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FINANCE AND CAPITAL MARKETS

Market Update

GENERAL TRENDS

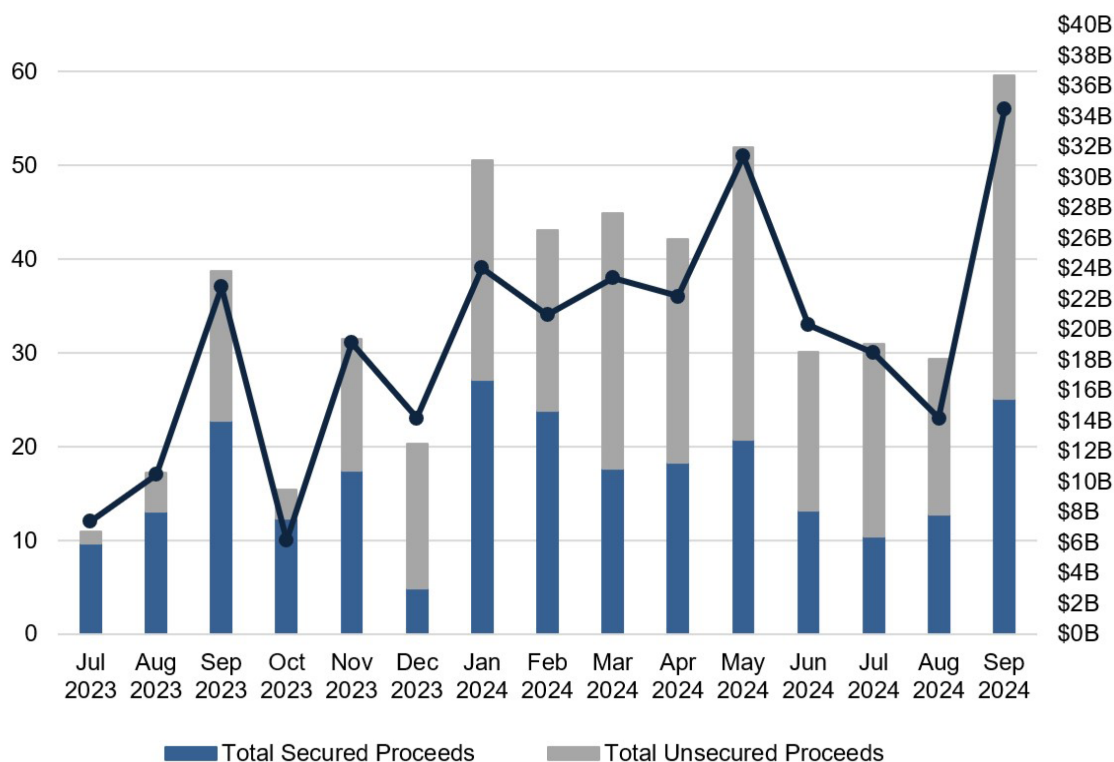
U.S. financing activity in the third quarter of 2024 was generally in line with overall activity during the second quarter of 2024 and remained considerably elevated from activity during the third quarter of 2023. Activity in the U.S. investment-grade bond market increased relative to the second quarter of 2024 and the third quarter of 2023. Activity in the U.S. high-yield bond market declined slightly relative to the second quarter of 2024, but was significantly higher than the third quarter of 2023. Activity in the total U.S. syndicated leveraged loan market decreased in the third quarter of 2024 as compared to the second quarter of 2024 and increased as compared to the third quarter of 2023, while activity in the leveraged buyout ("LBO") market increased as compared to the second quarter of 2024 and the third quarter of 2023. The number of and total proceeds from U.S. follow-on equity offerings in the third quarter of 2024 increased significantly relative to both the second quarter of 2024 and the third quarter of 2023. U.S. IPO activity in the first quarter of 2024 decreased modestly as compared to the second quarter of 2024 but increased as compared to the third quarter of 2023.

BONDS

U.S. High-Yield Bonds

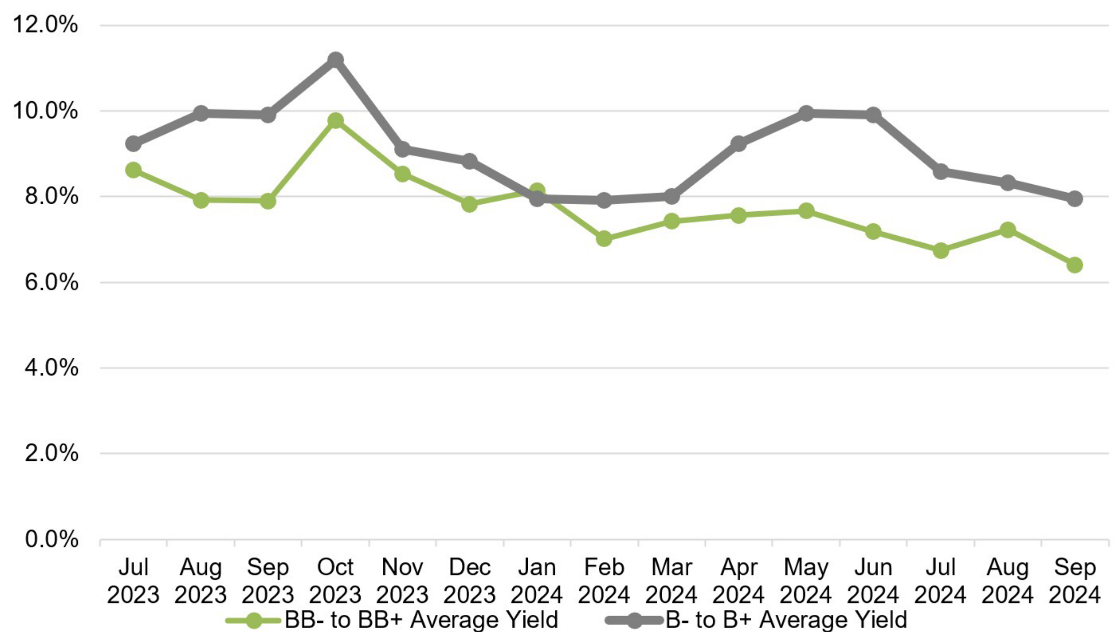
Total proceeds from U.S. high-yield bond issuances were $73.8B in the third quarter of 2024, down 3.5% as compared to the second quarter of 2024 ($76.4B) and up 79.4% as compared to the third quarter of 2023 ($41.1B).

Total proceeds from unsecured high-yield bond issuances were $44.1B in the third quarter of 2024, consistent with $44.3B in the second quarter of 2024 and up 235.5% as compared to $13.2B in the third quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

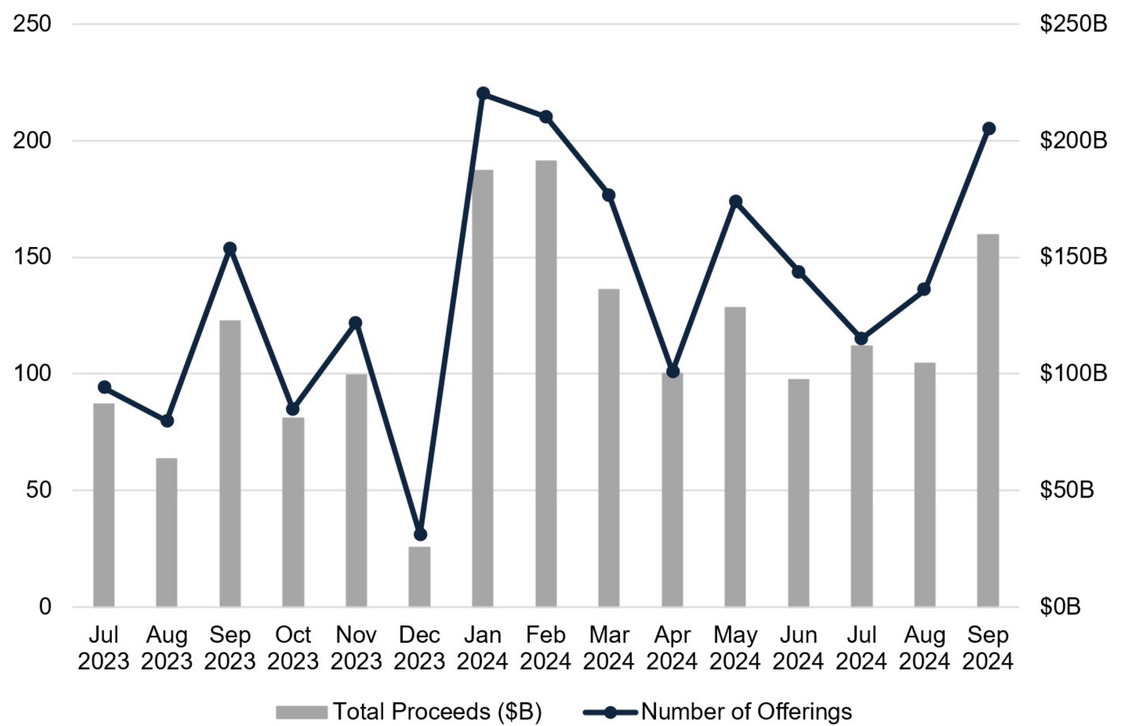
The average initial yield on high-yield notes rated BB- to BB+ issued in the third quarter of 2024 was 6.8%, as compared to 7.5% in the second quarter of 2024 and 8.1% in the third quarter of 2023. The average initial yield on high-yield notes rated B- to B+ issued in the third quarter of 2024 was 8.3%, as compared to 9.7% in both the second quarter of 2024 and the third quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

