



LEADING TREASURY
PROFESSIONALS

The ACT Borrower's Guide to the LMA's Investment Grade Agreements

Produced by

SLAUGHTER AND MAY



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This guide has been produced for the ACT by Slaughter and May to provide assistance to corporate treasurers reviewing draft facility agreements based on the LMA documentation for investment grade borrowers.

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Introduction

The Association of Corporate Treasurers (“ACT”) sets the global benchmark for treasury excellence. As the chartered body for treasury, it leads the profession through internationally recognised qualifications, by defining standards and championing continuing professional development. It is the authentic voice of the treasury profession, educating, supporting and leading the treasurers of today and tomorrow.

The ACT has worked with the Loan Market Association (“LMA”) to provide the borrower’s perspective on its suite of template documentation for investment grade lending for many years. The ACT, advised by Slaughter and May, participated in the working party that settled the initial text of the recommended forms of facility agreement for investment grade borrowers (the “Investment Grade Agreements”). The ACT has continued to assist the LMA with the Investment Grade Agreements ever since.

LMA documentation and guidance materials are available only to LMA members via its website¹. This guide, the first edition of which was produced shortly after the LMA published the first Investment Grade Agreements in 1999, aims to assist treasurers reviewing draft loan documentation, using an Investment Grade Agreement as a benchmark. It explains the operation of its main clauses and highlights the key areas for negotiation.

This latest edition has been updated comprehensively to reflect changes in law, practice and subsequent amendments made by the LMA to the Investment Grade Agreements. It is divided into four parts:

- Part I (Overview) describes the Investment Grade Agreements, their place in the broader LMA library and how they should be approached. It also outlines the main aspects of an Investment Grade Agreement that are typically negotiated (discussed further in Part III).
- Part II (Recent developments) introduces a number of recent legal, regulatory and market developments that have implications for loan documentation, some which have resulted in changes to the Investment Grade Agreements since the last edition of this guide.
- Part III (Commentary on the Investment Grade Agreements) outlines the meaning and intent of the key clauses, and how they might be viewed from the borrower’s perspective.
- Part IV (Commentary on the Lehman provisions) contains an overview of the LMA’s Finance Party Default Clauses and highlights some of the key points from the borrower’s point of view.

This guide uses an Investment Grade Agreement as its primary reference point, but the commentary will be of interest to treasurers representing all types of borrower, whether or not investment grade. The Investment Grade Agreements are designed for and require least adaptation when used to document investment grade facilities. However, they are frequently used as a starting point for loan facilities extended to all types of borrower, adjusted and supplemented as appropriate.

Capitalised terms used in this guide and not otherwise defined have the meanings given in the Investment Grade Agreements. The guide refers to sections and clause numbers of an Investment Grade Agreement. As these are liable to change in a draft prepared for a transaction, the names of the relevant section or clause are given as well as the number.

This 5th edition of the ACT’s Guide to the LMA’s Investment Grade Agreements was first published in April 2017. It was updated and re-published on 1 September 2017 primarily to reflect some minor adjustments to the Investment Grade Agreements made by the LMA on 18 July 2017, but also to note recent announcements relating to the future of LIBOR and amendments to the anti-money laundering regime in the EU and the UK.

Slaughter and May
1 September 2017

¹ www.lma.eu.com.

This guide is written in general terms and its application to specific situations will depend on the particular circumstances involved. While it seeks to highlight certain issues that may be raised by borrowers in relation to an Investment Grade Agreement, it does not purport to address every issue that borrowers could or should raise. It does not necessarily describe the most borrower-friendly approach that may be taken. The observations in this guide relating to market practice may not be appropriate or relevant to all types of transaction. What is achievable in any particular case will depend on a variety of factors, including the identities of the borrower and the lenders and market conditions.

Readers should therefore take their own professional advice. This guide should not be relied upon as a substitute for such advice. Although Slaughter and May has taken all reasonable care in the preparation of this guide, no responsibility is accepted by Slaughter and May or any of its partners, employees or agents or by the ACT or any of its employees or representatives for any cost, loss or liability, however caused, occasioned to any person by reliance on it.

Part I: Overview

1. The Investment Grade Agreements

The LMA is the trade body for the syndicated loan industry in Europe, the Middle East and Africa. It undertakes a variety of activities, but is perhaps best known to the treasurer community for its template documentation. The LMA publishes primary documentation and guidance material applicable to a wide variety of loan products as well as for the secondary trading market.

The Investment Grade Agreements were the first of the LMA's primary documents and are probably the most widely used. The Investment Grade Agreements are the "plain vanilla" of the LMA's various forms of facility agreement. As such, they provide a baseline for the mechanical aspects of loan documentation and a starting point for the commercial aspects which can be applied across most sectors of the loan market. The success of the Investment Grade Agreements has contributed significantly to the speed and efficiency of the documentation process for loans of all types.

There are currently eleven Investment Grade Agreements. The template is available as a single currency or multi-currency term and/or revolving facility or facilities. Versions of the revolving facility agreements are also published incorporating dollar and euro swingline facilities, which operate as a sub-set of the revolving facilities. A version of the multi-currency term and revolving facility is available which caters for the revolving facility to be drawn by way of fronted letters of credit.

The LMA also publishes an Investment Grade Agreement governed by each of French, German and Spanish law. These are not discussed further in this guide, save to note that the LMA's general approach to those documents has been to adapt the legal aspects of an English law Investment Grade Agreement to reflect the requirements of the relevant governing law, so many of the points made in Part III of this guide are likely to apply equally to the versions governed by the laws of those countries.

The Investment Grade Agreements, like all LMA templates, are intended to be a starting point for negotiation. They are designed, as the name suggests, for European syndicated loan transactions involving high quality corporate borrowers:

- The commercial terms (for example, the representations, undertakings and Events of Default) cover only the areas that are typically addressed in investment grade transactions.
- They incorporate guarantee provisions but the facilities are unsecured.
- It is assumed that the Agent is based in London and syndication takes place primarily in London and the Euromarkets.

As discussed in paragraph 2 below, it is important to appreciate that no LMA template can be used without amendment, even for transactions of the type for which the relevant template is designed. Where an Investment Grade Agreement is used for different types of transaction, it will require further amendment. For example, a more extensive covenant package than that reflected in an Investment Grade Agreement, and perhaps requirements to provide security, will typically be required if the template is used to document a facility for a borrower without investment grade status.

2. How to approach the Investment Grade Agreements

The front page of every LMA template contains the following statement:

"For the avoidance of doubt, this document is in a non-binding, recommended form. Its intention is to be used as a starting point for negotiation only. Individual parties are free to depart from its terms and should always satisfy themselves of the regulatory implications of its use."

Each Investment Grade Agreement also incorporates the text of the Joint Statement that was issued by the LMA, the ACT and the British Bankers' Association ("BBA") when the first of the documents were published:

"The recommended form of syndicated facility agreements (the "Primary Documents") were developed by a working party consisting of representatives of the Loan Market Association, the Association of Corporate

Treasurers and major City law firms. It is hoped that the existence of the Primary Documents will facilitate more efficient negotiation of loan documentation for the benefit of primary and secondary loan markets.

Through the involvement of the three associations in the working party, together with the law firms represented, the objective was to balance the interests of borrowers and lenders. In the Primary Documents, financial covenants and related definitions have been deliberately left blank.

When considering use of the Primary Documents it is recommended that borrowers and lenders should:

- *consider the option of continuing to use existing documentation*
- *carefully consider changes to the Primary Documents that may be required*
- *always have the benefit of independent legal advice*

The three associations believe that the Primary Documents will provide a valuable aid to the development and efficiency of the syndicated loan market.”

Some essential points for treasurers emerge from these statements:

Use of LMA documentation is not mandatory.

The adoption of LMA terms has brought significant benefits to the market, enabling the parties to focus on settling the commercial aspects and ensuring that the contractual restraints are proportionate and operationally workable.

However, neither the Investment Grade Agreements, nor LMA terms more generally, are used for all lending transactions. For example, long-standing relationship facilities may be documented on simpler or alternative terms and bilateral loans may not follow the LMA format which is designed for the syndicated market (although equally, many do). The LMA format is also generally not as prevalent in domestic transactions governed by the laws of other European jurisdictions as in the English law market.

The view that treasurers and their advisers may take on whether to use an Investment Grade Agreement or other LMA terms (or whether they are able to resist the preferences of their lenders) will depend on their varying circumstances. Some may feel more comfortable with their existing, non-LMA terms, updated as required. If a syndicated facility is likely to be traded, lenders may be insistent on the adoption of the LMA style.

Accordingly, there should be a discussion between the lead banks and the borrower (at term sheet stage, if applicable) about the appropriate format.

LMA documentation is a starting point for negotiation. Changes are expected to accommodate individual transactions.

In practice, the LMA and ACT's efforts mean that, on the whole, the Investment Grade Agreements reflect a position that balances the interests of lenders and borrowers, including many of the concessions that would typically be achieved by an investment grade borrower. For example:

- many provisions are qualified by materiality: for example, representations must be true in all material respects when repeated at utilisation;
- similarly, the concept of a “Material Adverse Effect” is used to soften various provisions, such as the representation as to the absence of litigation;
- grace periods and threshold amounts are envisaged, for example in the negative pledge and cross-default provisions; and
- the borrower's consent (not to be unreasonably withheld or delayed) is required for most loan transfers.

The aspects of the LMA template that borrowers seek to negotiate have certainly diminished over time. However, it is not the case that LMA terms are not negotiated at all, in particular by stronger borrowers. The clauses of an Investment Grade Agreement that borrowers may wish to consider negotiating in appropriate circumstances are discussed in Part III.

The template also contains a number of “soft” provisions, blanks and optional provisions, plus footnotes alerting the parties to particular negotiating points.

The soft provisions include many of the clauses that treasurers will be most closely focused on. For example:

- The key commercial terms, the applicable pricing, fees, repayment terms and the final maturity date are all left blank to be negotiated.
- The financial covenants clause is blank in the Investment Grade Agreements, acknowledging that the terms of such provisions vary widely (and that some highly rated borrowers may be able to borrow without the constraints of financial covenant tests).
- The list of representations to be repeated requires negotiation on a case-by-case basis.
- The parties will need to settle the definition of Material Adverse Effect, a key definition used throughout the Investment Grade Agreements.
- The key restrictive undertakings, Clauses 22.3 (*Negative pledge*) and 22.4 (*Disposals*), include blanks, anticipating that the parties will negotiate further exceptions.
- Clause 23 (*Events of Default*) contemplates that the parties will agree grace periods (for example in relation to non-payment) and threshold amounts (for example in relation to cross-default) to soften the specified triggers.

The existence of these soft provisions further demonstrates that the LMA templates cannot be used without amendment.

As well as the need to adapt what is in the template to the circumstances of the transaction, it is also often necessary to supplement the template to address additional issues. Additional terms may be credit driven (in general, the weaker the borrower, the tighter the covenant package). Some extra provisions may be required because they are customary in loans to borrowers in the relevant sector. Others may be specifically designed to address risks relating to the borrower’s business that cause concern to lenders. The extension of the LMA’s library means that increasingly, it is possible to model such additional provisions on clauses that feature in other documents in the LMA’s collection (see further below) although in most facilities, it remains the case that bespoke drafting of some sort is required.

Finally, LMA documentation will generally require adjustment for any recent developments with which the templates have not yet caught up. Some of the main issues currently affecting loan terms are outlined in Part II.

In summary, borrowers should not be deterred by the use of an LMA form from negotiating in their own interests.

The LMA recommends that the first draft of each loan agreement should be marked-up to show the changes made to the Investment Grade Agreement used as a starting point by the drafting law firm. Although this was reasonably common in the early years of LMA documentation, a mark-up is no longer provided routinely, at least to borrowers. However, it is straightforward to produce and treasurers may wish to request a mark-up from their legal advisers to determine the extent to which lenders have departed from the LMA position on particular points.

3. The Investment Grade suite

The LMA's suite of documents for investment grade lending extends beyond the Investment Grade Agreements. It includes a number of ancillary documents and slot-in clauses, as well as guidance material.

Ancillary documents include forms of confidentiality letter, forms of mandate letter and a term sheet. A User Guide to the Investment Grade Primary Documentation (the “**LMA User Guide**”) explains the mechanics of the Investment Grade Agreements.

The most heavily used of the slot-in clauses are the Finance Party Default Clauses. These are a series of optional clauses, which address primarily the potential consequences of one of the lenders, the Agent or other administrative parties to the facility agreement defaulting on their obligations or becoming insolvent. The need for provisions of this kind became apparent in the aftermath of the collapse of Lehman Brothers in 2008, which is why these LMA clauses are generally referred to as the “**Lehman provisions**”.

In general, many of the Lehman provisions are desirable from the borrower's perspective. The aspects relating to “Defaulting Lenders” and “Impaired Agents” are widely used and treasurers who have negotiated loan documentation since 2009 are likely to be familiar with them. The aspects of the Lehman provisions of most interest to borrowers are discussed in Part IV.

4. The LMA library

It is important to be aware that the Investment Grade Agreements, and the broader investment grade suite, are part of a very large library of lending documentation published by the LMA. The inclusion of a particular provision in a facility agreement simply because “it's in the LMA” (often a source of frustration, in particular for lawyers representing borrowers), holds even less weight than may have been the case in the early years, in part due to the multiplicity of LMA sources from which the provision might originate.

Following the publication of the Investment Grade Agreements, the LMA turned its attention to leveraged lending, a busy and developing sector of the European market in the early 2000s. A form of facility agreement for senior/mezzanine leveraged acquisition financing (the “**Leveraged Agreement**”) was published in 2004. The collection expanded from there. Today the LMA produces documentation for many other more specialist sectors of the market including leveraged financing structures involving bonds, real estate financing and private placements. There are currently more than 20 forms of English law facility agreement in the LMA library, plus (as already mentioned), versions of the Investment Grade Agreements governed by the laws of other European jurisdictions and an extensive set of agreements governed by the laws of various African countries. These are all accompanied by ancillary documentation and guidance notes.

The market's enthusiasm for the Investment Grade Agreements and the expansion of the LMA library means that LMA terms have come to be the starting point for, or at least an important influence on, the terms applicable to the majority of English law commercial loans (syndicated or otherwise) and to many cross-border transactions in the EMEA region.

The number of LMA forms now available enables those tasked with drafting loan documentation to mix and match provisions from different documents. The various forms of facility agreement, for example, are used as a clause library from which lawyers are able to build the document that suits their transaction. An Investment Grade Agreement, where used (as is often the case) as the basis of a facility for a borrower at the lower end of the investment grade spectrum or in the cross-over space, will typically be supplemented with additional representations and undertakings modelled on those in the Leveraged Agreement.

