

## FUND FINANCE FRIDAY

## Are Loans Securities? A Kirschner Case Update

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We continue to follow the litigation over the question of whether certain syndicated loans are securities. *Kirschner v. JPMorgan Chase Bank, N.A.*, which has been before New York federal courts for years, is now before the United States Court of Appeals for the Second Circuit. In our [last update](#), we noted that this case has been described by players in the syndicated loan market as everything from “a potential game changer” to an “existential threat” to the syndicated loan market.

As a reminder, in this case, the Court will consider an appeal of a 2020 decision by the U.S. District Court for the Southern District of New York which held that the syndicated term loan in question was not a security and therefore not subject to state and federal securities laws and regulations.

The Court is working to get to the bottom of this question and, recently, following a hearing, the Second Circuit entered an order asking the U.S. Securities and Exchange Commission (“SEC”) to submit “any views it wishes to share” on whether the loans in the Kirschner case are securities. While the SEC has previously weighed in on the subject and has indicated that in certain situations and under certain factual scenarios, loans could be securities, many experts are worried about the effect it would have if the SEC made a statement that loans actually are securities. The Court set a deadline for the submission by the SEC of April 13, 2023, which was extended to June 27, 2023 when the SEC filed a motion requesting extension of time to respond to the Court’s request. Parties watching the case are trying to read the tea leaves of the SEC’s motion for extension of time to see if they can tell what the response will be.

The consequence of a determination that syndicated loans are securities would be significant. It would mean, among other things, that the syndicated loan market would have to comply with various state and federal securities laws, which would significantly change the cost of these transactions as well as the means by which syndication and loan trading take place. The Loan Syndications and Trading Association (“LSTA”) weighed in on the potential consequences of such a statement and indicated that it would be “destabilizing” to the institutional loan market,

the size of which the LSTA estimates to be about \$1.4 trillion and which is an essential source of capital to many types of borrowers, including the fund borrowers in the fund finance market.

The LSTA has said that the very features that distinguish loans from securities are what make them so attractive to both borrowers and lenders – and why the market should be preserved just how it is. These features include efficient execution, the ability of borrowers to choose their agent and lenders (including the members of the syndicate), the ability to easily amend loan documents, and the ability of lenders to obtain confidential information about the borrowers. This rings true for many types of financing transactions and definitely for fund finance deals that come across our desks here at Cadwalader. The transactions are quick-moving and relationship-based, and the papers have high touch in terms of amendments and other maintenance for deals.

In the event the SEC were to make a statement that loans are securities and therefore subject to securities laws, the potential disruption would have a one-two punch of both short- and long-term consequences. Short-term, more immediate consequences include a fundamental question by lenders and borrowers – and their lawyers – as to whether the parties could continue to perform under their existing deals. Loan origination and borrowing would be completely halted until there was guidance as to compliance with the relevant securities laws. In the lending space, deals would be frozen. In the private credit and other fund lending space, there may be additional destabilization in the form of redemption requests by investors in open-end funds. Other markets like the CLO market would also likely grind to a halt. While this may be the immediate impact, the determination that loans are securities would additionally have a number of longer term effects to the market as transaction parties grapple with the complexities of compliance with securities laws.

Keep in mind that even if the SEC does not express a view that loans are securities, the Second Circuit still needs to rule in the case. So, even if the SEC determines that loans are not securities, the Court could still do so. The suspense continues!

We continue to monitor this case and will update you here as it develops.