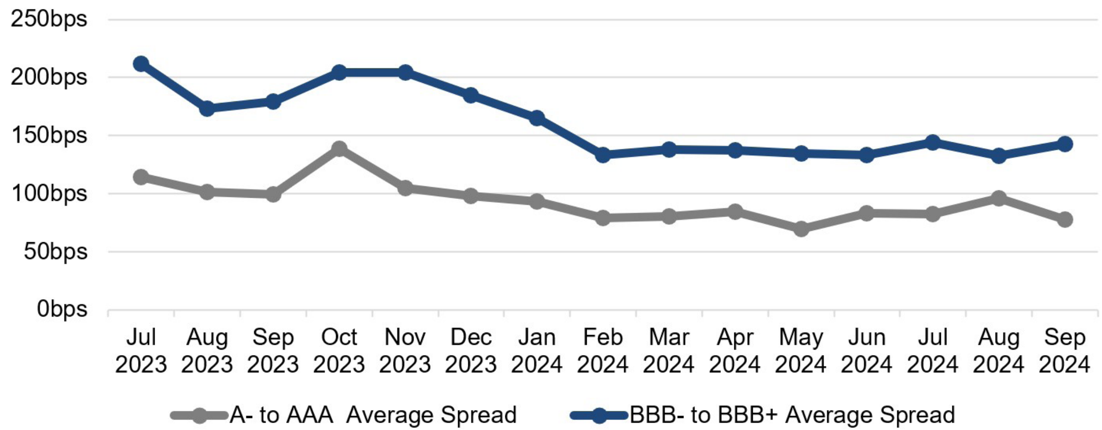
U.S. Investment-Grade Bonds

Total proceeds from U.S. investment-grade issuances were $375.7B in the third quarter of 2024, up 15.2% from $326.1B in the second quarter of 2024 and up 37.5% from $273.3B in the third quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated A- to AAA in the third quarter of 2024 increased 7.4% as compared to the average pricing spread for the second quarter of 2024 and decreased 18.9% as compared to the average pricing spread for the third quarter of 2023. The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated BBB- to BBB+ in the third quarter of 2024 increased 3.4% as compared to the average pricing spread for the second quarter of 2024 and decreased 25.9% as compared to the average pricing spread for the third quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Treasury 7-year and 10-year Yields

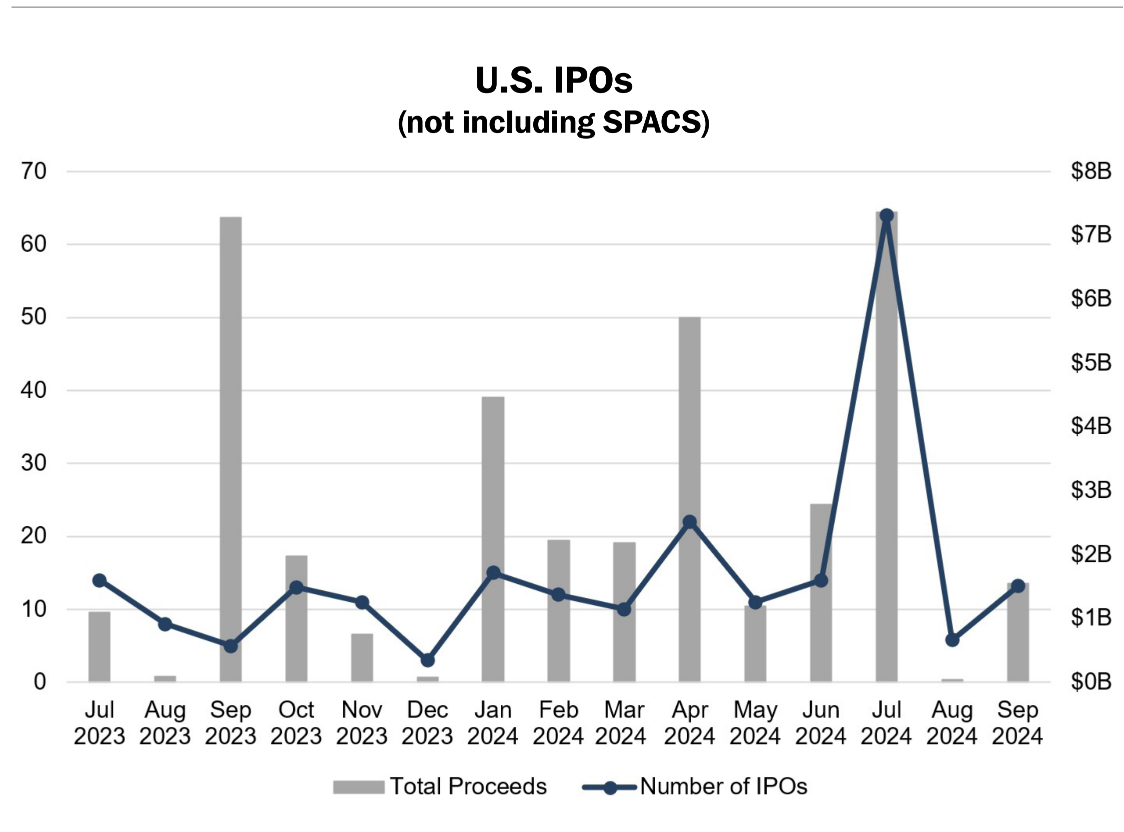
In the third quarter of 2024, the Federal Reserve made its first interest rate cut since March 2020, cutting the target federal funds rate 50 bps to the 4.75%–5% range. U.S. Treasury 7-year yields decreased 66 bps to 3.67% at the end of the third quarter of 2024, down 15.2% as compared to 4.33% at the end of the second quarter of 2024. U.S. Treasury 10-year yields decreased 55 bps to 3.81% at the end of the third quarter of 2024, down 12.61% as compared to 4.36% at the end of the second quarter of 2024.