Treasurers should note that although many of the LMA templates contain provisions that originated in an Investment Grade Agreement, the LMA does not consult the ACT in relation to any of its documentation other than the Investment Grade Agreements and the Lehman provisions. The Investment Grade Agreements and the Lehman provisions remain the only documents in the LMA library that carry the ACT's specific endorsement.

Part II: Recent Developments

1. Introduction

All of the LMA's templates are regularly amended to keep pace with legal and regulatory developments and changes in the market environment. Each time the Investment Grade Agreements are reviewed (which can be quite frequently in periods of intensive regulatory change as we have experienced in the years since the global financial crisis), there is a discussion between the LMA, the ACT and their respective advisers and the document is revised and republished as swiftly as possible. However, LMA documentation cannot reasonably be expected to reflect the implications of all recent developments:

- Sometimes issues are capable of identification, but continue to develop over time. This applies to most important regulatory initiatives.

Example: *The first proposals for reform of the LIBOR process were put forward in 2012. Although a number of those have been implemented, the process remains ongoing. The LMA has made a series of changes to the Investment Grade Agreements and its other recommended forms, but the benchmark provisions of its templates seem likely to require further adjustment as the global regulatory focus on benchmarks moves into each of its next phases.*

- There may be a lack of consensus as to how certain issues should be addressed. A certain level of consensus among users is an obvious pre-requisite for the inclusion of provisions in recommended form documentation.

Example: *There remains a range of views in the banking community with regard to what level of provision should be made in loan documentation for sanctions compliance. As a result, the LMA has not felt it appropriate to add sanctions provisions to its English law facility agreements, although all of the documents include footnotes reminding the parties to consider this topic.*

- It may not be immediately clear whether a particular risk is likely to be an enduring feature of the market to an extent that justifies making already complex documentation even more so (especially where there is also uncertainty with regard to its precise effects).

Example: *Brexit could have a range of documentation implications, but at the time of writing, it remains unclear which of these are likely to be of ongoing concern. The LMA has formed a working group which has identified the main issues and how they might be managed contractually, but Brexit is clearly a topic that will require monitoring over the longer term.*

It is important that treasurers, with support from their advisers, keep abreast of recent developments as they will be at the forefront of lenders' minds.

It is also worth bearing in mind, as such issues need to be considered and addressed on a case-by-case basis, that the number of recent developments to be dealt with will have an impact on the time taken to settle the documentation, in particular in otherwise straightforward investment grade refinancings. To facilitate a smooth documentation process, treasurers should discuss the issues that are likely to arise with their legal advisers at an early stage in the transaction, with a view to establishing the lead arrangers' views in advance of detailed documentation discussions.

Since the last edition of this guide was published in 2013, some of the more significant loan market developments include:

- the increased use of uncommitted extension options and "accordion" facilities;
- negative benchmark rates;
- the implementation of changes to the administration, submission process and calculation methodology for LIBOR and EURIBOR and more broadly, regulatory developments relating to benchmarks and benchmark submissions;
- increased focus on the impact of sanctions and anti-corruption laws on lending relationships;
- the accommodation in lending documentation of the US Foreign Account Tax Compliance Act ("FATCA");

- the finalisation of new lease accounting standards (including IFRS 16);
- the implementation of Article 55 of the EU Bank Recovery and Resolution Directive²; and
- the UK's EU referendum result and the prospect of Brexit.

The background to and implications for loan documentation of each of these key developments is outlined below, including the LMA's response and, where applicable an overview of how the relevant points are currently being managed in practice. The commentary in this Part II is supplemented in appropriate cases by the discussion of how these developments affect particular provisions of the Investment Grade Agreements in Part III.

As is emphasised in the commentary that follows, the developments highlighted in this Part II are still evolving. The commentary, where possible, reflects current market practice, but this may change as further information on the relevant topic emerges. Treasurers should seek legal advice with regard to the latest position.

2. Extension options and accordion facilities

Background

Repeated central bank interventions in response to the global financial crisis, the difficulties in the Eurozone, and more recently, the result of the UK's referendum on EU membership have fuelled a protracted period of low interest rates. Certain base rates and key benchmarks have reached historic lows.

This lengthy period of stable and for many, favourable loan pricing has led borrowers to look for ways of ensuring that keenly-priced facilities are locked in at current rates for as long as possible. It has become very common for investment grade working capital facilities to incorporate options to extend their maturity. A “+1” structure, in other words a fixed loan tenor coupled with one or two one-year extension options, is often agreed at the upper end of the market.

Similarly, a number of borrowers whose funding needs might increase over the term of the facilities have sought to include “accordion” rights to increase the initially agreed amount of the facilities, within the framework of their existing documentation.

In most cases, these options entitle the borrower simply to request an extension to the tenor and/or to increase the amount of the facilities, which each lender is free to accept or reject. However the fact that the agreement contemplates the possibility that lenders will extend and/or increase their commitments on the same terms can be an effective and time-efficient alternative to a full “amend and extend” or refinancing transaction, in particular (in the case of an accordion facility) if the borrower retains the option to source funds from elsewhere should any of the existing lenders decline to participate.

The Investment Grade Agreements do not contain extension options or accordion facilities. The mechanics that are adopted in practice, however often follow a reasonably familiar framework.

Current market practice

Extension options

Extension options in working capital facilities are typically uncommitted. The borrower is given the right to request, on one or two occasions, a one-year extension to the tenor of the loan. The request is normally permitted to be made only within a particular window, which is often on or before the first and, if applicable, the second anniversary of the facility (the option therefore providing the ability during the early years of the term to preserve the tenor originally fixed). There is normally no obligation on the lenders to commit to the extension, so whether the extension is available will depend on the borrower's relationships with its lenders at the time it wishes to exercise the option (which explains why extension options are perhaps more widespread at the investment grade, relationship-led end of the market).

² Directive 2014/59 EU.

The commitments of any lenders who do not participate in the extension will be cancelled at the end of the original term.

Fees are often, although not invariably, paid to extending lenders. Sometimes these are specified in the agreement; sometimes they are left to be agreed as and when the extension is exercised.

Accordion facilities

Accordion facilities are uncommitted lines within committed facilities that can be called on as required. An accordion provides access to additional funds which are available to meet increased working capital needs or, for example, to take advantage of an acquisition opportunity. The attraction for the borrower is usually the means to access further funds from its relationship bank group without paying commitment fees.

The accordion mechanism is incorporated into the borrower's committed facility agreement. In the corporate loan market, the mechanic quite commonly permits the borrower to request the lenders to increase their commitments by a *pro rata* amount, up to an agreed cap. If any of the lenders decline the borrower's request, the shortfall amount will be offered to the accepting lenders. If the existing lenders do not wish to assume commitments equal to the total increase amount, the borrower may bring in new lenders to take up the shortfall, who will accede to the facility on the same terms as the existing lenders.

Accordion facilities are often offered broadly along these lines, but the detailed terms are negotiated on a case-by-case basis. For example, sometimes an accordion is structured as a separate facility on new commercial terms to be agreed when the accordion is exercised. The number of accordion requests that are permitted over the life of the facility varies. The conditions to which the exercise of the accordion may be subject also vary, although access to both extension options and accordion facilities is often subject to the accurate repetition of the Repeating Representations and the absence of any continuing Default or Event of Default.

3. Negative benchmarks

Background

The impact of negative benchmarks on pricing has been a live issue in the European debt markets since CHF LIBOR dipped below zero during the summer of 2011. This prompted lenders to focus on the effects of negative benchmark rates on the borrower's payment obligations under LMA terms.

Then-current LMA terms made no indication of whether negative rates should be disregarded for the purposes of determining the applicable interest rate, providing for interest to be payable at a rate which is the sum of the relevant benchmark (for example, LIBOR) and the Margin. Based on those terms there is a reasonably strong argument that if the relevant benchmark is negative, the Margin (and therefore the amount of interest payable by the borrower to the lenders) should be reduced to the extent of the negative rate.

Lenders generally considered that an unacceptable position.

LMA response

The LMA produced a note containing guidance on how to amend the definitions of LIBOR (or other benchmarks) in its templates to impose a floor of zero on the relevant rate. The suggested language provided that if the relevant benchmark is negative, it will be deemed to be zero for the purposes of the agreement.

The zero floor language in the LMA's guidance note (being of minimal consequence for borrowers in most major currencies) was initially quite widely adopted, although it was sometimes resisted by borrowers in CHF and other currencies affected by negative rates. It was gradually incorporated into the benchmark definitions in most of the LMA's recommended forms, including, in 2014, the Investment Grade Agreements. However, whether the language should be included has been negotiated more frequently since 2014, when certain EURIBOR and euro LIBOR rates first fell below zero.

Current market practice

Broadly, the current position seems to be that while some stronger borrowers are able to resist the zero floor language, most are asked to accept the zero floor. If the borrower chooses to resist, lenders may argue that they cannot in practice fund the loan without paying interest even if rates are negative. The borrower's response might be that lenders' funding costs and the benchmark rate may be mismatched whether the relevant benchmark is positive or negative.

Borrowers should certainly anticipate that the language will appear in the majority of first draft loan documentation.

Borrowers who are able to persuade their lenders that the zero floor should not apply should note that the benefit of any negative rate is likely to be capped at the amount of the Margin. In other words, if the negative value of the rate exceeds the positive amount of the Margin, LMA terms make no provision for the excess amount to be paid by the lenders to the borrower, or to be deducted from the principal amount of the loan. To achieve that position (which would be highly unusual), it is likely that express drafting would be required.

A zero floor features in the definitions of "LIBOR", "EURIBOR" and "Benchmark Rate" in the Investment Grade Agreements and is discussed further in the context of those definitions in Part III.

4. Benchmarks

Background

Reforms to LIBOR, EURIBOR and other benchmarks used in loan documentation have prompted the LMA to make a number of changes to the provisions catering for the use of benchmarks, and for the consequences of the non-availability of the chosen benchmark in all of its recommended forms of facility agreement.

Some of the amendments required in response to the reform process were starting to be identified at the time the last edition of this guide was published in 2013. As reform proposals relating to LIBOR became clearer during 2013/14, the LMA was able to conclude a comprehensive review of their implications for its recommended forms.

Since then, the proposals have continued to be developed by regulators and administrators. For example, in 2016, ICE Benchmark Administration ("IBA"), the current administrator of LIBOR, published its "roadmap" for LIBOR (the "IBA Roadmap")³, which included (as discussed further below) proposals for further changes to the calculation process.






LMA response

The changes made by the LMA to date include the following:

- *"Future-proofing" of relevant definitions:* The LMA definition of LIBOR originally referred to LIBOR as published by the BBA on a specified screen page (for example, Reuters or Telerate). This caused concern when it first became clear that responsibility for LIBOR was to pass from the BBA to a new administrator because the definition did not contemplate specifically that the administrator (or the relevant screen page) could change over time. All relevant definitions ("LIBOR", "EURIBOR" and "Screen Rate") have since been altered to ensure that in the future, they should be unaffected by any such changes.
- *Provision for intra-day rate re-fixing:* This change was in response to the publication by the IBA and the European Money Markets Institute ("EMMI"), the administrator of EURIBOR, of error policies that provide for the correction and re-publication of the relevant rate later the same day if it turns out to have been erroneously calculated. The definition of "Screen Rate" has been adjusted to allow the parties to choose whether to use the corrected rate or the originally published rate.
- *Provision for use of interpolated rates:* Loan agreements normally contemplate that the interest period for each loan drawn will accord to a maturity for which the applicable benchmark is available.

³ www.theice.com/publicdocs/ICE_LIBOR_Roadmap0316.pdf.

However, circumstances can arise where it is necessary to borrow for a different interest period. General practice in the loan market has always been to calculate the interest rate for such periods by interpolation, but this was not provided for expressly under LMA terms. The discontinuation of the lesser-used LIBOR maturities during 2013 prompted the LMA to amend Clause 11 (*Changes to the Calculation of Interest*) to provide expressly for the use of an “Interpolated Screen Rate”.

Current LIBOR rates	
Currencies	Maturities
 GBP	O/N
 USD	1 week
 JPY	1 month
 CHF	2 month
 EUR	3 month
	6 month
	12 month

- **New framework for Non-LIBOR currencies:** LIBOR rates for a number of currencies, namely NZ\$, AU\$, CAN\$, Danish Kroner and Swedish Kronor were discontinued in 2013 because they were not widely used and were not supported by a sufficient volume of local trading data to produce a reliable LIBOR rate. This meant that alternative benchmarks had to be found for facilities in those currencies.

The LMA’s response was to add an optional framework for the use of a “Benchmark Rate” for “Non-LIBOR Currencies” into the templates. Essentially at all junctures where a benchmark rate is mentioned (see for example, Clause 9 (*Interest*)), the Investment Grade Agreements give the parties a choice of using LIBOR, EURIBOR or a “Benchmark Rate” to be defined. Where a “Benchmark Rate” is chosen, as well as adding a definition of that term, the parties must add details of the market conventions appropriate to that Benchmark Rate to Schedule 14 (*Other Benchmarks*).

To supplement this framework, the LMA has produced a series of slot-in clauses, the “Domestic interest rate benchmark schedules”, which contain the drafting required to complete the framework (the definition of Benchmark Rate and the additions to the Schedule) where the chosen Benchmark Rate is one of the following: BBSY (BID), BBSW, BKBM (MID), CDOR, CIBOR or STIBOR.

- **Optional Reference Bank Rates:** The LMA’s recommended forms provide for the use of fallback rates if the Screen Rate is unavailable (for example, because the rate has not been published or the rate-providers have had technical problems).

The primary fallback rate has always been the “Reference Bank Rate”. The Reference Bank Rate mechanism provides for the appointment of two or three Reference Banks by the Agent in consultation with the borrower, to provide quotes as required which are averaged to produce a Reference Bank Rate. The Reference Banks are asked to quote on the same basis as they would if they were contributing to the relevant benchmark.

It became clear that the UK and global regulatory regimes did not cater adequately for benchmark administration and submission as the alleged misconduct of various institutions in relation to LIBOR submissions started to come to light. This gap was swiftly addressed. Once the new regulatory framework was in place, several banks expressed reluctance to act as Reference Banks. The use of Reference Bank Rates was therefore marked as optional in all LMA templates and a number of new protections for Reference Banks were added. These include new clauses protecting Reference Banks from liability in respect of any rates they may provide and new confidentiality provisions.

- **Confidentiality of rate quotations:** All of the templates now include confidentiality obligations that require the parties to keep Reference Bank Rates and “Funding Rates” (individual lenders’ cost of funds, if cost

of funds is applicable), confidential (see Clause 37 (*Confidentiality of Funding Rates [and Reference Bank Quotations]*)).

