to Brazil").

[11] *See generally* Wellons, *supra* note 10, 470–71 (1985) ("Home affiliation is important in debt crises. Banks from particular countries group together and act in concert during the workouts: U.S. banks led the Mexican rescheduling (indeed, the Latin American reschedulings), German banks led the Polish rescheduling. Existing exposure does not adequately account for this pattern. If it did, one would expect the banks' role in restructuring to reflect the degree of their exposure").

[12] Ahlberg, *The Status of Note Participations under the Federal Securities Acts*, 8 Harv. J. L. Pub. Pol'y 427, 469 (1985); Szathmary, *supra* note 1, at 78 (there is no legal relationship between the sub-participant and the borrower).

[13] *See* Semkow, *Syndicating and Rescheduling International Financial Transactions: A Survey of the Legal Issues Encountered by Commercial Banks*, 18 Int'l Law. 869, 886 (1984).

[14] *See infra* text accompanying notes 75–86.

[15] *See infra* text accompanying notes 45–74.

[16] R. Johnston, The Economics of the Euro-Market: History, Theory and Policy 16–18 (1982).

[17] *Id.* at 167–68 (LIBOR is the rate at which banks lend to each other in the London Eurocurrency market); Tompsett, *supra* note 5, at 38–39. *See generally*, W. Hogan & I. Pearce, The Incredible Eurodollar (1982); D. Kane, The Eurodollar Market and the Years of Crisis (1982) (general introductions to the Eurodollar market).

[18] *See* Pigott, *The Historical Development of Syndicated Eurocurrency Loan Agreements*, 10 Int'l Bus. Lawyer 200, 201 (1982).

[19] *See* Johnston, *supra* note 16, at 17.

[20] *See* Mortimer, *The Law of Set-Off in New York: General Principles and International Aspects* in Sovereign Lending: Managing Legal Risk 189, 194 (M. Gruson & R. Reisner eds. 1984).

[21] *See* In re Alda Commercial Corp., 327 F. Supp. 1315, 1317 (S.D.N.Y. 1971).

[22] *See* U.C.C. § 9-304 (1977).

[23] *See* Simpson, *Loan Participations: Pitfalls for Participants*, 31 Bus. Law. 1977, 1993 (1976).

[24] *See generally* Armstrong, *The Developing Law of Participation Agreements*, 50 J. Com. Bank Lending 45 (1968); Stahl, *Loan Participations: Lead Insolvency and Participants' Rights (Part I)*, 94 Banking L. J. 882 (1977).

[25] *See, e.g.,* Hibernia Nat'l Bank v. Federal Deposit Ins. Corp., 733 F.2d 1403, 1407 (10th Cir. 1984) ("The 'participants' can look solely to the lead for satisfaction of their claims because they are not themselves creditors of the borrowers and cannot assert creditor claims against the borrowers".); Federal Deposit Ins. Corp. v. Mademoiselle of California, 379 F.2d 660, 665 (9th Cir. 1967) (a sub-participant must be able "to identify a specific fund or payment in the possession of the [lead's] receiver cognizable in equity as [the sub-participant's '] own property"); Chase Manhattan Bank, N.A. v. Federal Deposit Ins. Corp., 554 F. Supp. 251, 256 (W.D. Okla. 1983) ("[T]he participating bank which is not an assignee has merely contractual rights and no property rights in the participated loans or the collateral securing them."); In re Yale Express System, Inc., 245 F. Supp. 790, 792 (S.D.N.Y. 1965) (the sub-participant was not a "creditor entitled to set off the bank account in the amount of $361,739.71 which [the borrower] had with [the sub-participant] at the time of the [borrower's] filing of the petition for reorganization.").

[26] *See* Stratford Fin. Corp. v. Finex Corp., 367 F.2d 569 (2d Cir. 1966).

[27] *See* 4A W. Collier, Collier on Bankruptcy, ¶ 70.32 at 445–46 (1976).