DATA SOURCE U.S. Department of the Treasury

EQUITY

U.S. IPOs

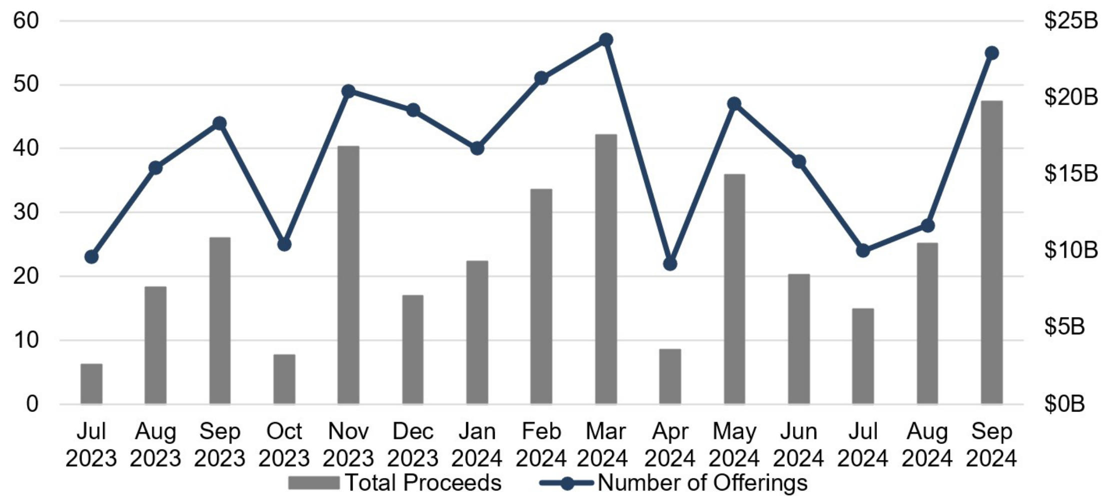
The U.S. IPO market in the third quarter of 2024 experienced a slight decrease in activity since the second quarter of 2024. The $8.9B in total proceeds from U.S. IPOs (not including SPACs) in the third quarter of 2024 was down 7.6% as compared to $9.7B in total proceeds in the second quarter of 2024 and up 5.7% as compared to $8.5B in total proceeds in the third quarter of 2023.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Follow-On Offerings

The $36.5B in total proceeds from U.S. follow-on equity offerings in the third quarter of 2024 was up 35.5% as compared to $26.9B in total proceeds in the second quarter of 2024 and up 73.5% as compared to $21.0B in total proceeds in the third quarter of 2023.

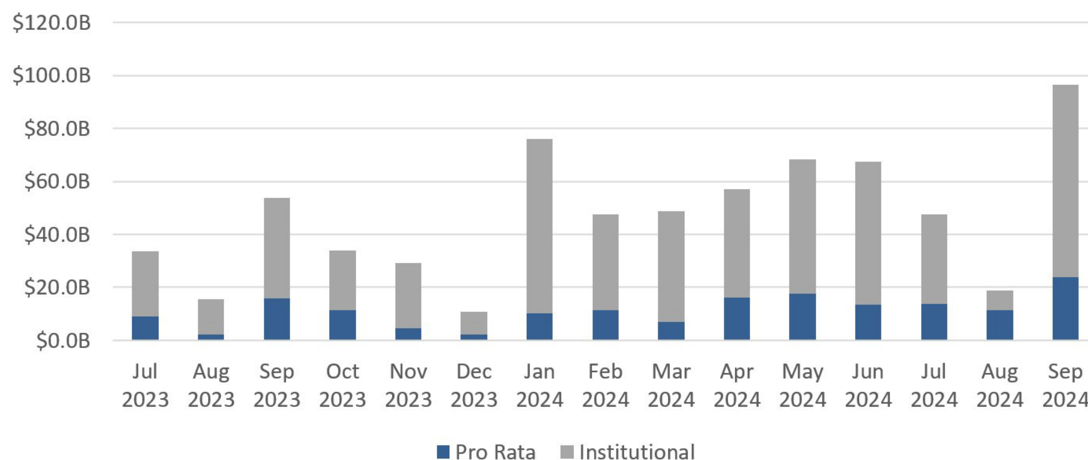


DATA SOURCE Refinitiv, an LSEG Business

U.S. Syndicated Leveraged Loan Issuances

Activity in the U.S. syndicated leveraged loan market decreased in the third quarter of 2024, with total volume of $163.0B, down 15% as compared to the second quarter of 2024 ($192.6B). The decrease came from institutional loan volume, which decreased by 22% as compared to the previous quarter, whereas pro rata loan volume increased by 5% as compared to the previous quarter. Despite the decrease in deal volume as compared to the previous quarter, September saw the highest total deal volume year to date ($96.5B).

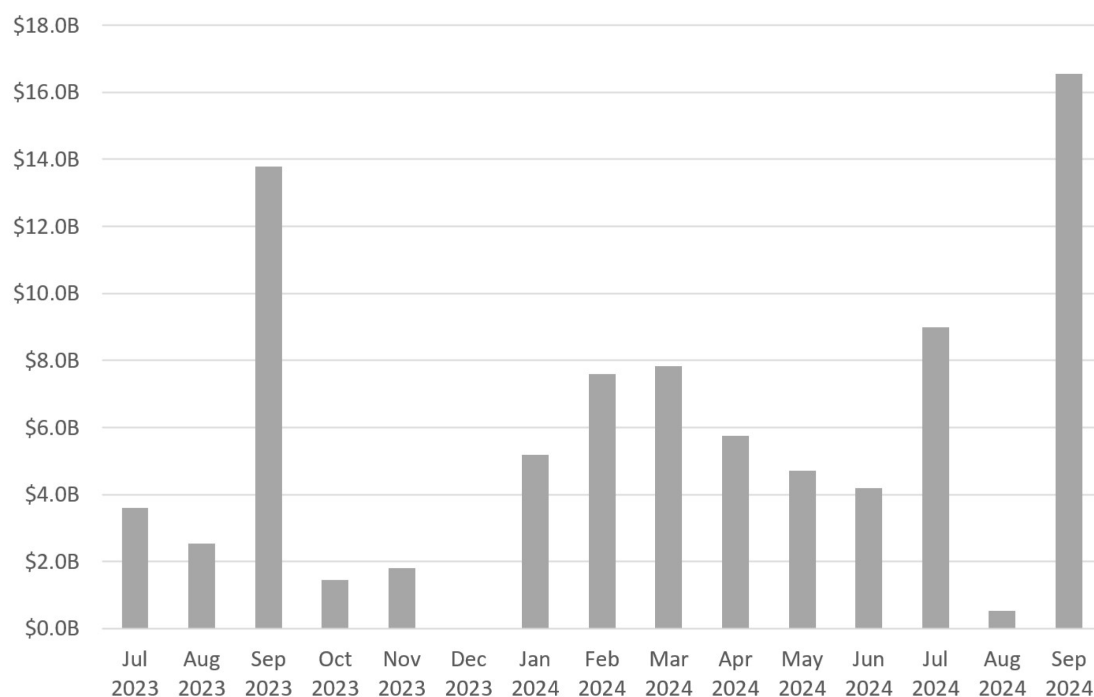
Total deal volume in the third quarter was stronger than last year, with an increase in total deal volume of 58% as compared to the third quarter of 2024 ($102.9B), driven by both institutional loan volume, which was $113.6B in the third quarter of 2024, up 50% as compared to the third quarter of 2023 ($75.8B), and pro rata loan volume, which was $49.4B in the third quarter of 2024, up 82% as compared to the third quarter of 2023 ($27.1B).



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Syndicated LBO Loan Volume

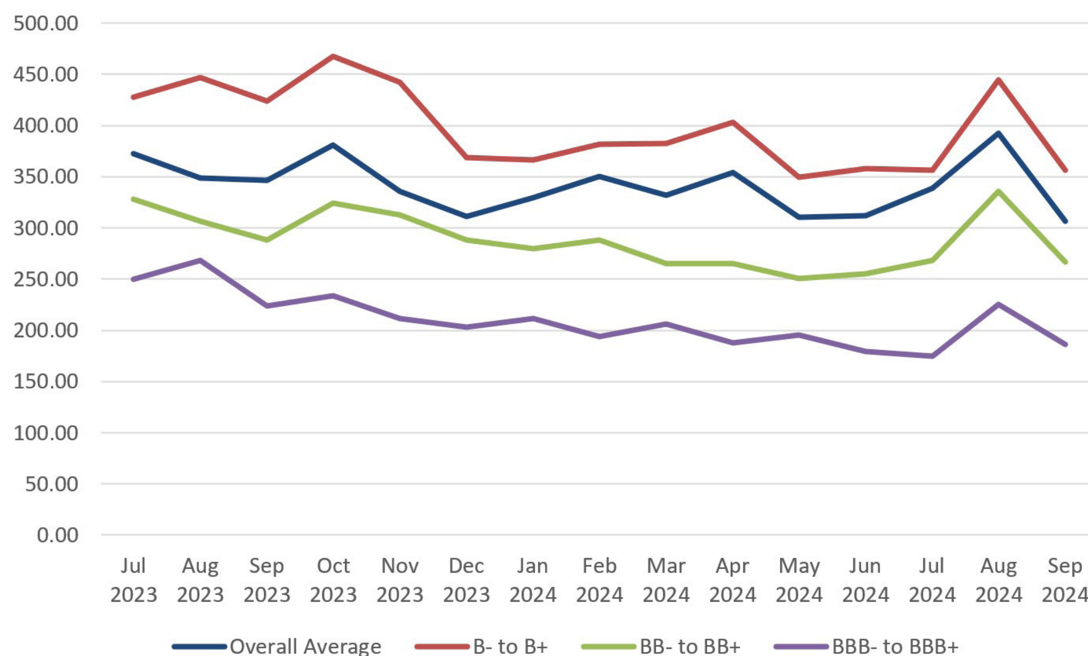
In the third quarter of 2024, there were $26.1B of U.S. syndicated LBO loans issued, which was an increase of 78% as compared to $14.7B in the second quarter of 2024 and an increase of 31% as compared to $19.9B in the third quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