The need for confidentiality obligations stems from LIBOR contributors' obligations under the LIBOR Code of Conduct for Contributing Banks to keep their funding rates confidential, which is in turn designed to implement the IBA's obligations under the Financial Conduct Authority ("FCA") regulatory regime applicable to benchmark administrators. The Code permits the disclosure by contributing banks of submitted rates to individuals who have (in summary) a business need to know and/or to certain customers, so long as "appropriate arrangements for preserving confidentiality" are in place. As Reference Bank Rates are intended to be calculated on broadly the same basis as LIBOR (or the benchmark they are intended to replace), contributing banks felt it appropriate that such rates should similarly be kept confidential.

- *New Screen Rate fallback options:* Clause 11.1 (*Unavailability of Screen Rate*) in the Investment Grade Agreements and other LMA templates, which sets out the fallback rates to be used if the chosen Screen Rate is unavailable, was comprehensively re-drafted in 2014. LMA terms have always provided for the use of Reference Bank Rates if the relevant Screen Rate is unavailable. If the Reference Bank Rate is unavailable, each lender may charge the borrower its cost of funds for the relevant period.

As noted above, the Screen Rate fallback provisions now provide expressly for the use of Interpolated Screen Rates. A new optional fallback provision has also been added, which caters for the use of rates for shortened interest periods ("Fallback Interest Periods") and "Historic Screen Rates" before moving to Reference Bank Rates and lenders' cost of funds.

- *Changes to accommodate IBA Roadmap:* As the Reference Bank Rate is designed to operate as a proxy for the benchmark it replaces, it is generally defined to require the Reference Banks to provide the same rate to the Agent as contributors to the relevant benchmark would be required to provide to the relevant administrator.

The definition of Reference Bank Rate as a fallback for LIBOR in the LMA templates was altered in November 2016 following discussions with the ACT. The updated definition provides that only Reference Banks which are LIBOR contributor banks shall quote on the same basis as they do for LIBOR, but only in so far as their LIBOR submission consists of a single rate. In all other circumstances, the Reference Bank Rate for LIBOR will be based on unsecured wholesale funding market rates.

The background here is the IBA Roadmap, the contents of which aim to ensure that the submission methodology for LIBOR is transparent and uniform and that submissions are as far as possible non-subjective and fully transaction based.

The move to a transaction-based rate supported by a detailed methodology for inputs in the absence of transaction data renders the "definition" of LIBOR, which was used to describe the rate required of contributors historically and which was tracked in the LMA's definition of "Reference Bank Rate", obsolete. The administrator's question ("*At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11am?*") is to be replaced with an "Output statement", which essentially describes the calculation methodology. The IBA has stated that it expects this transition to be completed during 2017.

The Output Statement is both difficult to describe in a few lines and difficult for a non-LIBOR contributor to replicate, hence the revised definition.

The IBA Roadmap also proposes that in due course, contributors will potentially be asked to submit raw data rather than a rate to the LIBOR administrator. This will obviously be impracticable for the purposes of a Reference Bank Rate. This is why the definition of "Reference Bank Rate" in relation to LIBOR requires contributor banks to follow the LIBOR methodology only in so far as it requires them to submit a single rate.

EMMI has also been investigating turning EURIBOR into a transaction-based rate. However a recent data collection process intended to inform the new methodology indicated that it is not feasible to do so under current market conditions. Accordingly EMMI announced in May that EURIBOR will continue as a quote-based benchmark while the development of a hybrid methodology is explored.

In addition, the above changes to the benchmark provisions prompted a review of, and some adjustments to, the market disruption provisions (see commentary on Clause 11.3 (*Market Disruption*) in Part III).

Current market practice

The changes to the Investment Grade Agreements relating to benchmarks were, as usual, discussed by the LMA and the ACT. Although they are quite wide-ranging, they are not in the main, controversial. However, the introduction of more optionality into the interest rate provisions means that they have been the subject of closer focus in documentation discussions over the last few years than was previously the case.

The aspects that are discussed in practice are the optional provisions:

- The choice of whether to include or exclude the impact of any intra-day re-fix of the relevant benchmark rate in the LMA definition of “Screen Rate” in Clause 1.1 (*Definitions*).
- The identity of the “Reference Banks” (which still feature in most transactions), defined in Clause 1.1 (*Definitions*).
- The fallback rates applicable if the Screen Rate is unavailable in Clause 11.1 (*Unavailability of Screen Rate*) and related market disruption provisions in Clause 11.3 (*Market Disruption*).

These options are discussed in detail in the context of the relevant clauses in Part III.

Interestingly, the option to use Reference Bank Rates is not generally being discussed and Reference Bank Rates are being retained in most agreements. It is true that the circumstances in which they are likely to be required are very limited. However, if they are required, doubts as to whether the rates would be made available (see Clause 11.2 (*Calculation of the Reference Bank Rate*)) might suggest that the utility of the current mechanism could be revisited in future.

The question then, is what might be used in place of Reference Bank Rates, if the default position of paying individual lenders’ cost of funds in the event Reference Bank Rates are unavailable is to be avoided? It may be that for some borrowers, an average rate based on a sub-group of lenders’ individual funding costs (rather than a benchmark proxy rate) might be preferable, in particular for those with larger syndicates involving a range of lenders. It could potentially enable them to select their relationship banks’ rates rather than becoming obliged to pay the range of funding costs applicable to each lender. However, whether this would be of market-wide appeal is not clear. Lenders may feel that this sort of suggestion is rather too close to the “Alternative Market Disruption Provisions” that used to form part of the Lehman provisions, and which for the reasons explained in Part IV were not widely used. This is a topic that is likely to remain under review.

What’s next for LIBOR?

On 27 July, Andrew Bailey, the Chief Executive of the FCA made a speech examining the future of LIBOR. In summary, he noted that while significant improvements have been made to LIBOR since April 2013, data gathered by the FCA indicates that there are insufficient underlying transactions to support LIBOR calculations which raises a “serious question” about the sustainability of the benchmark. Reluctance among banks to expose themselves to the regulatory and reputational risks involved in LIBOR submissions, in particular those involving expert judgment, suggests that the continued existence of the rate is reliant on the FCA’s efforts to persuade and/or compel panel banks to participate in the LIBOR process. For various reasons, the FCA feels unable to continue to urge banks to submit to LIBOR over the longer term. Mr Bailey therefore indicated that the FCA will do so only until the end of 2021, a time frame selected to enable a smooth transition to any replacement rate.

What does this mean for the loan market?

The FCA’s view that it is unable to support the production of LIBOR indefinitely does not necessarily mean LIBOR will be discontinued on the specified cut-off date. LIBOR is produced by the IBA. If the IBA receives sufficient submissions for a particular LIBOR rate or rates, it may choose to continue to produce them. However, the shrinking number of banks willing to contribute suggests that market participants need to anticipate the implications of the demise of LIBOR in its current form. This requires an examination of the operation of existing documentation terms as well as the development of an appropriate alternative rate.

The LMA has already taken a number of steps to “future-proof” the benchmark provisions in its templates which cater for a variety of contingencies. The implications of the FCA’s announcement under existing LMA terms will depend on precisely what happens to LIBOR.

Will LIBOR disappear completely? If LIBOR is adapted in some way, questions may arise as to whether “LIBOR” as defined under LMA terms remains available, albeit in an altered form, such that existing agreements can continue undisturbed. These can only be analysed as and when proposals (if any) are put forward.

If LIBOR ceases to be available altogether, as noted above and discussed further in Part III, current LMA terms contain an extensive fallback rate regime and market disruption provisions. However, fallback rates are not intended to be used on a long-term basis and it is likely that the parties would need to agree a replacement rate. The LMA templates provide a framework for doing so which attempts to make the process as smooth as possible: if interest is being paid on a cost of funds basis under the fallback rate provisions in Clause 11 (*Changes to the calculation of interest*), either the Agent or the Company may instigate a 30 day negotiation period with a view to agreeing a substitute basis for determining the rate of interest. Further, optional Clause 35.4 (*Replacement of Screen Rate*) provides that if any Screen Rate is not available, the amendments to the agreement required to implement a substitute rate may be made with consent of the borrower and the Majority Lenders.

This framework does not assist, however, with the question of what rate the market might adopt - or develop - to replace LIBOR. Appropriate provisions for new agreements that anticipate and effect a transition to a new rate can only be developed when consensus as to the shape of any new rate emerges.

In the UK and in the US, working groups are looking to transition from LIBOR to a risk free rate, but have so far primarily focussed on the derivatives market. The Bank of England’s Working Group on Sterling Risk-free Rates has endorsed SONIA as an alternative to sterling LIBOR for the derivatives market, but acknowledges that further thought is required in relation to other LIBOR-based products. The Alternative Reference Rates Committee in the US is engaged in a similar exercise and has announced a Treasuries repo financing rate as an alternative to LIBOR for certain US dollar derivatives and other financial contracts. At the time of writing, the process of developing alternatives to LIBOR (and in particular, alternatives that are appropriate for the loan market) remains in its initial stages.

The implications of the potential discontinuation of LIBOR extend beyond the loan market, affecting all sorts of financial products and transactions. The ACT plans to continue to monitor developments and engage with treasurers, the trade associations and regulators on this important topic as it evolves.

5. Sanctions

Background

Sanctions can take multiple forms, including trade restrictions (for example, restrictions on the supply of arms to or the import of goods from the sanctions target), restrictions on travel by sanctioned individuals as well as financial sanctions intended to freeze the assets of the sanctioned person or entity or block access to capital markets and financial services.

Financial sanctions are of particular relevance to the debt markets. Such provisions may prohibit those to whom they apply from:

- dealing with funds or economic resources belonging to, or owned, held or controlled by a sanctions target; and
- making funds or economic resources available, directly or indirectly, to or for the benefit of a sanctions target,

in each case, without appropriate authorisation or a licence from the relevant authorities.

These restrictions can emanate from multiple sources, and to varying degrees, have an impact on the activities of both natural and legal persons located beyond the territorial limits of the imposing country. Sanctions imposed by a number of jurisdictions are often relevant to loan transactions depending on the nationality and location of operations of the lenders and the borrower group.

A breach of financial or trade sanctions carries serious reputational risks for a financial institution in addition to the financial implications of the heavy penalties that can be imposed. An investigation into the borrower group's compliance with sanctions laws is a customary and important part of a lender's pre-contract due diligence.

Historically, this due diligence, coupled with the general contractual assurances addressing illegality and unlawfulness customarily included in loan documentation (for example in the Investment Grade Agreements, Clause 8.1 (*Illegality*), Clause 22.2 (*Compliance with laws*) and Clause 23.10 (*Unlawfulness*)), were considered sufficient to address sanctions risks in most lending transactions. Specific contractual assurances were normally required only from borrowers operating in sectors or countries perceived to be higher risk in this context (meaning such provisions were more common in emerging markets and certain project financing transactions).

More recently, increasingly aggressive enforcement action, especially by the US sanctions authorities, has prompted lenders to seek contractual assurances on these topics (in the form of specific representations and undertakings), both to crystallise the results of their due diligence and to ensure that no compliance issues arise over the life of the facilities from all types of borrower as a matter of course. Although some strong investment grade credits are able to borrow without being subject to sanctions provisions (where lenders are able to be comfortable that due diligence is an adequate response), sanctions provisions of some type are now included in the majority of syndicated loan agreements.

This development has in many cases resulted in time consuming negotiations on sanctions provisions between lenders and borrowers. Lenders take a range of views on the appropriate scope of such provisions and each major bank has its own drafting proposals. The more wide-ranging protections sought by certain banks reflect the breadth of the legislative regimes they are intended to address. On the other hand, the risks to the borrower of agreeing to wide-ranging contractual provisions which are felt to be disproportionate to the risk to lenders can result in challenging discussions.

A key difficulty here is that lenders may be subject to different, or more extensive sanctions regimes than their borrowers and (in broad terms), lenders are obliged to ensure that their lending activities do not ultimately result in their funds being used in breach of the sanctions regimes to which they are subject. The "rub" often stems from the difference between US sanctions (with which most internationally active banks will comply, but which may not directly affect the business of UK or EU-based borrowers) and sanctions in place in the EU and other jurisdictions. Sanctions may target particular countries or sectors, but in recent years EU sanctions (the source of much of the UK regime) have tended to be quite focused on named individuals and entities connected with particular regimes and organisations. The US often takes a broader approach than the EU, combining country or sector-based sanctions with targeted designations.

As this is a topic that has been discussed on almost every transaction over the past two to three years, lenders, borrowers and their advisers have become more familiar with the key risks to be addressed, the issues that can be contentious and the possible compromise positions that might be offered. However, there remains no "market standard" position, and the detail of the drafting must still be settled on a case-by-case basis.

Current market practice

In terms of the key risks, lenders' opening proposals often include assurances in relation to the following:

- *Sanctions targets and sanctioned countries*: the borrower group and its directors, officers and employees are not the target of sanctions nor does the group operate in countries subject to comprehensive sanctions.
- *Compliance*: the borrower group's compliance with specified "Sanctions".
- *Use of proceeds and "clean funds"*: the proceeds of the facility will not be used in breach of sanctions and will not be repaid with the proceeds of sanctioned activities.
- *Absence of investigations*: the absence of investigations by sanctions authorities.
- *Policies and procedures*: the existence and maintenance of policies and procedures designed to facilitate and achieve compliance with sanctions.

Some borrowers, especially strong investment grade credits (unless considered “high risk” for some reason) may be able to limit the list of topics to be addressed in sanctions representations and undertakings quite significantly, for example, to focus solely on assurances that there is no sanctions target or activity in breach of sanctions within the group, and as to the use of the proceeds of the facilities.

Others may be required to give assurances on a more extensive range of issues. However, in the investment grade market, not all of the above topics are covered in all cases. In particular, assurances with regard to “clean funds” (to the effect that payments to lenders will not be made with the proceeds of sanctioned activities) and specific assurances with regard to the absence of investigations are not always required.

Once the list of topics on which lenders are to be given contractual assurance has been agreed, the detailed text of representations and/or undertakings on this topic requires discussion. Common negotiating points include:

- *Limitations on the concept of “sanctions” for the purposes of any representations and undertakings:* The lenders’ starting point may be that any provisions regarding sanctions compliance should encompass all applicable laws. Borrowers are often able to limit their scope to capture only sanctions regimes in key jurisdictions, commonly the US OFAC regime, the EU regime and the UK regime.
- *Limitations by reference to knowledge:* For example, it is common for undertakings relating to the use of the proceeds of the facility in breach of sanctions to extend to the direct or indirect use of those proceeds. Borrowers often seek to provide that they will not knowingly use the proceeds in breach of sanctions. Similarly, representations relating to compliance with sanctions by the borrower’s directors, officers and employees are often qualified by reference to the borrower’s knowledge.