[28] *Compare Stratford*, 367 F.2d at 571 (finding the existence of a trust in a lead/sub-participant arrangement notwithstanding a failure by the lead to segregate payments) *with Alda Commercial Corp.*, 327 F. Supp. at 1318 (rejecting a contention that a trust was created where there had been no segregation of payments received from the borrower).

[29] Transactions involving the creation of consensual security interests in personal property fall within Article 9 of the Uniform Commercial Code (UCC). If the sub-participant lends money to the lead with the intention that this loan be collateralized by the granting of an interest in the obligation of the borrower, this would create a security interest that would have to be perfected against claims of third parties. By its terms, however, Article 9 is inapplicable to an outright *sale* of an instrument (or an interest therein) such as a loan agreement or promissory note except in the case of accounts, contract rights or chattel paper. *See* U.C.C. § 9-102(1)(b) (1977). In the

conventional sub-participation where the underlying loan is not secured, the transfer of an undivided interest in the loan would probably be regarded as a sale of that interest to the sub-participant.

[30] *See* U.C.C. § 3-305(1) (1977) (a holder in due course takes a negotiable instrument free "of all claims to it on the part of any person"). *See generally*, Simpson, *supra* note 23, at 2008–19.

[31] If the lead bank is located in the United States and the sub-participant is not, the lead might also have responsibilities (and potential liabilities) as a "withholding agent" under subsections 1441(a) and (b) or subsection 1442(a) of the U.S. Internal Revenue Code. *See generally* Ryan, *Participations in Loans Under New York Law*, Int'l Fin. L. Rev., Oct. 1984, at 40, 45–46.

[32] *See* Hoffman & Giddy, *Lessons from the Iran Experience: National Currencies as International Money*, 3 J. Comp. Corp. L. & Sec. Reg. 271 (1981).

[33] *See* Hall, *Bank of England Clamp on Argentine Dealings*, Fin. Times, Apr. 14, 1982, at 4, col. 6.

[34] *See generally* Youngblood, *supra* note 8, at 159.

[35] *See, e.g., Mademoiselle of California*, 379 F.2d at 664–66 (depositor's account balance can be set off against the amount of its note to the lead bank, even though the bank had sold an 80% participation interest in the note; the sub-participant was not allowed a preferred claim for 80% of the set-off).

[36] For discussions of a bank's right to set-off, see Practising Law Institute, Lending Transactions and the Bankruptcy Reform Act, 1981, at 213–35 (1981); Clark, *Bank Exercise of Setoff: Avoiding the Pitfalls*, 98 Banking L.J. 196 (1981); TeSelle, *Banker's Right of Setoff – Banker Beware*, 34 Okla. L. Rev. 40 (1981).

[37] *See* Foster, *Loan Participations, Anyone?*, 2 Banking L. Rep. 69, 80 (1985).

[38] *See infra* text accompanying notes 45–86.

[39] *See* Schlifke, *The Basics of Bank Loan Participations*, 66 J. Com. Bank Lending 23, 25–26 (1984).

[40] *See* NBI Mortgage Inv. Corp. v. Chemical Bank, No. 75 Civ. 3411 (S.D.N.Y. Jan. 17, 1978); Westinghouse Credit Corp. v. James Talcott, Inc., 50 N.Y.2d 559, 408 N.E.2d 897, 430 N.Y.S.2d 567 (1980).

[41] *See* American Fletcher Mortgage Co. v. United States Steel Credit Corp., 635 F.2d 1247, 1249–50 (7th Cir. 1980), *cert. denied*, 451 U.S. 911 (1981).

[42] *American Fletcher Mortgage*, 635 F.2d at 1249–53.

[43] *Id.* at 1253.

[44] *Id.*

[45] *See generally* Ahlberg, *supra* note 12; Cookson, *Loan Participation Agreements as Securities: Judicial Interpretations of the Securities Act of 1933 and the Securities Exchange Act of 1934*, 24 Wm. & Mary L. Rev. 295 (1983); Jurman, *Bank Loan Participations as Securities: Notes, Investment Contracts, and the Commercial/Investment Dichotomy*, 14 Duq. L. Rev. 260 (1976–77); Kazon, *Loan Participations Under the Securities Act*, 1 Ann. Rev. Bank Lending 161 (1982); Scholl & Weaver, *Loan Participations: Are They "Securities"?*, 10 Fla. St. U. L. Rev. 261 (1976–77).