Primary Market Syndicated Institutional First-Lien Loan Spreads

Average spreads over benchmark rates on syndicated first-lien institutional loans for large corporate leveraged loan transactions were 346 bps in the third quarter of 2024, which is higher than the 341 bps average spread in the trailing 12-month period. Specifically, average spreads over benchmark rates on syndicated first-lien institutional loans to borrowers rated (a) B- to B+ were 386 bps in the third quarter of 2024, which is lower than the 402 bps average spread in the trailing 12-month period, (b) BB- to BB+ were 290 bps in the third quarter of 2024, which is slightly higher than the 288 bps average spread in the trailing 12-month period, and (c) BBB- to BBB+ were 195 bps in the third quarter of 2024, which is lower than the 211 bps average spread in the trailing 12-month period.

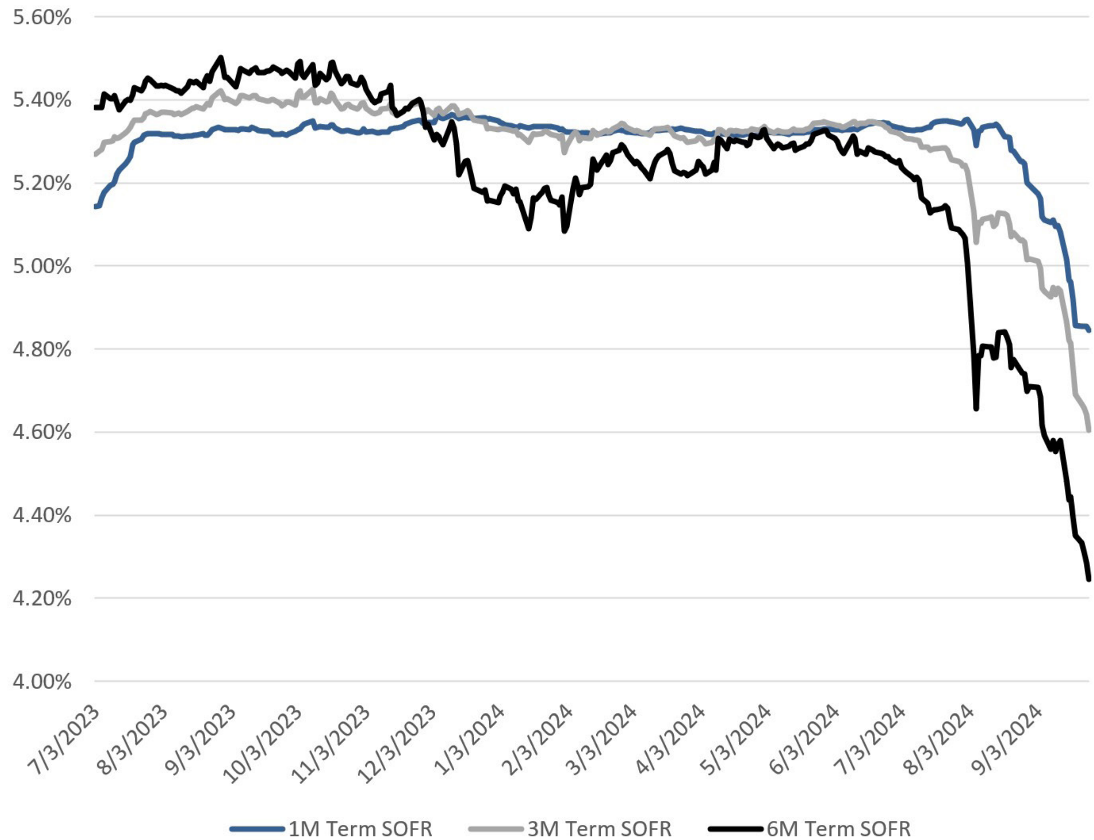


Note: Large corporate borrowers are defined as borrowers with an annual EBITDA of at least $50mm. Average spreads are dollar-weighted based on reported spreads, and do not reflect credit spread adjustments.

DATA SOURCE Leveraged Commentary & Data (LCD)

Term SOFR Reference Rate

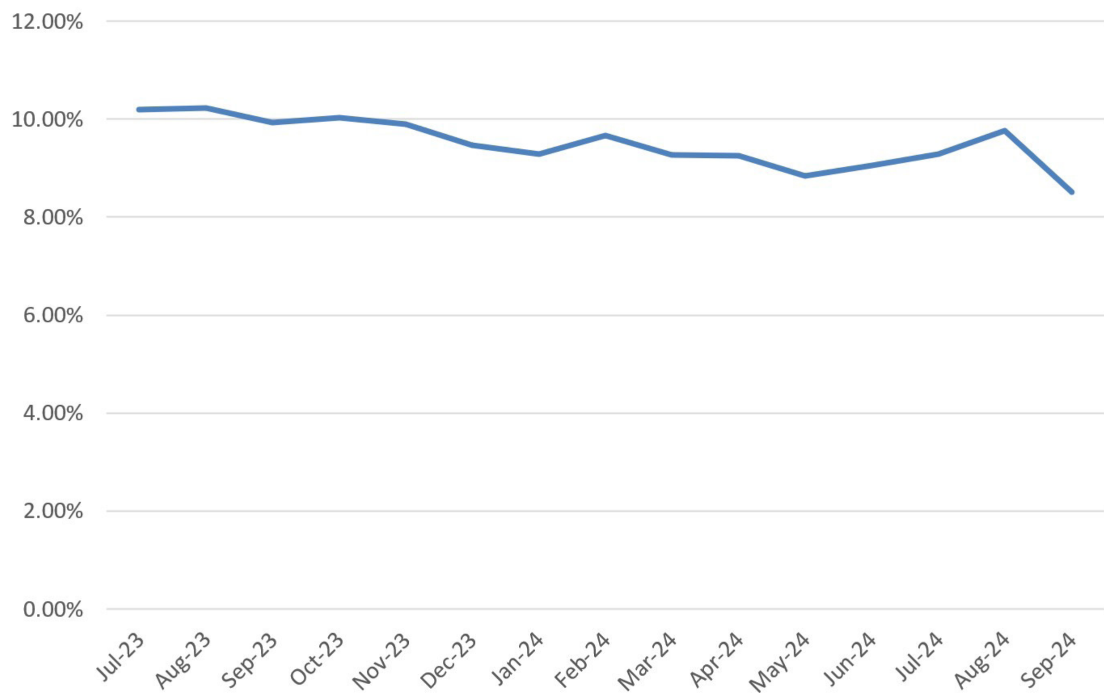
Term SOFR ended the third quarter of 2024 at 5.35%, 5.32% and 5.25% for the one-month, three-month and six-month tenors, respectively. Term SOFR for the one-month tenor was flat as compared to the end of the second quarter of 2024, while Term SOFR for the three-month and six-month tenors decreased by 3 bps and 8 bps, respectively, as compared to the end of the second quarter of 2024. The yield curve inversion that began on November 30, 2023 persisted throughout the third quarter of 2024 and was more pronounced than in the second quarter of 2024. During the quarter, Term SOFR for the six-month tenor was on average 26 bps lower than the three-month tenor and 40 bps lower than the one-month tenor, as compared to 4 bps lower than the three-month tenor and the one-month tenor in the second quarter of 2024.