Other qualifications, for example materiality qualifications, sometimes crop up but with less consistency. In addition, if the borrower group undertakes activities in countries that are subject to sanctions (for example, under licence), appropriate carve-outs from the sanctions provisions will need to be agreed.

Another important issue to consider is whether an Event of Default is the most appropriate consequence of a breach of any sanctions representations and/or undertakings. In syndicated transactions, lenders may take the view that they would prefer to determine for themselves whether to exit the deal in the event of a sanctions breach. Accordingly, a mandatory prepayment right may be more appropriate than an Event of Default. If the borrower is concerned about the possibility of wide-ranging representations and undertakings giving rise to hair-trigger Events of Default, they too may prefer a mandatory prepayment right. However, whether that would assist in avoiding any cross-default implications of a sanctions breach will depend on the drafting of the cross-default Event of Default.

The practical advice to treasurers is to make sure that legal advice on the likely nature and scope of such provisions is sought at an early stage and an agreed position is reflected in the term sheet.

LMA response

While the LMA has produced a number of helpful guidance notes on sanctions, to date, the LMA has not incorporated any specific clauses relating to sanctions into its English law templates. It is assumed that this is due to the differing views of lenders on this topic and also because the nature of such provisions remains dependent on the borrower’s business and circumstances. However, footnotes to the representations and undertakings clauses in all of the LMA’s facility agreement templates remind users to consider whether express contractual protection on this topic is required. The footnotes also suggest that the parties may wish to discuss whether amendments and waivers affecting any such provisions (if included) should be matters that require the consent of all lenders, something certain lenders are currently insisting on.

6. Anti-corruption laws

Background

The phrase “anti-corruption laws” is used primarily to describe laws designed to combat corrupt practices, in particular, bribery. In broad terms, anti-corruption regimes, including those in the UK and the US, are often

driven by international commitments, and prompt lenders actively to seek to identify bribery and corruption risks and put in place and maintain policies and processes to mitigate them.

Best practice is quite commonly considered to include contractual protection in appropriate cases. Contractual provisions relating to compliance with anti-corruption laws are therefore appearing with increasing frequency in corporate documentation, often alongside provisions relating to sanctions.

LMA response

The Investment Grade Agreements do not contain representations and undertakings relating to anti-corruption laws, accurately reflecting that such provisions, although not uncommon, are not standard practice in the investment grade market. Anti-corruption representations and undertakings are included in most of the LMA's other forms of facility agreement, for example the Leveraged Agreement and its suite of agreements for developing markets borrowers. These provisions are often used as a starting point for negotiations by lenders in various contexts, including in investment grade loans.

The LMA's form of representation and undertaking on this topic each address the borrower group's compliance with "applicable anti-corruption laws" including the UK Bribery Act 2010 ("**Bribery Act**") and the US Foreign Corrupt Practices Act 1977 ("**FCPA**") in the conduct of its business, as well as the adoption and maintenance by each member of the borrower group of policies and procedures designed to promote and achieve compliance with such laws.

The Obligors also undertake, on behalf of each member of the Group, not to use the proceeds of the facilities for any purpose that would breach the Bribery Act, the FCPA or other similar legislation.

The practice of seeking an undertaking with regard to the use of proceeds of the loan is interesting because it does not necessarily stem from a direct legal requirement (at least under the Bribery Act). Thus it potentially represents some gold-plating of the legal requirements on the part of the lenders. It does, however align undertakings regarding compliance with anti-corruption laws with undertakings on sanctions, where, as noted above, the parties are typically legally required to ensure the proceeds of the loan are not applied in breach of sanctions.

Current market practice

Provisions relating to anti-corruption laws are not imposed on all borrowers and may be resisted by stronger borrowers. This is typically on the same basis as historically applied in relation to sanctions provisions (see paragraph 5 above), that the group's compliance with anti-corruption laws is addressed adequately by pre-contract due diligence and the general assurances in the Investment Grade Agreements with regard to illegality and unlawfulness.

In general terms, contractual provisions relating to anti-corruption laws tend to be less controversial than equivalent provisions relating to sanctions, most likely because they tend to be more limited and less complex in formulation:

- Many borrowers are comfortable to give lenders comfort with regard to their compliance with anti-corruption laws, in some cases, subject to appropriate materiality qualifications.
- Many borrowers may also be comfortable to give comfort regarding policies and procedures. Criminal proceedings against a corporate for the offence of failure to prevent bribery under the Bribery Act can be defended if the company has adequate procedures in place to prevent bribery and corruption. While there is no obligation on (unregulated) corporates to have adequate procedures in place, if they do not, they will not be able to use the defence in the event of criminal prosecution. Many large UK corporates will therefore have well-established anti-corruption policies and procedures.

Undertakings with regard to the use of the proceeds of the loan are perhaps slightly less common notwithstanding the LMA language, most likely, as noted above, because this may not be a legal requirement. As in relation to equivalent undertakings regarding the use of proceeds of the loan in breach of sanctions, where included, knowledge qualifications (in particular with regard to the "indirect" use of proceeds) are negotiated reasonably often.

7. FATCA

Background

FATCA was introduced in 2010 as a means of addressing US tax evasion by US account holders. FATCA achieves this objective by requiring foreign financial institutions (“FFIs”) to provide detailed information on their US account holders to the US Internal Revenue Service (“IRS”). As the US Government does not have direct jurisdiction over most FFIs, FATCA encourages compliance primarily via the imposition of a 30% withholding tax on, *inter alia*, US source income paid to FFIs who do not comply with FATCA’s reporting requirements.

When FATCA was first announced, lenders and borrowers had serious concerns about how FATCA withholding risk would be allocated and how compliance with the reporting requirements might be achieved. In summary:

- Lenders worried about the cost and effort required to comply with FATCA in order to avoid withholding and raised legitimate concerns about their ability to comply without breaching applicable confidentiality and data protection rules.
- Borrowers were primarily concerned because of their contractual position: if a Finance Party suffers FATCA withholding on a payment made to it under a Finance Document, the risk is that it would (in the absence of a specific exclusion in the agreement) be able to pass this cost on to the borrower under Clause 13.2 (*Tax gross-up*), Clause 13.3 (*Tax indemnity*) or even Clause 14 (*Increased Costs*).

Further background on the application of FATCA to the syndicated loan market is included in Part III in the commentary on Clause 13 (*Tax Gross Up and Indemnities*).

LMA response

Following the enactment of FATCA in 2010, the LMA did not make any recommendations as to how the implications of FATCA should be addressed in the Investment Grade Agreements. Instead it provided guidance to the market in the form of a note to members, containing alternative options for the allocation of FATCA withholding risk between the Finance Parties and the borrower (the “FATCA Riders”).

The FATCA Riders initially comprised two alternative options, neither of which was particularly attractive from the borrower’s perspective.

A third option, Rider 3, was added to the FATCA Riders in July 2013 and was significantly more favourable to borrowers. Rider 3 entitled all parties to make any required FATCA withholding, but made clear that should a withholding requirement arise, no party would be obliged to gross-up or compensate any other party in respect of the relevant deduction. Rider 3 also excluded the possibility of claims relating to any FATCA deduction being pursued against the borrower via the tax indemnity or the increased costs clause.

Current market practice

Since the FATCA Riders were first published, the UK and many other key jurisdictions have entered into inter-governmental agreements (“IGAs”) with the US, which have the effect of largely eliminating FATCA withholding risk for lenders in those jurisdictions. As a result, since the last edition of this guide, Rider 3 has become the standard way of dealing with FATCA in European loan documentation, regardless of whether the borrower group includes a US entity or has US source income.

This widespread adoption of Rider 3 prompted the LMA to incorporate the text of Rider 3 (with some minor adjustments) into the Investment Grade Agreements in 2014.

The FATCA Riders also included certain “common provisions”, to be used in conjunction with each of the three Riders. They require each party to confirm its FATCA status to the others to facilitate compliance. They also provide a mechanism for replacing the Agent if its involvement risks triggering FATCA withholding. These “common provisions” were incorporated into the Investment Grade Agreements in 2014 alongside the text of Rider 3 (again with some minor modifications).

Thus although the contractual treatment of FATCA risk still requires discussion in transactions involving lenders in non-IGA jurisdictions, where there remains some variation in the agreed position, in many transactions the FATCA position does not require negotiation. The “Rider 3” approach to FATCA reflected in the Investment Grade Agreements is generally accepted.

8. Lease accounting

Background

Treasurers will be aware that leases may be accounted for in different ways under current rules. Under IAS 17, the accounting treatment depends on the underlying economic effect of the lease. If the arrangement amounts to the financial equivalent of an asset purchase (because it “transfers substantially all the risks and rewards of ownership of an asset to the lessee”), the lease is classified as a finance lease. Any lease that is not a finance lease, is an operating lease.

Finance leases are essentially treated as debt. In the lessee’s accounts, the leased asset appears on the asset side of the balance sheet and a discounted amount in respect of the obligation to pay rent will appear as a liability, as if the lessee had bought the asset and incurred debt to pay for it. Assets leased under an operating lease, in contrast, do not appear on the balance sheet. Rental payments in respect of operating leases are currently charged to the income statement as operating expenses.

IFRS 16

Significant changes to lease accounting rules have been on the IASB’s agenda for many years. New IFRS 16 was finally published in January 2016.

IFRS 16 represents a major alteration in the approach to lessee accounting. The key point for present purposes is that under IFRS 16, most leases, including leases that are currently classified as operating leases, must be accounted for on-balance sheet. As the standard is adopted, lessee companies’ balance sheet assets and liabilities will increase, in some cases, quite significantly. The change will also impact the income statement, as the charge for depreciation and interest expense that currently applies only to finance leases, will apply to all on-balance sheet leases.

Companies using IFRS are required to adopt IFRS 16 for accounting periods starting on or after 1 January 2019, although earlier adoption is permitted subject to conditions.

Impact of IFRS 16 on loan documentation

The balance sheet recognition of operating lease commitments has the potential to affect a number of financial tests and ratios customarily used in loan documentation:

- Loan terms that reference the lessee group’s total assets, for example, asset-based financial ratios and guarantor coverage tests, as lessees’ gross or total assets may increase.
- Measures of profitability such as EBITDA, which are commonly used in financial ratios and other tests, due to the increase in charges for depreciation and interest expenses.
- Provisions which purport to measure indebtedness, as loan market practice is to treat only finance lease obligations as borrowings, in line with the current accounting treatment.

The impact of IFRS 16 on provisions which measure indebtedness has been an area of particular focus. Prior to the recent changes made by the LMA:

- A “Finance Lease” was defined for the purposes of the LMA definitions of “Financial Indebtedness” and “Borrowings” as “any lease or hire purchase contract which would, in accordance with the Accounting Principles, be treated as a finance or capital lease”.
- The LMA definition of “Financial Indebtedness” (discussed under Clause 1.1 (*Definitions*) in Part III), which typically frames the scope of any covenant restricting the incurrence of indebtedness, as well as the cross-default Event of Default (and potentially also, aspects of the negative pledge) captured liabilities under “Finance Leases” only.
- Similarly, the LMA definition of “Borrowings”, which features in the LMA’s financial covenant provisions and determines the debt components of the leverage, interest cover and cash flow cover ratios, included “Finance Lease”, but not operating lease liabilities.

IFRS 16 does not dispense entirely with the classification of leases as finance leases and operating leases, but the distinction is retained only for the purposes of lessor accounting. In a lessee’s accounts, applying the

new standard, leases will not be required to be “treated” as finance or capital leases as envisaged by the LMA definition quoted above.

This prompts the question of how the LMA definition of “Finance Lease” quoted above and any other provisions that purport specifically to capture finance lease and not operating lease obligations would be interpreted once the new standard is adopted. The potential for uncertainty means that many borrowers with loan facilities extending beyond the implementation date for IFRS 16 have for some years been choosing to provide expressly that any reference in their documentation to the term “finance lease”, shall be interpreted in accordance with the accounting principles applicable as at the date the facility was entered into.

LMA response

In June 2016, following discussions with the ACT, the LMA updated all of its recommended forms of facility agreement to anticipate the transition to IFRS 16. All references to finance or capital leases in the templates have been replaced with a reference to:

“...any lease, which would, in accordance with applicable GAAP, be treated as a balance sheet liability [(other than any liability in respect of a lease or hire purchase contract which would, in accordance with GAAP in force [prior to 1 January 2019]/[prior to []]/[], have been treated as an operating lease)]...”

This revised definition applies for the purposes of the definition of “Financial Indebtedness” (discussed in Part III at Clause 1.1 (*Definitions*)). It is also incorporated into the definition of “Borrowings” that is used in the LMA templates that include financial covenant provisions (for example, the Leveraged Agreement).

The borrower’s perspective

The removal by the LMA of any reference to the term “finance lease” in its templates is useful to address the interpretative difficulties that will arise once that term has no meaning in the context of lessee accounts. Until such time as the balance sheet implications of IFRS 16 have been properly assessed, most borrowers are likely to wish to include the optional language excluding “old” operating leases.

It is necessary, however, to consider the most appropriate way to draft the limitation language. The LMA has included footnotes to relevant provisions to highlight that the appropriate drafting here is to be negotiated, taking into account whether the agreement is being negotiated before or after IFRS 16 comes into force and indeed whether IFRS 16 is the applicable accounting standard (the lease accounting standards under US and other domestic GAAP regimes are also changing).

For loan agreements being entered into prior to 1 January 2019, treasurers may feel slightly uncomfortable defining lease obligations that are to be counted as financial debt in accordance with “GAAP in force prior to” a future date (for example, 1 January 2019). It seems unlikely based on current information that further changes would be made to the accounting treatment of leases prior to 1 January 2019, but it is theoretically possible. In addition, some companies may adopt IFRS 16 at an earlier date if the relevant conditions specified in the standard are satisfied.

Accordingly, treasurers might prefer the following option (referred to in the footnotes to the LMA drafting) for the time being:

“...any lease, which would, in accordance with GAAP in force as at the date of this Agreement, be treated as a balance sheet liability...”

“Frozen GAAP”

The limitation language quoted above should ensure that the loan agreement is not disrupted by the change in accounting principles. However it does mean that once IFRS 16 is implemented, affected borrowers must continue to prepare accounts that distinguish between finance and operating leases (i.e. based on the pre-existing regime) in order to determine whether any limits on lease liabilities in their lending documentation have been complied with.