[46] For the registration requirements, *see* Securities Act of 1933, § 5, 15 U.S.C. §77 (e) (1982); Securities Exchange Act of 1934, § 12, 15 U.S.C. § 78(1) (1982). Disclosure requirements are in § § 11, 12, 17 and 24, 15 U.S.C. § 77(k), (l), (q), and (x) (1982).

[47] *See* Securities Act of 1933, § 17, 15 U.S.C. § 77(q) (1982); Securities Exchange Act of 1934, § 10, 15 U.S.C. § 78(j) (1982).

[48] *Compare* Commercial Discount Corp. v. Lincoln First Commercial Corp., 445 F. Supp. 1263, 1267 (S.D.N.Y. 1978) (sub-participations are securities) with Provident Nat'l Bank v. Frankford Trust Co., 468 F. Supp. 448, 454 (E.D. Pa. 1979) (sub-participations are not securities). For additional commentary, *see supra* note 53.

[49] 15 U.S.C. § 77(a)–(b)(b)(b) (1982).

[50] 15 U.S.C. § 78(a)–(k)(k) (1982).

[51] Securities Act of 1933, § 2(1), 15 U.S.C. § 77(b)(1) (1982).

[52] Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78(c)(a)(10) (1982).

[53] Tcherepnin v. Knight, 389 U.S. 332, 335 (1967).

[54] Securities Act of 1933, § 2(1), 15 U.S.C. § 77(b)(1) (1982).

[55] *Id.*

[56] *Id.*

[57] *See supra* notes 45, 48.

[58] 409 F.2d 989 (5th Cir. 1969).

[59] *Id.* at 990.

[60] *Id.* at 992.

[61] *Id.*

[62] *See* Kansas State Bank v. Citizens Bank of Windsor, 737 F.2d 1490, 1493 (8th Cir. 1984).

[63] Securities Act of 1933, § 2(1), 15 U.S.C. § 77(b) (1982); Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78(c) (1982).

[64] Courts have looked to a number of factors to distinguish investment from commercial notes, including the manner in which the notes were offered, the lender's reason for taking the notes, and the use to which the borrower put the money. *See, e.g.*, Bellah v. First Nat'l Bank, 495 F.2d 1109, 1113 (5th Cir. 1974) ("The record reveals that in extending the loans, the Bank merely intended to aid the Bellahs in the operation of their livestock business. It is bereft of any evidence indicating that the Bank sought to profit from the successful operation of this enterprise").

[65] *See, e.g.*, Great Western Bank and Trust v. Kotz, 532 F.2d 1252, 1257–58 (9th Cir. 1976) (factors the court looked at in determining whether the loan money was at risk included term of the note, collateralization, circumstances of issuance, relationship between amount borrowed and the size of the borrower's business and contemplated use of the proceeds).

[66] *See, e.g.*, Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126, 1137–38 (2d Cir. 1976); SEC v. Diversified Indus., Inc., 465 F. Supp. 104, 110–11 (D.D.C. 1979) ("the Court feels that the Second Circuit's [literal] approach is most consistent with the language of the statute and Congressional intent and is by far the easiest test to apply"). *But see* Landreth Timber Co. v. Landreth, 105 S.Ct. 2297, 2306 (1985) (declined to look into the "economic realities" of a transaction in holding that stock certificates were "securities" for purposes of federal securities laws. "We here expressly leave until some other day the question whether 'notes' or 'bonds' or some other category of instrument listed in the definition [of a security] might be shown 'by providing [only] the document itself' ").

[67] SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).

[68] *See* Union Planters Nat'l Bank of Memphis v. Commercial Credit Business Loans, Inc., 651 F.2d 1174, 1184–85 (6th Cir.), *cert. denied*, 454 U.S. 1124 (1981) (in a loan sub-participation context, the fixed rate of interest on the loan did not constitute "profits" for purposes of determining the existence of an investment contract; rejected the sub-participant's claim that it was relying on the lead's efforts to manage the loan properly).