DATA SOURCE Bloomberg Finance L.P.

Primary Market Syndicated Institutional First-Lien Loan Yields

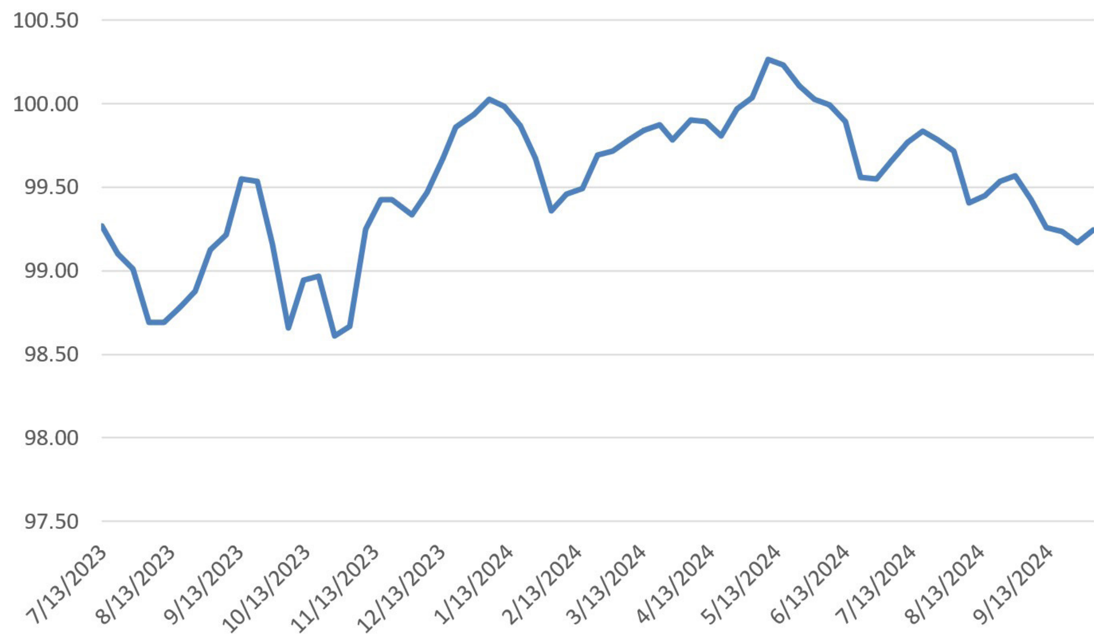
Yields on new-issue syndicated institutional first-lien term loans, inclusive of original issue discount, increased in the third quarter of 2024. The average yield of 9.19% in the third quarter of 2024 represented an increase of 14 bps as compared to the average yield of 9.09% in the second quarter of 2024 and a decrease of 22 bps as compared to the average yield of 9.41% in the first quarter of 2024.



DATA SOURCE Leveraged Commentary & Data (LCD)

Secondary Market Pricing

The average bid price of the LCD Flow Name Index as of the end of the third quarter of 2024 decreased by 42 bps as compared to the end of the second quarter of 2024 and decreased by 21 bps as compared to the end of the first quarter of 2024.



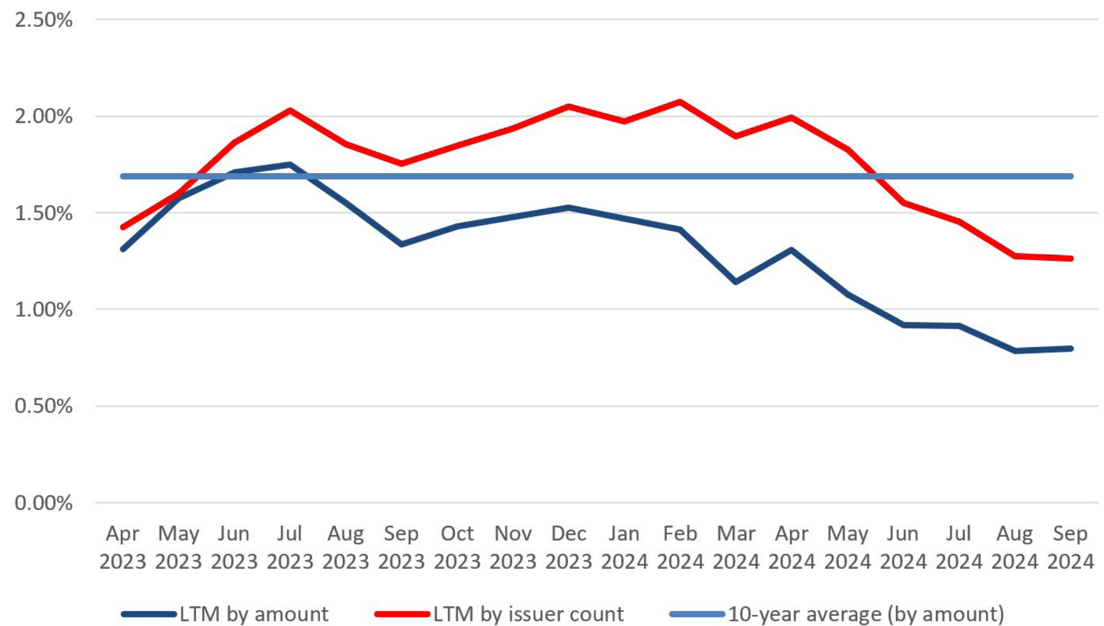
DATA SOURCE Leveraged Commentary & Data (LCD)[1]

1 The LCD Flow Name Index is a composite index of 15 institutional borrower names published on a twice-weekly basis by Leveraged Commentary & Data (LCD).

RESTRUCTURING

U.S. Leveraged Loan Default Rate

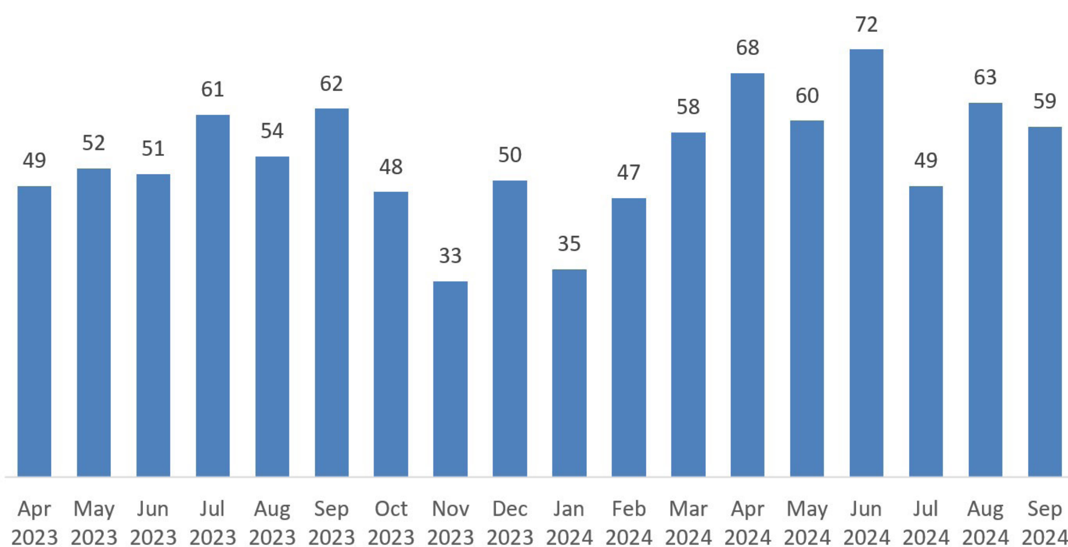
The default rate for U.S. leveraged loans fell throughout the third quarter of 2024. The default rate of the Morningstar LSTA U.S. Leveraged Loan Index was 0.80% by amount and 1.26% by issuer count for the LTM period ending September 30, 2024, compared to 0.92% by amount and 1.55% by issuer count for the LTM period ending June 30, 2024. The default rate by amount remained below the 10-year average default rate.