In the context of financial covenant tests, most loan agreements make express provision for this. All LMA facility agreements contain an optional, but commonly adopted provision (Clause 20.3(c) in the Investment Grade Agreements) which requires that each set of financial statements delivered pursuant to the agreement is prepared on a basis consistent with the first. If there is a change in accounting standards or policies,

the borrower is required to notify the Agent and provide information sufficient to enable the lenders to compare the most recently delivered financial statements with the original set and to determine whether the financial covenants (to the extent applicable) have been complied with.

The production of two sets of accounts is unlikely to be practical on an ongoing basis. Accordingly, treasurers should be thinking about the sorts of adjustments that are likely to be required to accommodate the effects of IFRS 16 in the longer term.

How will the market accommodate IFRS 16?

The LMA's drafting might be taken to indicate that the intention of the lending community is to capture all on-balance sheet leases within financial measures and ratios in loan documentation going forward. However, one might question whether the new standard could lead to any more fundamental changes in the way lenders assess the level of debt in a borrower's business in loan documentation. Leverage tests are a key metric for lenders in all sectors of the loan market as well as for certain regulators. It seems reasonably certain that it will become challenging to compare leverage levels across industries following the adoption of IFRS 16, due to differing levels of operating lease commitments. It remains to be seen whether this results in any change to how leverage ratios are used and formulated.

At the time of writing, many companies are still getting to grips with the full implications of the transition to IFRS 16, so these questions remain outstanding. For companies with extensive operating lease commitments, the impact of IFRS 16 may be significant. For some, a reassessment of their lease commitments on a structural level may ensue. This process will need to be completed before any related amendments can be made to a company's loan agreements or other financing documentation. However, it might be thought likely that many borrowers will ultimately have to negotiate adjustments to their covenant tests and baskets to accommodate IFRS 16.

Accordingly, borrowers embarking on a refinancing may wish to include a clause in their loan agreements that anticipates the need for future amendments, as happened prior to the adoption of compulsory IFRS in 2005. During that period, many lenders and borrowers supplemented the "frozen GAAP" and LMA reporting provisions referred to above with a clause endorsed by the ACT and the LMA, providing that in the event of a change in accounting principles, the parties will enter into good faith negotiations with a view to agreeing any amendments to the agreement necessary as a result of the change, with the aim of ensuring that the change does not result in any material alteration to the commercial effect of the relevant obligations. Such clauses provided a helpful framework for the implementation of IFRS-related covenant amendments and may be of similar assistance in anticipating IFRS 16 and the equivalent changes to US and other local GAAP regimes.

See further Clause 20.3 (*Requirements as to financial statements*) in relation to the LMA's "frozen GAAP" clause, including the text of the clause agreed by the ACT and LMA and mentioned above.

9. Article 55 of the BRRD

Background

The EU Bank Recovery and Resolution Directive ("BRRD") introduced an EU-wide framework for the recovery and resolution of EEA credit institutions and investment firms. The BRRD requires EU member states to confer special resolution powers on regulators in respect of EU credit institutions, most investment firms and their groups. These include the so-called "bail-in" power, which in outline, enables the relevant regulator to write down and/or convert the liabilities of a failing institution into equity. The BRRD has been implemented in full in the UK, primarily by amendments to the Banking Act 2009, the special resolution regime that was put in place some years ago in response to the financial crisis.

The BRRD and related legislation provides a framework for the mutual recognition of resolution powers exercised by an EEA regulator, across the EEA. Accordingly, the bail-in powers of EEA regulators should be effective in relation to any liabilities governed by the laws of an EEA country. However, this is not necessarily the case in relation to liabilities governed by the law of a country falling outside the BRRD regime. Article 55 of the BRRD attempts to address this. It requires EEA financial institutions to replicate contractually the statutory mutual recognition requirements that apply across the EEA in any agreements governed by non-EEA law pursuant to which the institution has a liability.

The key point to note is that the concept of “liability” for this purpose is quite broad. As applicable to UK institutions, for example, it potentially includes obligations in lending documentation such as lending commitments, indemnity obligations (the customary indemnities given by lenders to the Agent or other administrative parties) and any notification obligations under the agreement. Accordingly, notwithstanding representations from the LMA and others that such liabilities would not seem to be of the sort at which the bail-in tool is aimed, it has generally been concluded necessary to include a contractual bail-in clause in any loan documentation entered into by an EEA financial institution which is subject to the BRRD, and which is governed by the law of a non-EEA country (for example, a New York law loan agreement).

Neither the EU nor national regulators have specified the form a bail-in clause (an “A55 clause”) should take. The LMA, however, has produced a form of A55 clause to be included in LMA-based loan documentation governed by the law of a non-EEA country. Pursuant to the LMA A55 clause, the institution’s counterparties acknowledge that the institution’s obligations under the agreement are potentially subject to bail-in at the instigation of an EEA regulator.

The borrower’s perspective

A55 clauses respond to a regulatory obligation with which financial institutions within the scope of the BRRD are required to comply. As a result, whether or not to include an A55 clause is not generally a topic for negotiation. In any event, there are no particular points for borrowers on the text of the LMA A55 clause itself and resistance may have limited effect should the BRRD resolution powers be exercised in respect of the relevant lender. However, the prospect of a counterparty’s liabilities being disrupted as a result of regulatory or government intervention is generally unappealing. The existence of the BRRD bail-in powers and any other legal and regulatory powers to disrupt lending relationships in the event a financial institution gets into financial difficulty, including under the UK regime, are an important counterparty risk factor for treasurers to consider.

The main line of attack here for an investment grade borrower lies in maintaining close relationships with a variety of banks. In terms of documentation, it is helpful to negotiate as much control as possible over the composition of its syndicate (for example, by providing that transfers or assignments of lenders’ participations are subject to its consent, a right that is presented as standard in the Investment Grade Agreements, see Clause 24 (*Changes to the Lenders*) in Part III). The LMA’s Lehman provisions, which provide for the management of defaulting and insolvent lenders and administrative parties (these are discussed in Part IV) may assist in ensuring that a single lender or Agent in financial difficulties does not disrupt the entire facility.

Brexit

Following Brexit, the UK will (absent special arrangements) become a third country for the purposes of the BRRD. In anticipation, it has been suggested that A55 clauses should be included in English law contracts (such as the Investment Grade Agreements) under which an EEA institution has a liability and which is expected to continue beyond the UK’s withdrawal from the EU.

Currently there seem to be mixed views among the banking community in the EU27 as to whether this is necessary or advisable. So far, A55 clauses are not being adopted in English law lending documentation on a widespread basis.

This is possibly due to unwillingness on the part of UK institutions to address a contingency which it is not clear will arise. The withdrawal of the UK from the EU and therefore the BRRD regime may not affect pre-existing contracts (when the BRRD came into force, banks were not required to re-open pre-existing contracts to insert A55 clauses). More generally, the EU and the UK should have a mutual interest in maintaining the status quo as part of the exit negotiations. The withdrawal of the UK from the BRRD regime could weaken the collective ability of UK and EU regulators to manage and mitigate the extreme adverse consequences that could flow from the failure of a major cross-border bank or investment firm. It should therefore be a priority for the UK government and the EU to agree an alternative system of mutual recognition and co-operation in relation to the planning and exercise of resolution powers. This is a concern for banks in particular because a failure to achieve this objective could result in more stringent prudential regulation in both the EU and the UK to counteract actual or perceived weaknesses in cross-border co-operation.

The LMA has alerted its members to this issue (the debate as to whether to include A55 clauses in English law agreements) but has not recommended a course of action.

10. Brexit

Impact on loan documentation

The prospect of Brexit and the impact it may have on the financial sector and therefore the loan market is the risk factor that has received the most attention from loan market participants over the last 12 months. Most banking lawyers have reviewed the potential documentation implications of Brexit in some detail. Areas of focus include:

- Whether the provisions that enable lenders to change the Facility Office through which their participation is provided or transfer the loan to another entity within their group are sufficiently flexible to accommodate post-Brexit restructuring.
- Whether English law continues to be an appropriate choice of law for lending transactions.
- The impact of Brexit on dispute resolution options and the popularity of submissions to the jurisdiction of the English courts (current market practice being underpinned by EU legislation).
- The use of references to the EU and to EU legislation in lending documentation.
- The tax implications of leaving the EU for payments under loan documentation.
- Whether an A55 clause should be included in English law loan documentation (as noted in paragraph 9 above).
- Whether Brexit, of itself, could trigger an Event of Default or prepayment event under LMA terms.
- Whether lending documentation should include clauses that contemplate adjustments to particular terms after the UK leaves the EU, or specific termination rights.

Although these topics (and others) have been analysed in some detail, in general, none have prompted changes to current documentation terms.

In some cases, this is because closer analysis has led to the conclusion that Brexit is unlikely to present an issue, at least from a UK perspective. For example, the application of the UK withholding tax regime as it affects payments under a loan agreement is not predicated on EU membership, nor is the validity of a choice of English law (see comments at Clause 39 (*Governing Law*) in Part III).

In other cases, risks have been identified, but whether those risks need to be addressed contractually depends on the outcome of the UK's exit negotiations. For example, post-Brexit the UK will no longer benefit from the EU regulation that ensures exclusive jurisdiction clauses will be respected by EU member state courts. However, there is considerable incentive for the remaining EU member states to agree some form of reciprocal arrangement as part of the UK's exit negotiations to ensure their own judgments remain enforceable in the UK (as well as a number of legal options that the UK may take itself). The general conclusion so far has been that the likelihood of this risk materialising is not sufficiently high as to outweigh the benefits of current market practice (see comments at Clause 40 (*Enforcement*) in Part III). The question of whether to include an A55 clause in English law loan documentation (see paragraph 9 above) also falls into this category.

In summary, a conclusion on many of the points listed above is currently awaiting further information on the detail of the UK's exit and any transitional arrangements. This is reflected in the LMA's response. Although it has published some helpful guidance material, it has not yet recommended any changes to its template documentation. As a result, the need for and extent of any Brexit-related adjustments is likely to require attention in most loan transactions for some time to come (even if the conclusion, as is the case currently, continues to be that no action is required).

Some of the issues highlighted above with potential implications for particular provisions of the Investment Grade Agreements are discussed in a series of "Brexit Notes" in Part III.

A note on exchange rates

The UK's vote to leave the EU had an immediate effect on the value of sterling (and to a slightly lesser extent, the euro) against other world currencies, most notably, the US dollar. For some companies this

has been a positive development. For others, for example those with dollar exposure/reporting and sterling/euro revenues, this has led to concerns about whether sterling's continuing weakness could have adverse implications under lending terms. The prospect of Brexit of itself, may have had minimal effects on documentation, but its effect on the foreign exchange markets is, in some cases coming up in loan documentation discussions.

Currency movements can affect certain financial covenant calculations. The likely extent of the impact needs to be assessed on a case-by-case basis, but exchange rate movements most commonly affect restrictions on leverage. Most leverage ratios compare the borrower group's debt, a balance sheet number, to a measure of profitability, usually a defined concept of EBITDA. Discrepancies in exchange rates in the period over which profitability is measured and applicable rates at the balance sheet date may impact leverage multiples and in extreme cases, can result in a covenant breach.

Volatile exchange rates can lead borrowers to breach certain monetary or financial limits that are relatively common in loan documentation. For example, moving exchange rates can affect a borrower's ability to rely on exceptions to restrictive covenants that take the form of baskets capped at amounts specified in a particular currency (which might feature for example, in negative pledge provisions, restrictions on disposals and restrictions on the incurrence of Financial Indebtedness).

The potentially temporary or arbitrary effects of exchange rate movements under loan documentation can be excluded by express contractual provision. The appropriate solution tends to vary according to the borrower's circumstances and the nature of the issue, so no clauses of general application have yet emerged. However, it is a subject on which a number of treasurers are currently focused.

This topic is discussed further in Part III in the commentary introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) and at Clause 21 (*Financial covenants*).

Impact on lending generally

The generally uncertain outlook, most likely in large part prompted by the referendum result has had an impact on the volume of lending activity in Europe over the last 12-18 months. Borrowers may be uncertain about the impact of Brexit on their business. If potentially adverse, the treasury team may be thinking about what effect it might have on the group's future ability both to raise funds and to comply with existing financing terms. This is a topic that borrowers might anticipate lenders wishing to discuss with them as part of their credit analysis prior to committing to new financing arrangements.

Many treasurers will also be questioning what effect Brexit might have on the price and availability of credit in the medium to long-term, a concern that is likely to be more important to the borrower community than the documentation points highlighted above. For example:

- How many institutions are likely to leave the UK market and how might that affect banking relationships?
- Will the post-Brexit regulatory environment increase lenders' operational costs?
- How will lenders' funding costs be affected when (or if) central bank support is withdrawn?
- Will the cost of Brexit-related restructuring in the financial sector be passed on to borrowers in the form of higher margins and fees?

Most financial institutions authorised in the UK (which comprises institutions based outside the EU which use the UK as a base for their EU operations as well as the UK banks) have devoted a significant amount of time to analysing which of their business lines will be affected by the potential loss of "passporting" rights and whether it is likely to be possible and cost-effective to continue affected activities either in reliance on existing rights conferred by the EU on "third countries (countries outside the EU) or by continuing the relevant business through an EU-authorised subsidiary. A number of major institutions have already begun the process of restructuring. However, the extent to which this will affect the cost and availability of credit, in particular for UK-based groups, remains challenging to anticipate given the range of possible scenarios. Such concerns may affect the timing of refinancing plans and colour priorities in negotiations (for example, tenors, extension options and covenant terms).

Treasurers will be keen to understand from their relationship banks how Brexit is being managed, which will vary from institution to institution. This seems likely to be a continuing question for some time. Treasurers are well-advised to open communications with their banks on this topic, to ensure they understand each institution's strategy for managing the transition to Brexit as it emerges.

Part III: Commentary on the Investment Grade Agreements

Structure of Part III

This Part III contains a commentary on key clauses of the multicurrency term and revolving facilities version of the Investment Grade Agreement (which the LMA refers to as its “**MTR**”). This commentary is tailored for use with the MTR (and refers to clauses of the MTR), but can be used with any of the other versions of the Investment Grade Agreement, since they are the same in all but essential mechanics.

A description of the operation of each key clause is included to assist treasurers who may be using this commentary for the purposes of reviewing draft loan documentation without the benefit of access to the MTR template.

The commentary below each description sets out the background to the relevant clause and how it is commonly approached in practice.

