An Expert's View

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Janet is a senior corporate finance partner specializing in debt and private equity, and she serves on both the firm's Finance Committee and Compensation Committee. Her lending experience includes representation of both borrowers and lenders with respect to secured and unsecured lending transactions, loan syndications, fund financings, senior and subordinated debt financings, first lien/second lien deals, mezzanine loans and other banking and credit matters.

Janet examines issues around OFAC and anti-money laundering representations and describes factors that may affect middle market deal activity in the second half of the year:

What are the most common borrower and lender concerns about the inclusion in acquisition financing commitment letters of representations relating to Office of Foreign Assets Control (OFAC) and anti-money laundering statutes in the specified representations?

Lenders are increasingly requesting representations with respect to sanctions laws (including OFAC), PATRIOT Act, anti-money laundering and anti-bribery statutes due to concerns that violations of these laws might:

- Result in related violations and liabilities of the lenders.
- Damage the quality of the credit and value of the borrower.
- Result in highly damaging reputational issues for the lenders.

Including these representations in the narrow list of "specified representations" (which allows lenders to refuse to fund at closing regardless of the provisions of the relevant purchase agreement) creates a real risk for borrowers in acquisition financings that they may be required to fund under a purchase agreement and yet not be able to force funding by the debt sources.

Techniques by borrowers to reduce this risk include:

- Narrowing the list of relevant laws to named statutes in specified jurisdictions (for example, referring to the "UK Bribery Act" rather than "anti-corruption laws").
- Negotiating limits on the scope of required compliance, applying only to violations resulting from entering into the debt documents and the use of proceeds of the loan.
- Including the concept of "materiality" (if the lenders will not accept a standard of "material adverse effect," which often they will not).
- Increasing protections from the seller side, by adding corresponding representations to be made by the seller or target in the purchase agreement and/or conducting due diligence on the target.

Lenders, for their part to reduce risk, should "follow the money" and spend the time to understand the jurisdictions where the companies are doing business, including by reviewing vendor and supply arrangements, inquire about company policies and records and obtain representations that are relevant and tailored to the business of the company rather than relying only on form documents.

What factors do you see potentially affecting the level of deal activity in the middle market in the second half of 2014?

Looking ahead to the future is always exciting. We have seen throughout history that macro events can impact stability of US and global economies and dramatically affect the availability of liquidity, which is a huge driver of deal flow. Absent such events, this low interest rate environment, record high levels of capital raised by private equity firms and strong demand for yield by debt investors all contribute to a sense that deal activity will remain robust in the second half of 2014.

However, there are limits. Current sky high enterprise valuations will deter some players in the market and will favor strategic buyers (with their rich opportunities for synergies) over financial buyers. Also, the leveraged lending guidance issued by the Federal Reserve, the Federal Deposit Insurance Corporation and Comptroller of the Currency in 2013 is having an increasing impact on the market this year and reducing the availability of some higher leverage loans.

Previously, lenders were routinely doing deals above the limits set forth in the guidance, but in the face of recent statements by the Federal Reserve, lenders are becoming more conservative. As a result, we would expect larger equity checks and capital structures designed not to be subject to the guidance. Overall, however, the future looks busy, which is good news.

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