DATA SOURCE PitchBook | Leveraged Commentary & Data (LCD); Morningstar LSTA U.S. Leveraged Loan Index

U.S. Bankruptcy Filings

U.S. bankruptcy filings decreased slightly in the third quarter of 2024, with a total of 59 bankruptcy filings in September 2024, compared to 49 and 63 in July and August, respectively. Consumer discretionary, industrials and healthcare have continued to set the pace for bankruptcies in 2024, with 81 consumer discretionary bankruptcy filings through the first three quarters of 2024, compared to 60 bankruptcies in the industrials sector and 48 in healthcare.



Note: Bankruptcy filing data limited to public companies or private companies with public debt where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to $2 million, or private companies where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to $10 million.

DATA SOURCE S&P Global Market Intelligence

Regulatory Updates and Litigation Developments

Eighth Circuit To Hear Litigation on Climate Disclosure Rules

As previously discussed in the Q1 2024 edition of this newsletter, the Securities and Exchange Commission (the "SEC") adopted climate-related disclosure rules for public companies (the "Climate Rules") on March 6, 2024. Since then, several lawsuits have been filed challenging the Climate Rules. These lawsuits have been consolidated in the U.S. Court of Appeals for the Eighth Circuit, and the SEC has stayed the implementation of the Climate Rules pending the Eighth Circuit's review.

The Climate Rules are being challenged on the following grounds: (1) the SEC lacks the statutory authority to enact the Climate Rules; (2) the Climate Rules did not meet the procedural requirements of the Administrative Procedure Act (the "APA"), and the SEC acted unreasonably in adopting the rules and failed to properly assess the rules' economic impact; and (3) the Climate Rules violate the First Amendment by requiring disclosure on matters of political debate.

On August 5, 2024, the SEC filed its consolidated response brief. The SEC argued it has longstanding statutory authority delegated to it by Congress, under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"), to require disclosures that are necessary or appropriate in the public interest or for the protection of investors. The Climate Rules, they argued, are necessary to protect investors because of the risks climate related issues can pose to an issuer's business and because existing rules result in disclosures that are inconsistent and difficult to compare, thus requiring investors to expend time and money to assess risks based on these disclosures. Second, the SEC emphasized that the Climate Rules meet the requirements of the APA, as they underwent a significant notice and comment process and were modified in response to such comments to make disclosures more relevant to investors and less burdensome for companies. The SEC also emphasized that during the course of establishing the Climate Rules, they weighed the benefits and costs of implementation and found that the compliance burdens on companies were justified by the benefits of more reliable, consistent and comparable information for investors.
Finally, the SEC argued that the Climate Rules are consistent with the First Amendment. The SEC claimed the Climate Rules only require factual disclosures and pointed to Supreme Court cases where the Court has repeatedly upheld laws related to commercial speech when the required disclosures are "factual and uncontroversial information" and the regulations are "reasonably related to a legitimate government interest" without being unduly burdensome on protected expression.

In their reply brief on September 17, 2024, petitioners asserted that, through the Climate Rules, the SEC acts beyond its scope under the major questions doctrine (the "Major Questions Doctrine"), which restricts agencies from deciding questions of major economic and political significance unless Congress explicitly grants them the statutory authority to do so. Specifically, petitioners argue that the SEC asserts control over the major question of climate change without proper congressional authorization. They further argue that the SEC is imposing a fundamentally different disclosure scheme than those seen before, including by requiring disclosure of environmental information that is not material. Petitioners claim that even if the SEC had the authority to issue the Climate Rules, the rules are arbitrary and capricious because the SEC lacks a reasoned explanation for the major shift in its practice and the requirement of significantly more expansive climate disclosure. Petitioners call for the rule to be vacated.

The Eighth Circuit is expected to hold arguments for the consolidated litigation in the coming months with a court decision expected in June of 2026.

Dismissal of Multiple Claims, Including Internal Accounting Controls Claims, in SolarWinds Litigation

On July 18, 2024, the U.S. District Court for the Southern District of New York granted in part SolarWinds' motion to dismiss, dismissing most of the SEC's claims against SolarWinds and its former Chief Information Security Officer ("CISO"), Timothy Brown. The SEC initially filed suit against SolarWinds and its CISO in October 2023 after the highly public compromise of SolarWinds' software by the Russian Foreign Intelligence Service, which was publicly disclosed by SolarWinds in December 2020.

The Court dismissed the SEC's securities fraud claims based on (i) statements made by SolarWinds and the CISO in press releases, blog posts and podcasts, holding the statements were non-actionable corporate puffery; (ii) SolarWinds' Form S-1 cybersecurity risk disclosure (incorporated by reference into other pre-incident public filings), holding the risk disclosure "was sufficient to alert the investing public of the types and nature of the cybersecurity risks SolarWinds faced and the grave consequences" of such risks, and that based on the information known at the time SolarWinds was not required to update its risk disclosure after certain pre-December 2020 incidents had occurred; and (iii) SolarWinds' Form 8-K disclosures of the December 2020 incident, holding the disclosures "captured the big picture"—the severity of the attack—and were not materially false or misleading for not referencing prior incidents.

The Court also dismissed the SEC's (i) internal accounting controls claims under the Exchange Act, holding "cybersecurity controls are outside the scope of Section 13(b)(2)(B)", and that the "text of the statute strongly supports that the term 'system of internal accounting controls' . . . refers to a company's financial accounting"; and (ii) disclosure controls and procedures claims, holding SolarWinds had a system of controls for disclosure of cybersecurity risks and incidents and that the SEC had not adequately pled that the disclosure controls and procedures had systemic deficiencies or resulted in a failure to properly disclose prior incidents and vulnerabilities.

The only claims allowed to proceed were the SEC's securities fraud claims based on SolarWinds's website security statement. The Court held that the website security statement contained misleading representations as to the company's access controls and password protection policies, that such representations were material given the centrality of cybersecurity to the company's products and customers and that scienter (intent or knowledge of wrongdoing) was adequately pleaded. Given this holding, the Court concluded it was unnecessary to resolve on the pleadings whether three other aspects of the website security statement (compliance with the National Institute of Standards and Technology Cybersecurity Framework, network monitoring and compliance with the secure development lifecycle) were also misleading.

This ruling represents a potentially significant setback for the SEC's ability to exert direct oversight over cybersecurity practices. Notably, however, the SEC's July 2023 cybersecurity rules were not at issue in this case and provide an alternate avenue for the SEC to exert oversight in this space.

Restructuring Updates

Claims for Unmatured Interest: Wells Fargo Bank N.A. v. Hertz Corp.

On September 10, 2024, in the case of *Wells Fargo Bank N.A. v. Hertz Corp.*, the United States Court of Appeals for the Third Circuit held in an opinion by Judge Thomas L. Ambro that (i) solvent debtors must pay post-petition interest to unsecured creditors at the contract rate as opposed to the lower federal judgment rate and (ii) make-whole premiums owed under non-bankruptcy law constitute unmatured interest that is disallowed under Section 502(b)(2) of the Bankruptcy Code, but that nonetheless must be paid in full by a solvent debtor before making a distribution to equity.

In May 2020, Hertz Corporation and certain of its affiliates (collectively, "Hertz") filed chapter 11 bankruptcy petitions in the Bankruptcy Court for the District of Delaware. As the economy recovered from the pandemic, Hertz emerged from bankruptcy in June 2021, confirming a chapter 11 plan of reorganization, which called for paying off Hertz's pre-petition bonds in full and provided a recovery for equity.

Although the plan purported to leave all of its creditors unimpaired, it called for the post-petition interest to be paid at the federal judgment rate and did not call for payment of the make-whole premiums, which would have been payable outside of bankruptcy in the event of early repayment. Combined, the make-whole fees and the contract interest rate would have netted the noteholders an additional $270 million.

As unimpaired creditors, the noteholders could not vote on the plan, but as part of the plan they retained their right to litigate the pecuniary loss that resulted from not receiving payment for the make-whole fees and interest accruing post-petition at the contract rate. Thus, in July 2021, the noteholders filed a complaint against the reorganized Hertz, seeking payment of the make-whole fees and post-petition interest at the contract rate. The bankruptcy court dismissed the noteholder's claims, finding the federal judgment rate appropriate and the make-whole fees disallowed as unmatured interest under Section 502(b)(2) of the Bankruptcy Code. The Bankruptcy Court then certified its decision for direct appeal to the Third Circuit.