Parties to the Agreement: a note on terminology

The LMA terminology for the parties to the facility agreement (the “**Agreement**”) is as follows:

- The borrower-side parties comprise the “**Company**” (the holding company for the “**Group**”) and those of its “**Subsidiaries**” that are to be borrowers (“**Borrowers**”) and guarantors (“**Guarantors**”) under the Agreement:
 - The “**Company**” is usually a Borrower (often the main Borrower) and a Guarantor.
 - The Borrowers and Guarantors at the date of the Agreement (the “**Original Borrowers**” and “**Original Guarantors**”) are listed by name in Schedule 1.
 - The Borrowers and/or Guarantors under the Agreement from time to time are collectively referred to as the “**Obligors**”.

The definitions of “Group” and “Subsidiaries” are discussed at Clause 1.1 (*Definitions*).

- The lender-side and administrative parties comprise the “**Agent**”, the “**Arranger(s)**” and the “**Lenders**”:
 - The “**Lenders**” are the Lenders under the Agreement from time to time. The “**Original Lenders**” (the banks and financial institutions that enter into the Agreement as Lenders on Day 1), are listed by name in Schedule 1.
 - The “**Arranger(s)**” is/are the mandated lead arranger(s). They are usually also Lenders, but enter into the Agreement in their capacity as Arrangers as well as the Agreement confers certain rights on the Arrangers in their capacity as such (for example the right to receive arrangement fees, see Clause 12.2 (*Arrangement fee*)).
 - The “**Agent**” is the administrative agent for the Arranger(s) and the Lenders.
 - The Agent, the Arranger(s) and the Lenders are referred to collectively as the “**Finance Parties**”.

These are the only parties to the MTR as drafted. However, there may be additional parties in practice depending on the nature of the facilities. Secured syndicated facilities, for example, require the appointment of a security agent to hold the security on behalf of the Lenders. There may be additional lender-side and administrative parties if the facilities include swingline facilities (separate categories of swingline lenders and/or a swingline agent) or fronted letter of credit facilities, which require the appointment of one or more fronting banks (“**Issuing Banks**” in LMA terminology).

Section 1: Interpretation

Clause 1: Definitions and Interpretation

Clause 1.1: Definitions

This clause sets out the definitions of a number of key terms that are used repeatedly in the Agreement. The commentary below focuses only on certain key definitions and the optional definitions. They are listed in the alphabetical order in which they appear in the MTR.

“Availability Period”

This is the period for which each of the Facilities is available for drawing.

“Base Currency” and “Base Currency Amount”

The multi-currency versions of the Investment Grade Agreements operate on the basis that the Facilities are denominated in a “Base Currency”, into which any drawings in other currencies are converted on the date drawn.

The main implications of this are discussed at Clause 6.3 (*Change of currency*) and 6.4 (*Same Optional Currency during successive Interest Periods*).

“Benchmark Rate”

This optional definition is left blank to be completed by the parties. It is intended to describe the benchmark rate applicable to Loans drawn in currencies for which no LIBOR rate is published (***“Non-LIBOR Currencies”***). As discussed in paragraph 4 of Part II, the instances in which a benchmark rate other than LIBOR might be required have increased since the number of currencies for which LIBOR rates are produced was reduced in 2013.

This definition is part of a broader set of optional provisions catering for the use of alternative benchmarks for Non-LIBOR Currencies. If this definition is used, it will need to be completed alongside Schedule 14 (*Other Benchmarks*). The interest provisions of the Investment Grade Agreements reflect the conventions applicable to LIBOR and EURIBOR, which may not apply to other benchmarks. Schedule 14 is left blank for the parties to specify any adjustments to the Agreement that are required in relation to any Benchmark Rate (for example, to the definition of ***“Business Day”***, the payment, rate-fixing and calculation conventions, the Interest Periods that may be selected and the fallback rates to be used if the Benchmark Rate is unavailable).

When it was announced in 2013 that LIBOR rates for certain currencies were to be discontinued, attention focused on alternatives. In response to member demands, the LMA produced some “Domestic Interest Rate Benchmark Slot-in Schedules”, which contain a definition of “Benchmark Rate” and related provisions for the domestic benchmarks applicable to a number of currencies.

These provisions are technical, and generally not controversial once it has been agreed that one of the specified benchmarks is to be used (which is quite commonly the case in relation to the currencies covered). However, the LMA’s “Domestic Interest Rate Benchmark Slot-in Schedules” make clear that the LMA does not endorse the use of any particular benchmark and the parties must agree among themselves the operationally and commercially appropriate rate. Treasurers may wish to refer to the ACT’s Guide to LIBOR Alternatives⁴ or the Financial Stability Board’s “Reforming Major Interest Rate Benchmarks” update⁵.

⁴ www.treasurers.org/libor.

⁵ www.fsb.org/wp-content/uploads/Progress-in-Reforming-Major-Interest-Rate-Benchmarks.pdf.

LMA Domestic Benchmark Slot-in Schedules



Australian Dollars: Australian Bill Bank Swap Rates (BBSY (BID) and BBSW)



New Zealand Dollars: New Zealand Bank Bill Buy/Sell Rate (Average Mid) (BKBM (MID))



Canadian Dollars: Canadian Dealer Offer Rate (CDOR)



Danish Kroner: Copenhagen Interbank Offered Rate (CIBOR)



Swedish Kronor: Stockholm Interbank Offered Rate (STIBOR)

“Break Costs”

This definition determines the scope of the indemnity in Clause 11.6 (*Break Costs*), which is designed to compensate the Lenders for their broken funding costs if a Borrower makes a prepayment of principal on any day other than the last day of an Interest Period. “*Break Costs*”, in summary, consist of the amount by which:

- the interest which a Lender should have received on the relevant Loan, for the period from the date of receipt to the end of the Interest Period, exceeds
- the amount which it would be able to obtain by depositing the same amount for a period starting on the Business Day following receipt and ending on the last day of the Interest Period.

This is based on the theoretical assumption that Lenders arrange the funding of each Loan to coincide with the relevant Interest Period. As a result, if they are prepaid before the end of the Interest Period, costs or losses may be incurred. However, the early prepayment means that Lenders should be able to re-invest the amount prepaid by the Borrower, so their return on that re-investment is taken into account and will reduce the amount of Break Costs payable by the Borrower.

In practice

The LMA formulation of Break Costs is customary and the concept (the basis of calculation) is rarely questioned. The main commercial point that Borrowers take on this definition is that the calculation of Break Costs includes the Margin. The Margin is a return on the Lenders’ Commitment, which (the Borrower may argue), the Lenders should not be entitled to once that Commitment has been repaid (even if early). Break Costs should be specified to exclude the Margin. This is a particularly strong argument if the prepayment is the result of circumstances involving no fault on the Borrower’s part, such as under Clauses 8.1 (*Illegality*), 11.3 (*Market Disruption*), 13 (*Tax Gross Up and Indemnities*) and 14 (*Increased Costs*).

Other objections to the LMA’s definition of Break Costs raised by some Borrowers include that Lenders are not expected to re-invest the funds on the same day: this amounts, in effect, to a prepayment premium of one day’s interest on the amount prepaid. The Borrower could argue that it should not have to subsidise the Lenders for not acting promptly. The Lenders may reply that, however efficient they are, it is almost impossible to re-invest funds (certainly non-domestic funds) received on the same day, especially if they are received late in the day and without notice.

Some very strong Borrowers have argued that if the Lenders realise a profit following a prepayment on a day other than the last day of an Interest Period, this should be paid back to the Borrower (sometimes referred to as “break gains”). This is not a point that has often been raised in recent years and might be thought challenging to enforce in practice. It remains a feature of a few (often longer running) agreements.

“Business Day”

The LMA defines ***“Business Day”*** as a day on which banks are open for general business in London (reflecting that the Agent is assumed to be in London) and any other specified financial centre, which will depend on the currency of the Facilities.

This is an important definition which is used to frame the time periods for payment obligations, notification obligations and other actions under the Agreement. Its role in defining times for payment under the Agreement means that it needs to refer to days on which the financial centre of the currency in which each Facility is denominated is generally open for business. In relation to euro, it is customary to define ***“Business Day”*** as a day on which TARGET is open (see comments in relation to definition of ***“TARGET Day”*** below). This is also reflected in the LMA’s definition.

“Commitment”

This is the amount the Lenders have agreed to lend. Each Lender’s Commitment will reduce as the Facilities are finally repaid or cancelled.

“Compliance Certificate”

Clause 20.2 (*Compliance Certificate*) provides that the Borrower will deliver a Compliance Certificate alongside its financial statements, the form of which is set out in Schedule 9 (*Form of Compliance Certificate*). The purpose of the Compliance Certificate is primarily to confirm the Group’s compliance with any financial covenant tests. Accordingly, if none apply, this definition can usually be deleted.

There are some points for Borrowers on the form the Compliance Certificate is required to take. These are discussed at Clause 20.2 (*Compliance Certificate*).

“Confidential Information”

This definition determines the scope of the Finance Parties’ confidentiality undertaking to the Obligors. It is discussed at Clause 36 (*Confidential Information*).

“Confidentiality Undertaking”

The LMA publishes forms of confidentiality letter for use in conjunction with its recommended forms. This definition refers to its form of secondary market confidentiality letter, the current version of which is intended to be included in the Agreement at Schedule 11 (*LMA Form of Confidentiality Undertaking*). The letter protects Confidential Information relating to the Borrower and the Facilities in the hands of a potential purchaser of a participation in the Facilities. If the potential purchaser becomes a Finance Party, the terms of the letter are superseded by Clause 36 (*Confidential Information*) of the Agreement.

In practice

The LMA’s form of confidentiality letter is widely used. The letter is between the selling Lender and the prospective purchaser. Accordingly, the Borrower’s only opportunity to comment on the letter is at the point at which the agreed form is appended to the Agreement. Borrowers may want to ensure that any concessions achieved in the negotiation of Clause 36 (*Confidential Information*) apply equally to the form of letter in Schedule 11 (for example, with regard to the duration of the confidentiality obligations).

“Default”

Events of Default are defined in Clause 23 (*Events of Default*).

A Default is an Event of Default or any event or circumstance specified in Clause 23 which would be an Event of Default with the expiry of a grace period or the giving of notice or the making of any determination under the Finance Documents. A Default thus includes both an Event of Default and a potential Event of Default.

“Eligible Institution”

This definition describes the type of entity which is permitted to become a Lender pursuant to Clause 2.2 (*Increase*) and Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*). An Eligible Institution is any existing Lender or other bank, financial institution, trust, fund or other entity selected by the borrower. It broadly tracks the description of permitted transferees and assignees of Lenders’ interests in Clause 24.1 (*Assignments and transfers by the Lenders*), but differs in two respects. Firstly, according to the definition of “Eligible Institution”, the incoming Lender need not be “regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets” as specified in Clause 24.1. Secondly, the definition of ***“Eligible Institution”*** includes an optional exclusion for members of the Group. Whether members of the Group (or indeed any holding company of the Group, if the Group is not listed) should be excluded from this definition is a point that certain Borrowers might negotiate if there are entities within the Group or among its shareholders that could potentially hold a participation in the Facilities.

“EURIBOR”

The applicable benchmark for Loans in euro may be euro LIBOR or EURIBOR.

The EURIBOR rate administered by EMMI, the domestic euro rate for the euro area, is the more popular choice for euro-denominated syndicated loans. EMMI EURIBOR is currently defined as the rate at which euro interbank term deposits are offered within the EMU zone by one prime bank to another prime bank at 11 a.m. (CET)⁶. It is calculated on the basis of quotes from a range of banks, selected from across the EU.

Both LIBOR and EURIBOR are defined for the purposes of the Agreement as the Screen Rate on the specified day for the relevant currency and period, where a Screen Rate is available. If a Screen Rate is unavailable, the applicable rate is determined according to Clause 11.1 (*Unavailability of Screen Rate*).

The definitions of LIBOR and EURIBOR include an optional zero floor, to the effect that if the relevant rate is less than zero, it shall be deemed to be zero for the purposes of the Agreement.

In practice

The main point to negotiate in this definition is the zero floor language, discussed above in paragraph 3 of Part II. As noted, it is commonly included, but remains optional in the Investment Grade Agreements. Borrowers should not feel constrained from questioning its inclusion in appropriate circumstances.

If the applicable benchmark is agreed to be subject to a zero floor, Borrowers may wish to consider whether the floor should be matched in any associated interest rate hedging arrangements.

See further comments under “Screen Rate” below, Clause 9 (*Interest*) and Clause 11.1 (*Unavailability of Screen Rate*).

“Facility Office”

This is the office or offices through which each Lender performs its obligations under the Agreement. It is defined as the office or offices notified to the Agent on or before the date the Lender joins the syndicate, or following that date, any office of which the Agent is given five Business Days’ notice.

In practice

Borrowers should be aware that the effect of this definition is that any Lender is able to alter the office through which it performs its obligations at any time. This should not generally be objectionable to Borrowers unless in doing so, the Lender incurs additional tax or other costs which it is then entitled to claim from the Borrower.

Clause 24.3(c) of the Investment Grade Agreement, which provides that no Lender shall be able to claim additional amounts under Clause 13 (*Tax Gross Up and Indemnities*) and Clause 14 (*Increased Costs*) as a result of a Lender assigning or transferring any of its obligations under this Agreement or changing its Facility Office is important protection in this regard. Clause 16 (*Mitigation by the Lenders*) is also relevant here.

⁶ This definition could change going forward as EMMI EURIBOR evolves.

“Fallback Interest Period”

This optional definition is relevant to the Screen Rate fallback options provided in Clause 11.1 (*Unavailability of Screen Rate*). The length of the Fallback Interest Period is left blank to be agreed.

In practice

The LMA’s intention in providing for the use of a Fallback Interest Period is that it will be as short as possible. Periods typically agreed might range from around one week to one month.

“FATCA” and related definitions

These definitions are for the purposes of the provisions in Clause 13 (*Tax Gross Up and Indemnities*) which, as noted in paragraph 7 of Part II, ensure that each Party to the Agreement is responsible for managing its own risks in relation to FATCA and that information relating to each Party’s FATCA status is shared appropriately.

The LMA’s FATCA provisions are discussed at Clause 13 (*Tax Gross Up and Indemnities*).

“Financial Indebtedness”

This definition aims to capture liabilities for financial indebtedness of various types, including by way of guarantee or indemnity. In the Investment Grade Agreements it is used in the negative pledge (Clause 22.3), which restricts the creation of **“Security”** and **“Quasi-Security”** for Financial Indebtedness. It is also used in the cross-default clause (Clause 23.5), which provides for an Event of Default if there is a default under any Financial Indebtedness of a member of the Group.