[69] *See* NBI Mortgage Inv. Corp. v. Chemical Bank, [1977–1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,066 (S.D.N.Y. May 24, 1977) (existence of sub-participant's right to veto major changes to the underlying loan is not, by itself, sufficient to rebut the claim that the sub-participation agreement was a security).

[70] *See* Securities Act of 1933, § 4, 15 U.S.C. § 77(d) (1982); Securities Exchange Act of 1934, § 12, 15 U.S.C. § 78(1)(g) (1982).

[71] Securities Act of 1933, § 4(2), 15 U.S.C. § 77(d)(2) (1982).

[72] The SEC itself appears to regard the private placement exemption as the traditional "exemption from registration for bank loans, and private placements of securities ..." SEC Sec. Act Rel. No. 4552, Announcement of Statement Regarding Availability of Non-Public Offering Exemption from Registration Statements (Nov. 6, 1962). The implication of this statement, however, is that bank loans qualify as securities whose sale without registration requires an exemption.

[73] Interestingly, in 1959 the SEC proposed a new rule that would interpret the phrase "transactions by an issuer not involving a public offering" to include "the offering and sale to corporate or institutional investors of participations in loans held by the International Bank for Reconstruction and Development where the participations are arranged separately with each such investor and the investor buys for investment and not with a view to distribution". SEC Sec. Act Rel. No. 4028, Proposed Rule Relating to Certain Transactions by the International Bank for Reconstruction and Development, (Feb. 10, 1959). The proposed rule was subsequently withdrawn because the SEC determined that "it has become clear that there is no present need for the suggested rule". SEC Sec. Act Rel. No. 4161, Proposed Rule 144 Withdrawn (Nov. 30, 1959).

[74] *See* Securities Act of 1933, §§ 11, 12, 17, 15 U.S.C. §§ 77(k), (l), (q) (1982); Securities Exchange Act of 1934, §§ 18, 20, 15 U.S.C. § 78(r), (t) (1982).

[75] *See* Carondelet Sav. & Loan Ass'n. v. Citizens Sav. & Loan Ass'n., 604 F. 2d 464 (7th Cir. 1979).

[76] Manchester Bank v. Connecticut Bank & Trust Co., 497 F. Supp. 1304 (D.N.H. 1980).

[77] *Id.*

[78] *Id.*

[79] *Carondelet*, 604 F.2d at 464.

[80] *See* Kansas State Bank v. Citizens Bank of Windsor, 737 F.2d 1490 (8th Cir. 1984).

[81] *See* Ryan, *The Colocotronis Case: Considerations for Multibank Lenders*, 60 J. Com. Bank Lending 54 (1978); Note, *The Colocotronis Dispute: When is a Loan Participation Share a Security*? 13 J. Int'l Law & Econ. 165 (1978).

[82] *See* Note, *supra* note 81, at 167.

[83] *Id.*

[84] *Id.* at 168.

[85] *Id.*

[86] *Id.* at 168–69.

[87] *See, e.g., Manchester Bank*, 497 F. Supp. at 1314–15.

[88] [1977–1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,066 (S.D.N.Y. May 24, 1977).

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *See* Fisher & Muratif, *supra* note 7; Invenko & Stein, *supra* note 7.

[93] *See* Guttentag & Herring, *What Happens When Countries Cannot Pay Their Bank Loans? The Renegotiation Process*, 5 J. Comp. Bus. & Cap. Market L. 209 (1983); Tapia, *Mexico's Debt Restructuring: The Evolving Solution*, 23 Colum. J. Transnat'l Law 1 (1984); *see also* Wellons, *supra* note 10.

[94] Banking Circular 181, Loan Participation by National Banks – OCC Policy Guidelines (Dec. 8, 1983). This circular was revised and reissued, see 5 Fed. Banking L. Rep. (CCH) ¶ 60,799 (Aug. 2, 1984).

[95] *Id.* at 38,859-2.