Writing for Third Circuit panel, Judge Ambro addressed two separate issues: (1) whether the make-whole fees should be disallowed as claims for "unmatured interest" under Section 502(b)(2) of the Bankruptcy Code and (2) whether Hertz, as a solvent debtor, was obligated to pay its unimpaired creditors post-petition interest at the contract rate or the federal judgment rate.

On the first issue, Judge Ambro found make-whole fees to constitute unmatured interest, both by definition and as its economic equivalent, as fees lenders bargain for in exchange for the debtor's right to use the principal. Accordingly, claims for make-whole fees against insolvent debtors are disallowed as claims for unmatured interest under Section 502(b)(2) of the Bankruptcy Code.

On the second issue, Judge Ambro held that the solvent debtors must pay unimpaired creditors post-petition interest at the contract rate, citing the absolute priority rule. According to the absolute priority rule, creditors must be paid in full before equity holders can receive any payment. Thus, notwithstanding disallowance of their claims for unmatured interest, the Third Circuit held that Hertz's payment scheme denying creditors $270 million in make-whole fees and post-petition interest at the contract rate while distributing value to equity holders violated the absolutely priority rule. Judge Ambro's opinion held that Hertz, as a solvent debtor, must pay the post-petition interest at the contract rate, including the make-whole premiums.

With this decision, the Third Circuit joined the Fifth Circuit in *In re Ultra Petroleum Corp.* and the Ninth Circuit in *In re PG&E Corp.*

in recognizing this solvent debtor exception to payment of post-petition interest to creditors and that post-petition interest in such circumstance must be paid at the contract rate, rather than the federal judgment rate.

While solvent debtors are relatively rare, the holding that make-wholes are disallowed as unmatured interest may have broader impact.

No Pre-petition Liens on Avoidance Actions: In re BDC Group Inc.

Avoidance actions are legal remedies a debtor-in-possession or bankruptcy trustee can use to unwind transactions that occurred before bankruptcy. Since avoidance actions arising under the Bankruptcy Code cannot be asserted prior to initiation of a bankruptcy case, it had been considered well-settled law that a secured creditor cannot take a security interest in avoidance actions prior to a bankruptcy filing.

Two recent appellate decisions called this consensus into question. In August 2023 and January 2024, the Eighth Circuit in *In re Simply Essentials* and the Fifth Circuit in *In re South Coast Supply* respectively, each held that avoidance actions constitute property of the estate as of the commencement of the case and can be sold by a debtor-in-possession or trustee. The Eighth Circuit's decision expressly stated that the debtor held an "inchoate interest" in avoidance actions prior to commencement of the bankruptcy case. These decisions led to speculation that secured creditors may be able to obtain perfected security interests in these inchoate rights prior to a bankruptcy filing.

On September 10, 2024, in the case of *In re BDC Group Inc.*, Chief Bankruptcy Judge Thad J. Collins of the United States Bankruptcy Court for the Northern District of Iowa expressed strong disagreement with this speculation in holding that lenders cannot have a lien on avoidance actions before a bankruptcy petition is filed.

BDC Group, Inc. ("BDC") was a telecommunications firm that filed a chapter 11 petition in the Bankruptcy Court for the Northern District of Iowa on June 13, 2023. Multiple pre-petition security agreements contemplated that lender Keystone Savings Bank ("KSB") held a security interest in substantially all of BDC's assets, including general intangibles. KSB submitted a motion in the bankruptcy court to recognize the validity of its security interest in the estate's avoidance actions as a general intangible and any proceeds therefrom. KSB then filed a motion for summary judgment on the issue, which was opposed by the bankruptcy trustee appointed in the case.

At issue in *In re BDC Group Inc.* was whether the debtor's "inchoate interest" in avoidance actions could act as a sufficient legal basis for a lien on these avoidance actions through the pre-petition pledge of general intangibles.

Judge Collins ruled against the secured creditors, holding they do not and could not have a pre-petition security interest in avoidance actions, as the debtor's inchoate interest therein does not include the right to pursue and recover on those actions. Rather, this inchoate interest is limited to the legal right to file for bankruptcy and invoke the Bankruptcy Code. Because avoidance actions are statutory rights that come into legal existence only upon the filing of a bankruptcy petition, any right to recover from avoidance actions does not and cannot ever exist outside of bankruptcy. Thus, debtors have no ownership interest in avoidance actions pre-petition and cannot grant security interests in them.

Bankruptcy Judge Collins further clarified that avoidance actions also cannot constitute proceeds of pre-petition collateral because avoidance actions arise post-petition as after-acquired property. Avoidance actions are rights that are created by statute post-petition, not as a continuation of pre-petition rights.

Allowing pre-petition liens on avoidance actions could adversely affect the recovery of unsecured creditors. By striking down the validity of these pre-petition liens, Bankruptcy Judge Collins preserved important principles of avoidance actions, namely that avoidance actions arise by statute post-petition for the benefit of all creditors.

Though not a surprising result, Judge Collins's opinion is useful in clarifying and restating the previously well-settled view that avoidance actions only come into existence upon the filing of a bankruptcy case.

Other Developments

District Court Upholds Jury Verdict in Panuwat Decision, Supporting SEC's "Shadow Trading" Liability Theory

As previously discussed in the Q2 2024 edition of this newsletter, *SEC v. Matthew Panuwat* is the first case to find a defendant liable for insider trading under the shadow trading theory. "Shadow trading" is an insider trading theory of liability for trading securities of a company based on MNPI about another company. On September 9, 2024, Judge Orrick of the United States District Court for the Northern District of California upheld the jury's verdict in *SEC v. Matthew Panuwat*, rejecting Panuwat's motions for a new trial and judgment as a matter of law and further ruling that there was "substantial evidence" to support the finding of insider trading liability.

Judge Orrick disagreed with Panuwat's claim that labeling the charges as "insider trading" was unjust by relying on the *United States v. O'Hagan* ("*O'Hagan*") Supreme Court case. Judge Orrick stated that *O'Hagan* explicitly recognized the misappropriation theory, which encompasses "shadow trading", as an alternative to the traditional theory of insider trading.

The court imposed a civil penalty of $321,197.40, the maximum civil penalty permitted under the Insider Trading Sanctions Act of 1984, and permanently enjoined Panuwat from future securities law violations. Though the SEC also requested the court prohibit Panuwat from serving as an officer or director of a public company, the court declined to impose that penalty. Panuwat has not yet appealed. The Department of Justice did not pursue criminal charges against Panuwat.

SEC Finalizes Amendments to Reg NMS to Reduce Tick Sizes

On September 18, 2024, the SEC adopted amendments to the Regulation National Market System ("Reg NMS"). Notable among these amendments was an amendment to Rule 612 of Reg NMS that reduces the minimum pricing increments (also called "tick sizes") for quotes and orders of National Market System stocks priced $1.00 or more based on such stock's time weighted average quoted spread ("TWAQS") over a designated evaluation period. For stocks with a TWAQS greater than $0.015, the minimum tick size remained at $0.01. However, for stocks with a TWAQS less than or equal to $0.015, the amendment lowered the minimum tick size to $0.005. The SEC argues this amendment will improve "liquidity, competition, and price efficiency in the markets" and will lower costs for investors to trade the applicable stocks because they will be priced more efficiently and competitively.

The amendment will become effective on December 9, 2024, and the compliance date is the first business day of November 2025.

New Schedule 13G Filing Deadlines Go Into Effect

In 2023, the SEC adopted amendments to the beneficial ownership rules, which included quicker deadlines for filing initial and amended Schedule 13Gs. On September 30, 2024, the new deadlines went into effect.

Deadlines for Schedule 13G filings depend on whether the filer is a qualified institutional investor ("QII"), passive investor or exempt investor. The below table sets out the previous and new deadlines as outlined in the SEC adopting release.