Definition of Financial Indebtedness (Investment Grade Agreements)

“Financial Indebtedness” means any indebtedness for or in respect of:

- (a) *moneys borrowed;*
- (b) *any amount raised by acceptance under any acceptance credit facility or dematerialised equivalent;*
- (c) *any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;*
- (d) *the amount of any liability in respect of any lease or hire purchase contract which would, in accordance with GAAP, be treated as a balance sheet liability [(other than any liability in respect of a lease or hire purchase contract which would, in accordance with GAAP in force [prior to 1 January 2019] / [prior to []] / [] have been treated as an operating lease)];*
- (e) *receivables sold or discounted (other than any receivables to the extent they are sold on a non-recourse basis);*
- (f) *any amount raised under any other transaction (including any forward sale or purchase agreement) of a type not referred to in any other paragraph of this definition having the commercial effect of a borrowing;*
- (g) *any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price (and, when calculating the value of any derivative transaction, only the marked to market value (or, if any actual amount is due as a result of the termination or close-out of that derivative transaction, that amount) shall be taken into account);*
- (h) *any counter-indemnity obligation in respect of a guarantee, indemnity, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution; and*
- (i) *the amount of any liability in respect of any guarantee or indemnity for any of the items referred to in paragraphs (a) to (h) above.”*

In practice

Significance of this definition

Borrowers will need to give detailed consideration to the ways in which this definition is used in any draft agreement presented to them. It is used for limited purposes in the Investment Grade Agreement. Whether it presents a problem in the context of the negative pledge or the cross-default Event of Default may depend on whether those restrictions of themselves are appropriately framed (see comments in relation to those clauses). In practice, any detailed negotiation of this definition is often prompted by its use in the context of a covenant restricting the incurrence of Financial Indebtedness (which while relatively common in loan agreements generally, is not a feature of the upper end of the investment grade market and is not included in the Investment Grade Agreements).

Moneys borrowed

Paragraph (a) is very broad, covering any obligation to pay in relation to moneys borrowed. This includes all borrowings, overdraft and otherwise, whether the creditor is another member of the Group or a bank or other financial institution.

Leasing

Paragraph (d) catches indebtedness under any lease or hire purchase arrangement treated as a balance sheet liability under applicable accounting principles (“GAAP”). There is an optional exclusion for the amount of any liability in respect of a lease or hire purchase contract which would, in accordance with GAAP in force at an optional date to be specified, have been treated as an operating lease.

The background is that loan market practice has always been to treat finance leases, but not operating lease liabilities as “Financial Indebtedness”. As explained in paragraph 8 of Part II, new IFRS 16, which will become mandatory for accounting periods starting on or after 1 January 2019, will abolish for the lessee the distinction between finance leases and operating leases for most purposes, and require that all lease liabilities are balance sheet liabilities. Accordingly, the LMA language will capture all lease commitments unless the optional language, which aims to preserve the historic intent of this limb, is included.

Receivables financing and debt factoring

Paragraph (e) catches receivables discounting and debt factoring on recourse terms. Receivables discounting and debt factoring on recourse terms often take the form of an assignment of debts, in return for a price paid to the Borrower. The bank’s or factor’s recourse to the Borrower may take the form of either a guarantee by the Borrower for the payment of the debts, or of the Borrower’s undertaking to buy the debts back if they are not paid within a fixed period.

Receivables sold or discounted on a non-recourse basis are excluded. Non-recourse receivables financing can take a variety of forms, the most straightforward of which involves an outright sale (or assignment) of the receivables by the Borrower, in return for a cash advance; if the debtors fail to pay, the finance house has no recourse to the Borrower: its only claim is against the debtors. However, many “non-recourse” discounting or factoring arrangements involve recourse in certain circumstances, such as where the receivable is invalid or the counterparty has a right of counterclaim or set-off. As a result, some Borrowers might need to seek clarificatory exclusions to ensure particular transactions are treated as non-recourse (which may be achieved by negotiating specific exclusions to affected covenants rather than by altering this definition).

Any amount raised having “the commercial effect of a borrowing”

A wide range of transactions can be caught by paragraph (f), including for example forward purchases and sales of currency and repo arrangements. Conditional and credit sale arrangements could also be covered here as could certain redeemable shares.

The precise scope of this limb can be uncertain. Ideally, from the Borrower’s perspective, if there are additional categories of debt which should be included in “Financial Indebtedness”, these should be described specifically and this catch-all paragraph, deleted. A few strong Borrowers do achieve that position. Most, however are required to accept the “catch-all” and will therefore need to consider which of their liabilities might be caught by it, and whether specific exclusions might be required.

Derivatives

Paragraph (g) captures derivatives transactions, requiring their marked to market value (“fair value”) to be included in the Financial Indebtedness calculation, whether their purpose is “protection” or “benefit” from movements in a rate or a price (so covering arbitrage as well as hedging).

Some stronger Borrowers (as well as Borrowers in sectors that make heavy use of derivatives) are able successfully to exclude derivatives transactions from Financial Indebtedness. There are various arguments in favour of doing so.

Borrowers might take the view that derivative transactions, in particular those entered into to protect against fluctuations in any rate or price should not form part of Financial Indebtedness because they are not a means of raising finance. If derivatives are entered into for the purpose of raising finance, (it might be argued), they are likely to be captured by paragraph (f) of the definition of Financial Indebtedness as transactions which have “the commercial effect of a borrowing” in any event, discussed above.

In the Investment Grade Agreement, as already noted, “Financial Indebtedness” is used in only two clauses: the negative pledge (Clause 22.3) and the cross-default Event of Default (Clause 23.5). To the extent derivatives exposures are relevant to those clauses, it may be preferable to deal with them specifically in those provisions rather than to incorporate the fair value from time to time of such exposures into the definition of Financial Indebtedness.

In the negative pledge clause, “Financial Indebtedness” is used in the restriction on “Quasi-Security” arrangements, which are prohibited where they are entered into for the purpose of raising Financial Indebtedness or financing the acquisition of an asset.

If derivatives are included in the definition of “Financial Indebtedness”, the suspension, cancellation or close out of those transactions (which may occur as a result of circumstances affecting its counterparty) could trigger the cross-default Event of Default. This may be justifiable if the transaction is terminated, and an Obligor becomes subject to a payment obligation in favour of the counterparty and then defaults on that obligation.

The same may not be true if (for example) an insolvency event of default occurs affecting the Obligors’ counterparty and as a result, a termination payment becomes due. Accordingly, there are reasons for excluding derivatives transactions, or at least, for addressing them specifically in this context. This point is discussed further at Clause 23.5 (*Cross-default*).

There may be additional grounds for deleting paragraph (g) from Financial Indebtedness depending on how the definition is used in the document. As noted below, derivatives are usually excluded from the “Borrowings” calculation for the purposes of the financial covenants (see for example the definition of “Borrowings” in the Leveraged Agreement) due to the potential for year on year fluctuation in the value of derivative exposures. If the definition of Financial Indebtedness is used to define a threshold or limit (for example, if the Agreement restricts the amount of Financial Indebtedness which may be incurred by the Obligors), Borrowers may seek to delete paragraph (g) or limit its application for the same reason. Borrowers may also argue that the inclusion of derivatives at fair value does not reflect the effectiveness of the hedge. Accordingly, if the derivatives in question qualify for hedge accounting, that may be a further reason to exclude their fair value in this context.

Other points

Other points Borrowers may make in relation to this definition include the following.

- Various paragraphs of this definition have the potential to overlap. In particular where the definition of Financial Indebtedness is used in the Agreement to define a threshold or limit (for example, in the context of a covenant restricting Financial Indebtedness or a basket for permitting indebtedness or security), it is common to make clear that “Financial Indebtedness” will be calculated without double-counting.

- Depending on how this definition is used, the amount of “Financial Indebtedness” may need to be calculated at a point in time that does not accord to an accounting date. This can be problematic, in particular if it involves the marking to market of derivatives exposures, for example. Borrowers sometimes seek to clarify that the amount of Financial Indebtedness (or even just particular limbs, such as the derivatives limb) will be calculated on any given date by reference to the accounts most recently prepared (or most recently delivered for the purposes of the Agreement).

Finally, Borrowers should note that this definition is unlikely to be appropriate for use in debt-based financial covenant ratios (if applicable), where a narrower concept of financial debt is generally appropriate. For example, the definition of “Borrowings” in the LMA financial covenant provisions, while based on “Financial Indebtedness”, is slimmer in a number of respects. In particular, as already noted, it does not include paragraph (g), which takes into account the marked to market value of derivative transactions. It would be unusual to do so in a definition of debt that is used for financial covenant purposes given the potential for that number to inflate or deflate the total debt figure from time to time by an amount that does not reflect actual indebtedness.

“GAAP” and “IFRS”

The definition of “**GAAP**” is intended to describe the accounting policies applied to the Group’s accounts. This is important because the Borrower is required to represent to the Lenders, in relation to each set of accounts, that they are prepared in accordance with GAAP, consistently applied. The definition of GAAP is “generally accepted accounting principles in []”, with an option to continue “including IFRS” (so if all relevant financial statements are prepared in accordance with IFRS, the definition of GAAP could be dispensed with or defined as “IFRS”).

“**IFRS**” is defined as international accounting standards within the meaning of the EU IAS Regulation⁷, to the extent applicable to the financial statements.

Borrowers should note that the LMA definition of IFRS is therefore appropriate only for EU companies and Groups. The background here is that IFRS in general parlance describes the body of accounting standards published by the International Accounting Standards Board (“**IASB**”). The application of IFRS to the financial statements of EU companies, is regulated at EU level.

The IAS Regulation requires all EU listed companies to apply EU-adopted IFRS to their consolidated financial statements. Member states are given the option of extending that requirement to other companies’ financial statements. The Companies Act 2006 enables unlisted UK companies to choose whether they wish to use EU-adopted IFRS or UK GAAP.

The important point for present purposes is that under the EU IAS Regulation, before UK (and other EU) companies can use the standards written by the IASB, they must be endorsed and adopted in the EU. Although the EU has adopted the bulk of the IFRS regime, there remain aspects which have not been endorsed for use in the EU⁸.



BREXIT NOTE: References to EU legislation

The reference to the EU IAS Regulation is one of two references to an EU legislative provision in the Investment Grade Agreements (the other appears in the definition of “VAT”). Others may of course apply in negotiated agreements. How might such references be interpreted post-Brexit when the UK is no longer subject to the relevant EU rule? Should the statutory reference continue to be read as written (as a reference to the EU regime), or should it be read as a reference to the post-Brexit UK equivalent?

English law principles of contractual interpretation require the affected provisions to be considered in their documentary and contractual context with a view to establishing what a reasonable person having all the background knowledge available to the parties when they entered the contract would have understood the language to mean. This requires a consideration of each such reference in the context of the clause in which it appears.

⁷ EU Regulation 1606/2002.

⁸ Reports on the endorsement status of IFRS are available on the EFRAG website: www.efrag.org/Endorsement.

Clause 1.2 (*Construction*) appears in all of the LMA templates and provides that a reference to “a provision of law is a reference to that provision as amended or re-enacted”. Depending on the context, this might be helpful in construing references to EU legislation post-Brexit. While it may be technically debatable whether any UK legislation applicable after Brexit constitutes an “amendment” or “re-enactment” of (for example), the IAS Regulation, a court might point to that construction clause as evidence of the parties’ intention that provisions that refer to statutory provisions should be updated as the law changes.

It is hoped that many of these issues can be sensibly addressed once further information is available on the post-Brexit legislative regime. Whether disputes arise in practice may depend on the extent to which the existing EU and the post-Brexit UK regimes diverge.

“Group”

This definition is discussed alongside the definition of “*Subsidiary*” below.

“Historic Screen Rate” and “Interpolated Historic Screen Rate”

These optional definitions, like the optional definition of “*Fallback Interest Period*”, are relevant to the Screen Rate fallback options provided in Clause 11.1 (*Unavailability of Screen Rate*). The age of these Historic Screen Rates is left blank to be agreed.

In practice

The LMA’s intention is that these rates should not be too historic, to preserve as far as possible the rate that would have applied had the relevant Screen Rate been available. The maximum number of days old the rate is permitted to be is typically somewhere between one Business Day and one week.

“Increase Confirmation” and “Increase Lender”

These definitions are relevant to Clause 2.2 (*Increase*), which permits a new Lender (an “*Increase Lender*”) to take on previously cancelled Commitments in certain circumstances subject to conditions, including the completion of an “*Increase Confirmation*” substantially in the form set out in Schedule 13 (*Form of Increase Confirmation*).

“Interpolated Screen Rate”

Clause 11.1 (*Unavailability of Screen Rate*) provides for the use of an Interpolated Screen Rate where possible if a Screen Rate is unavailable for the required maturity. The definition provides for the available Screen Rates for the relevant benchmark to be interpolated on a straight line basis.

This method of interpolation was chosen to reflect the method of interpolation that would ordinarily be adopted in interest rates swaps on ISDA terms. Ideally, the applicable rounding convention for this purpose should be consistent with any corresponding interest rate swaps. The LMA language reflects the convention in the 2006 ISDA definitions.

“LIBOR”

This definition refers to ICE LIBOR (formerly known as BBA LIBOR), which provides an indication of the average rate at which a LIBOR contributor bank can obtain unsecured funding in the London interbank market for a given period, in a given currency. ICE LIBOR rates are calculated based upon submissions from LIBOR contributor banks (a panel of between 11 and 17 for each currency).

As in relation to EURIBOR, LIBOR is identified for the purposes of the Agreement by reference to a Screen Rate and is subject to an optional zero floor. The comments made above in relation to the definition of “*EURIBOR*” apply equally to “*LIBOR*”.

“Majority Lenders”

This definition specifies how a voting majority of Lenders will be calculated. Majority Lenders is determined according to Lenders’ “*Total Commitments*”, which encompasses both drawn and undrawn Commitments.

In practice

The Investment Grade Agreements provide, optionally that the Majority Lenders shall be Lenders representing $66\frac{2}{3}$ of Total Commitments (which encompasses drawn and undrawn commitments as already noted). In the investment grade market, this percentage is almost always applicable.

In the early iterations of the Investment Grade Agreement, Majority Lenders was calculated by reference to Lenders' undrawn Commitments while the Facilities remain undrawn, and by reference to the Lenders' drawn Commitments where Loans are outstanding (i.e. the Facilities have been drawn). If the Facilities encompassed both term and revolving facilities, and the term facility was drawn at a point when the revolving facility was not, this potentially resulted in the revolving facility Lenders being effectively disenfranchised. This was spotted and addressed by the LMA in 2011. It is a point worth being alert to in older facilities.

If the Agreement encompasses more than one Facility (for example, a term and a revolving facility) and Lenders do not hold participations in each Facility in the same proportions, as noted in the LMA's Users' Guide to the Primary Documents, the relative participations of the Lenders in each Facility at the relevant time will determine Majority Lenders, which has the potential to create anomalies, for example, if the term Commitments are significantly larger than the revolving Commitments. In some circumstances therefore (which are relatively rare), Lenders may seek to adjust this definition.