[96] *Id.*

[97] *Id.*

[98] *Id.* at 38,859-2 to -3.

[99] *Id.* at 38,859-3.

[100] Guttentag & Herring, *supra* note 93, at 208, 213.

[101] *Id.*

[102] Tompsett, *supra* note 5, at 32.

[103] Fisher & Muratif, *supra* note 7, at 267.

[104] *See* Tompsett, *supra* note 5, at 32.

[105] Complaint No. 83-CV-3227-DT (E.D. Mich. filed Aug. 5, 1983) (on file at the office of the J. of Comp. Bus. & Cap. Mkt. L.) [hereinafter cited as Complaint]. *See also Michigan Bank Sues Continental Illinois on Penn Square Loans*, Wall St. J., Nov. 16, 1982, at 2, col. 2.

[106] Complaint, *supra* note 105, at 3–4.
[107] *Id.* at 5.
[108] *Id.* at 5–6.
[109] *Id.* at 6.
[110] *Id.* at 9–12.
[111] *See generally* Note, *supra* note 1.
[112] *See* Clark & Hughes, *Approaches to the Restructuring of Sovereign Debt* in Sovereign Lending: Managing Legal Risk 131, 135-36 (M. Grusen & R. Reisner eds. 1984).
[113] *See* Horn, *The Restructuring of International Loans*, 12 Int'l Bus. Law. 400 (1984).
[114] *See* Hughes & Palache, *Loan Participation – Some English Law Considerations*, Int'l Fin. L. Rev., Nov. 1984, at 21, 26.
[115] The new money component of a restructuring package typically involves the borrower country asking each of its commercial bank creditors to commit a specified percentage of their outstanding loans in the country as of a target date as part of a syndicated new money facility. This technique was used by Mexico in its 1983 restructuring and subsequently adopted by many other countries undergoing debt renegotiations.
[116] *See generally* Isaacson & Golden, *Summary of Proceedings International Faculty Seminar on Corporate and Capital Market Law*, 7 J. Comp. Bus. & Cap. Mkt. L. 1, 12–14 (1985).
[117] Tompsett, *supra* note 5, at 32.
[118] Sandler, *The Great Debate Over LDC Loan Swapping*, Institutional Investor, May 1984, at 263, 265.
[119] *Id.* at 264.
[120] *See* Hutchins, *supra* note 1, at 449, n. 12; *see also* Note, *supra* note 1, at 1121.
[121] *See* Hutchins, *supra* note 1, at 448, n. 11.
[122] *Id.* at 449; *see also* Note, *supra* note 1, at 1121 ("loan participations enable the lead bank to share the risk of loan default with other institutions").
[123] *See, e.g.*, Sandler, *supra* note 118, at 263; Gilpin, *How Banks Share Borrowers*, N.Y. Times, Aug. 26, 1984, § 3, at 7, col. 1.
[124] *See* Greene & Coles, *What is a Security*, Int'l Fin. L. Rev., Nov. 1984, at 17, 21 ("Loan participations will probably be seen along a spectrum and if sold like short-term notes to purchasers other than banks, they will probably be held to be securities").
[125] *See* Grant, *How Banks Revamp Assets*, Euromoney, April 1984, at 66, 69.
[126] Glass–Steagall Act of 1933, 12 U.S.C. § 378 (1982).
[127] *See generally* Ianni, *"Security" Under the Glass–Steagall Act and the Federal Securities Acts of 1933 and 1934: The Direction of the Supreme Court Analysis*, 100 Banking L.J. 100 (1983) (examines the history of the Glass–Steagall Act and the judicial response); Note, *"Security" Under the Glass–Steagall Act: Analyzing the Framework for Determining Permissible Bank Activity*, 70 Cornell L. Rev. 1194 (1985) (discusses when commercial paper should be considered a security for purposes of the Act). Moreover, it is not clear that exemptions – such as the private placement exemption – from the registration requirements of the securities laws would also be available in the context of Glass–Steagall Act restrictions. *See* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., No. 80-2730 (D.D.C. Feb. 4, 1985).