High Water Mark Provisions Enter the U.S. Broadly Syndicated Loan Market

In the U.S. broadly syndicated loan market, debt covenants typically include baskets with a cap set at the greater of a fixed dollar amount and a percentage of a financial metric, such as EBITDA (the "grower"), which is calculated for the applicable test period. If the borrower's performance improves, then such improvement results in increased basket capacity due to the increased size of the grower, rewarding the borrower with greater flexibility. If the borrower's performance declines, then the fixed dollar amount acts as a floor. However, some borrowers in the sponsor market have recently sought to import a different construct known as "high water marking", which is found in the European broadly syndicated loan market. High water mark provisions set the value of the financial metric at the greater of its value for the applicable test period and its highest value to date. The floor for the basket is therefore dynamic and can only increase. If the borrower begins to underperform after a period of strong performance, the basket remains set at the high water mark, decoupling flexibility from current performance. Although high water mark provisions remain rare in the U.S. broadly syndicated loan market, this is a trend to watch.

Basel III Endgame Update: Fed Announces Re-Proposal

As discussed in the Q2 2024 edition of this newsletter, Federal Reserve Chair Jerome Powell announced in March of this year that the Federal Reserve Board's previously announced plans to increase bank capital requirements would be scaled back, following extensive opposition to the proposed regulations in comments from lobbying groups, academics and industry executives.

In a speech on September 10, 2024, top Federal Reserve official Michael S. Barr previewed the Fed's re-proposal, stating, "There are benefits and costs to increasing capital requirements. The changes we intend to make will bring these two important objectives into better balance, in light of the feedback we have received." Barr presented the re-proposal as a joint effort with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

The re-proposal would increase capital requirements for the largest and most complex banks by 9 percent, as compared to 19 percent in the original plan. Additionally, the requirements would apply to a narrower set of banks than originally contemplated, as banks with assets between $100 billion and $250 billion would no longer be subject to the same standards as the largest banks. Barr noted that the Fed remains open to comments on any aspect of the proposals.

	PREVIOUS DEADLINE	AMENDED DEADLINE
INITIAL FILING DEADLINE	QIIs & Exempt Investors: 45 days after calendar year-end in which beneficial ownership exceeds 5%. QIIs: 10 days after month-end in which beneficial ownership exceeds 10%. Passive Investors: Within 10 days after acquiring beneficial ownership of more than 5%.	QIIs & Exempt Investors: 45 days after calendar quarter-end in which beneficial ownership exceeds 5%. QIIs: Five business days after month-end in which beneficial ownership exceeds 10%. Passive Investors: Within five business days after acquiring beneficial ownership of more than 5%.
AMENDMENT TRIGGERING EVENT	All Schedule 13G Filers: Any change in the information previously reported on Schedule 13G. QIIs & Passive Investors: Upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership.	All Schedule 13G Filers: Material change in the information previously reported on Schedule 13G. QIIs & Passive Investors: Same as previous deadline (Upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership).
AMENDMENT FILING DEADLINE	All Schedule 13G Filers: 45 days after calendar year-end in which any change occurred. QIIs: 10 days after month-end in which beneficial ownership exceeded 10% or there was, as of the month-end, a 5% increase or decrease in beneficial ownership. Passive Investors: Promptly after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership.	All Schedule 13G Filers: 45 days after calendar quarter-end in which a material change occurred. QIIs: Five business days after month-end in which beneficial ownership exceeds 10% or a 5% increase or decrease in beneficial ownership. Passive Investors: Two business days after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership.

ESG Litigation and Sustainability-Linked Loans

The Q4 2023 edition of this newsletter noted that U.S. issuances of sustainability-linked loans, which offer borrowers a spread discount or penalty triggered by their performance against environmental, social or governance ("ESG") goals, declined by 80% in 2023 compared to 2022. Some researchers have attributed this decline in part to increased political opposition to ("ESG") investing, which has manifested in a variety of state laws.

In recent months, these laws have faced challenges in court. This July, an Oklahoma state court judge issued a permanent injunction preventing the enforcement of a law that restricted the state from working with financial firms that allegedly boycott energy companies, holding in part that the statute was unconstitutionally vague. In August, a federal judge barred Missouri from enforcing a rule that would have required securities firms and professionals to obtain signed consent from Missouri investors before incorporating a "social objective" or other "nonfinancial objective" into recommendations or investment advice for investors, holding that the rule was preempted by a federal statute regulating oversight of nationwide securities offerings. In late August, a sustainability-focused business group challenged a 2021 Texas law (SB13) in federal court. Similar to the enjoined Oklahoma law, SB13 prohibits certain state entities from investing in or contracting with companies that allegedly boycott energy companies. The business group has asserted that SB13 unconstitutionally restricts speech and violates the right of free association.

As the validity of restrictions on ESG investing continues to play out in courts, the impact of these contests on the popularity of sustainability-linked loans remains to be seen.

Crypto Updates

District Court Rejects SEC's Disgorgement Theory in SEC v. Ripple; SEC Appeals Decision

As previously mentioned in the Q3 2023 edition of this newsletter, the Southern District of New York delivered a partial victory to Ripple Labs, Inc. ("Ripple") in *SEC v. Ripple Labs, Inc*, through a summary judgment decision in July 2023. The decision evaluated whether Ripple violated Sections 5(a) and 5(c) of the Securities Act by failing to either register XRP tokens as a security or satisfy an exemption from registration. In evaluating this question, Judge Analisa Torres ruled that, while Ripple's institutional sales of XRP constituted an unregistered securities offering, its programmatic sales did not.

On August 7, 2024, Judge Torres issued her final judgment order in *SEC v. Ripple Labs*, regarding Ripple's institutional sales of XRP. Judge Torres took a transaction-by-transaction approach to calculate the civil penalty for Ripple's violations of the securities registration provisions and ordered Ripple to pay a $125,035,150 penalty. This figure was far lower than the SEC's requested $876,308,712 penalty. Judge Torres also rejected the SEC's disgorgement theory by stating that the SEC had not proven that any investors were harmed by Ripple's XRP sales and issued an injunction barring Ripple from further violations of Section 5 of the Securities Act. The court also denied Ripple's request to waive the "bad actor disqualification," thus preventing the company from using the Regulation D exemption for securities offerings for the next five years.

As of October 2, 2024, the SEC has filed an appeal of the July 2023 summary judgment ruling and the August 2024 final judgment with the Second Circuit Court of Appeals in Manhattan.

District Court Dismisses Consensys Suits against SEC Amid Concurrent SEC Enforcement Action against Consensys for Its Non-Custodial Liquid Staking Product

On September 19, 2024, the United States District Court for the Northern District of Texas dismissed Consensys Software Inc.'s ("Consensys") pre-emptive suit against the SEC. Consensys is a software developer whose business centers on Ethereum, a blockchain network where users pay fees with a digital asset called "ether" or "ETH." Consensys also developed MetaMask (a non-custodial crypto wallet application), MetaMask Staking (a non-custodial liquid staking product that allows users to stake their ETH to transact on Ethererum) and MetaMask Swaps (an application which allows users to communicate with third-party decentralized exchange to buy, sell or exchange tokens).

On April 10, 2024, the SEC issued Consensys a Wells Notice indicating that the SEC staff was recommending that the SEC bring enforcement action against Consensys. Shortly thereafter, on April 25, 2024, Consensys sued the SEC, seeking a declaratory judgement that MetaMask is not an unregistered securities offering.

On June 28, 2024, the SEC sued Consensys in the US District Court for the Eastern District of New York ("EDNY"), claiming that MetaMask Staking facilitated unregistered offers and sales of securities for two liquid staking protocols, Lido and Rocket Pool. The SEC alleges that, because the Lido and Rocket Pool staking programs are offered and sold as investment contracts, Consensys acted as an underwriter of securities. The SEC also argued that Consensys is an unregistered broker of crypto asset transactions through its MetaMask Staking and MetaMask Swaps products.

After initiating this enforcement action in EDNY, the SEC argued in the Texas district court that Consensys' Texas suit should be dismissed as not ripe for adjudication. The Texas district court agreed and dismissed the case, finding that (i) there was no final agency action fit for judicial review in this case because a Wells Notice is merely a recommendation that the SEC can decline and the mere allegations made in the EDNY enforcement action do not impose the requisite sort of legal obligations; and (ii) Consensys failed to show it will suffer hardship if the court withholds consideration of its claim.

The SEC's EDNY enforcement action remains pending.

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