“Mandatory Costs”

The interest provisions of the Investment Grade Agreements provide that the rate payable to the Lenders shall be the aggregate of the applicable benchmark rate, the Margin and (optionally) “Mandatory Costs” (see Clause 9 (*Interest*)).

The term Mandatory Costs is essentially intended to comprise certain regulatory costs incurred by Lenders in relation to their lending function. Until 2013, most loan agreements provided for the payment of Mandatory Costs in accordance with the LMA's Mandatory Costs formulae (which was appended to the Agreement).

The LMA formulae provided a means of calculating the rate of Mandatory Costs payable to each Lender. For Lenders with Facility Offices in the UK, it took into account, in relation to sterling loans, the Lender's cost (if any) of complying with the Bank of England's reserve asset or “cash ratio deposit” costs plus, in relation to both sterling and non-sterling loans, amounts payment under the Fee Rules of what was then the Financial Services Authority.

For Lenders with a Facility Office in the Eurozone the rate was the percentage notified by that Lender as its cost of complying with European Central Bank requirements in respect of Loans made from that Facility Office.

The operational difficulties and commercial sensitivities involved in the collection and payment of Mandatory Costs on a Lender by Lender basis, meant that for many years they were not customarily claimed or paid. As a result, in April 2013, the LMA's Mandatory Costs formulae was withdrawn and the Mandatory Costs provisions were marked as optional in all of its templates.

Mandatory Costs are still defined in the Investment Grade Agreements as an annual rate calculated in accordance with Schedule 4 to the Agreement. If the optional provisions are used, the parties will have to prepare the contents of that Schedule themselves in the absence of LMA guidance.

In practice

Since the withdrawal of the LMA Schedule, the Mandatory Costs provisions are very rarely included in negotiated agreements.

See further comments at Clause 9 (*Interest*).

“Margin”

The Investment Grade Agreements contemplate that the Margin will be a fixed percentage amount as is often the case in investment grade loans, in particular those for stronger Borrowers.

In practice

Variable Margins have become more prevalent in the syndicated market since the implementation of Basel II, which imposes varying capital requirements on loan exposures according to credit risk (which may be measured by rating - this is explained in more detail at Clause 14 (*Increased Costs*)). Investment grade Borrowers with external credit ratings may be subject to Margins that vary according to their rating. Margins applicable to unrated Groups or borrowers lower down the credit spectrum are often set by reference to financial covenant test results (see Clause 21 (*Financial Covenants*)).

The nature and operation of any ratchet mechanism is an important commercial point.

“Material Adverse Effect”

The term “**Material Adverse Effect**”, in summary, describes events of such magnitude that they should trigger consequences under the Agreement. It is used to soften three provisions in the Investment Grade Agreements: the representations in Clause 19.9 (*No default*), Clause 19.13 (*No proceedings*) and the limb of Clause 20.4 (*Information: miscellaneous*), which requires the Company to notify the Agent of any litigation. However, the term is typically used much more widely in negotiated agreements, as a device to limit the scope of representations, undertakings and Events of Default and also as the trigger for any “no material adverse change” Event of Default (see Clause 23.12 (*No Material Adverse Change*)). Accordingly, this is an important definition from the Borrower’s perspective.

The definition of Material Adverse Effect is left blank in the Investment Grade Agreements, to be negotiated on a case-by-case basis. The Leveraged Agreement, in contrast, includes a definition of Material Adverse Effect, which is often used as a reference point for the completion of the blank in the Investment Grade Agreements.

Definition of Material Adverse Effect (Leveraged Agreement)

“**Material Adverse Effect**” means [in the reasonable opinion of the Majority Lenders] a material adverse effect on:

- (a) [the business, operations, property, condition (financial or otherwise) or prospects of the Group taken as a whole; or
- (b) [the ability of an Obligor to perform [its obligations under the Finance Documents]/[its payment obligations under the Finance Documents and/or its obligations under Clause 27.2 (Financial condition)]]/[the ability of the Obligors (taken as a whole) to perform [their obligations under the Finance Documents]/[their payment obligations under the Finance Documents and/or their obligations under Clause 27.2 (Financial condition)]]; or
- (c) the validity or enforceability of, or the effectiveness or ranking of any Security granted or purporting to be granted pursuant to any of, the Finance Documents or the rights or remedies of any Finance Party under any of the Finance Documents.]”

In practice

The definition in the Leveraged Agreement contains significant optionality. If the least borrower-friendly options are selected, the concept is very wide-ranging. Most Borrowers (whether or not investment grade) will seek to limit this definition in a number of ways. Points commonly raised by Borrowers include the following:

- The occurrence of a Material Adverse Effect should be objectively determined rather than depending on the opinion of Majority Lenders. Recent case law indicates that a subjective test here sets a low bar. A subjective test requires only that the Majority Lenders rationally and honestly believe that the event in question gives rise to a Material Adverse Effect; whether objectively, that is the case will not be relevant⁹.

⁹ Cukurova Finance Intl Limited v Alfa Telecom Turkey Ltd (BVI) [2013] UK PC 2.

- The reference to a material adverse effect on the “prospects” of the Group in limb (a) is unacceptably wide (this argument is very commonly accepted; a reference to prospects is rare in a negotiated definition).
- Limb (b) should be limited to the ability of the Obligors (taken as a whole) to perform their obligations. If the Lenders have the benefit of cross-guarantees, the fact that one Obligor is unable to perform should not, of itself, disrupt the Facilities. The Facilities are extended on the basis of the strength of the Obligors and/or the Group as a whole.
- Limb (b) should be limited to the ability of the Obligors (taken as a whole) to perform their most important obligations, namely their payment obligations. This is a point that is commonly raised in the investment grade market.

In relation to the use of MAC provisions generally, please see comments at Clause 23.12 (*Material adverse change*).

“Non-LIBOR Currency”

This optional definition is left blank and is required only if the Facilities are denominated in a currency for which a LIBOR rate is not available. See comments above under **“Benchmark Rate”**.

“Optional Currency”

An Optional Currency is a currency other than the Base Currency (see above), which is approved for drawing under the Facilities in accordance with Clause 4.3 (*Conditions relating to Optional Currencies*).

“Original Financial Statements”

These are the audited consolidated financial statements of the Group, and the audited financial statements of each Original Obligor, which are required to be delivered to the Lenders as a condition precedent (see Clause 4.1 (*Initial Conditions Precedent*)).

The Obligors give representations in relation to the Original Financial Statements (see Clause 19.11 (*Financial statements*)).

“Quotation Day”

The Quotation Day is the day on which the chosen benchmark rate is fixed. The definition reflects the conventions for rate-fixing applicable to LIBOR and EURIBOR currencies: rates for sterling are fixed on the same day as the Utilisation; rates for euro, two TARGET Days beforehand; and rates for all other currencies, generally two Business Days beforehand.

A **“Business Day”** requires banks to be open for general business in London and the home financial centre of the Base Currency. In relation to any date for payment in any other currency, banks must also be open in the home financial centre of the currency in question.

A **“TARGET Day”** is any day on which TARGET2 is open for the settlement of payments in euro. TARGET2 is open on all weekdays every year except New Year’s Day, Good Friday, Easter Monday, 1 May, Christmas Day and 26 December. This means TARGET2 is open on the last Mondays in May and August, which are bank holidays in England, but closed on 1 May, which is not a bank holiday in England, unless it falls on a Monday.

The definition provides the option to cater for any different rate-fixing convention that might apply in respect of a **“Non-LIBOR Currency”** (if relevant).

Rate fixing is usually as of 11 a.m. (CET in respect of EURIBOR).

See comments under Clause 5 (*Utilisation*).

“Reduction Date” and “Reduction Instalment”

These optional definitions are required only if (unusually) the revolving facility limit (Facility B) is to reduce over time. If not, they can be deleted.

“Reference Bank Rate”

This optional definition is relevant if a Reference Bank Rate is included as a fallback rate in Clause 11.1 (*Unavailability of Screen Rate*).

Broadly speaking, the Reference Banks are required to quote on the same basis as a panel bank would contribute to the benchmark the Reference Bank Rate is designed to replace. As noted in the LMA User Guide, this is important to banks who sit on benchmark panels as it enables them to use the same processes in acting as Reference Banks as they do for their benchmark submissions.

As discussed in paragraph 4 of Part II, the definition of Reference Bank Rate as a fallback for LIBOR was altered in November 2016 following discussions with the ACT. The updated definition provides that only Reference Banks that are LIBOR contributor banks shall contribute on the same basis as they do for LIBOR, and only in so far as their submission consists of a single rate. In all other circumstances, the Reference Bank Rate for LIBOR will be based on unsecured wholesale funding market rates.

These changes cater for the fact that a) the LIBOR submission methodology has become more complex (and therefore difficult for a non-LIBOR contributor bank to replicate) and b) it is proposed that in future contributors may submit raw data rather than a rate to the LIBOR administrator, which would mean the process is impracticable for use as a Reference Bank Rate.

Similar changes may be required to the Reference Bank Rate for EURIBOR if EMMI makes changes to its submission methodology.

Reference Bank Rates, according to the definition are rounded to four decimal places for all rates, as has long been customary, notwithstanding that rounding of the EURIBOR Screen Rate is to 3 decimal places, while rounding of the LIBOR Screen Rate (including euro LIBOR) is to 5 decimal places.

In practice

The use of Reference Bank Rates is optional in all of the LMA's recommended forms. Nonetheless, Reference Bank Rates are used as a fallback rate in most transactions, although the institutions that are to provide such rates are quite often not named at the outset (see “**Reference Banks**” below). Reluctance to abandon Reference Bank Rates might be attributed to a number of factors, including the absence of alternatives, measures taken by administrators to minimise the circumstances where Screen Rates will be unavailable, and the fact that should Reference Bank Rates be required, under current LMA terms, Reference Banks are under no obligation to provide a quote (see Clause 26.18 (*Role of Reference Banks*)).

See paragraph 4 of Part II for the background to this topic which is also discussed at Clause 11.1 (*Unavailability of Screen Rate*).

“Reference Banks”

Reference Banks are appointed to provide the Reference Bank Rate that is used as a fallback rate if the Screen Rate is unavailable (see Clause 11.1 (*Unavailability of Screen Rate*)). The definition contemplates that the Reference Banks will be two or three named institutions or such other institutions as shall be appointed by the Agent in consultation with the Borrower.

In practice

In the English law market, the Reference Banks are typically Lenders (although the Agreement does not impose that requirement). Currently, it is quite often difficult to identify Lenders who are willing to be named as Reference Banks, due to policies adopted by a number of institutions in the wake of the LIBOR scandal.

If no Lenders are willing to be named as Reference Banks, or less than the customary two/three are willing to act, a solution often adopted is to provide that the Reference Banks will be the relevant offices of “*such [other] banks as may be appointed by the Agent [in consultation with the Company/with the prior consent of the Company] from time to time*”. An alternative is to remove the Reference Bank Rate as a fallback option from the Agreement altogether, but as noted above, that remains unusual in the syndicated market.

“Repeating Representation”

This definition, which identifies which of the representations in Clause 19 (*Representations*) are to be repeated, is only partially completed and is settled on a case-by-case basis.

The representations that are typically repeated and the intervals at which they are repeated are discussed at Clause 19.14 (*Repetition*).

“Rollover Loan”

A “Rollover Loan” is a revolving facility Loan that is re-drawn for a further Interest Period. See Clause 2.1 (*The Facilities*).

“Selection Notice”

A Selection Notice is used by the Borrower primarily to notify the Agent of the Interest Period that is to apply to a Facility A Loan (a drawing under the term facility). A form of Selection Notice is set out in Schedule 3 (*Requests*).

See further Clause 10.1 (*Selection of Interest Periods*).

“Screen Rate”

Both LIBOR and EURIBOR are defined in the Investment Grade Agreements as the “**Screen Rate**” on the specified day for the relevant currency and period, where a Screen Rate is available. This definition identifies the rate and screen page and reflects changes agreed between the LMA and the ACT to cater for future changes to the administrator and/or publisher of LIBOR and to accommodate intra-day rate re-fixing.

Definition of Screen Rate (Investment Grade Agreements)

““**Screen Rate**” means:

- (a) *in relation to LIBOR, the London interbank offered rate administered by ICE Benchmark Administration Limited (or any other person which takes over the administration of that rate) for the relevant currency and period displayed [(before any correction, recalculation or republication by the administrator [published more than one hour after the time such rate is first displayed])] on pages LIBOR01 or LIBOR02 of the Thomson Reuters screen (or any replacement Thomson Reuters page which displays that rate)[; and*
 - (b) *in relation to EURIBOR, the euro interbank offered rate administered by the European Money Markets Institutes (or any other person which takes over the administration of that rate) for the relevant period displayed [(before any correction, recalculation or republication by the administrator [published more than one hour after the time such rate is first displayed])]* on page EURIBOR01 of the Thomson Reuters screen (or any replacement Thomson Reuters page which displays that rate)),
- or [, in each case,] on the appropriate page of such other information service which publishes that rate from time to time in place of Thomson Reuters. If such page or service ceases to be available, the Agent may specify another page or service displaying the relevant rate after consultation with the Company. [; and*
- (c) *in relation to a Benchmark Rate, the rate specified as such in respect of the relevant currency in Schedule [14] (Other Benchmarks)].”*

In practice

Both the IBA and EMMI (the administrators of LIBOR and EURIBOR respectively) have published error policies¹⁰ that provide for the publication of revised rates if there has been an error in the calculation

¹⁰ ICE LIBOR error policy: www.theice.com/publicdocs/ICE_LIBOR_Error_Policy.pdf,
EMMI's error policy for EURIBOR: www.emmi-benchmarks.eu/assets/files/D0356B-2015-EURIBOR%20REFIXING%20POLICY-template-clean.pdf.

or submission process. Policies along these lines may also apply to other benchmarks. As touched on in paragraph 4 of Part II, the commercial point here is whether the Screen Rate should be the relevant rate as originally published, or the rate as subsequently corrected in accordance with these error policies.

Some treasurers might take the view that they do not wish to use an erroneously calculated rate. Others may decide that they do not want to make correcting payments and have to concern themselves with adjustments later in the day. So far no clear preference has emerged across the market, on the part of either Agent banks or treasurers.

The operation of interest rate hedging may be a factor to consider. According to the 2006 ISDA definitions, interest rate hedging will take account of re-fixed/re-published rates only if they are re-published within an hour of the publication of the original rate, so LIBOR re-fixes may not qualify (the IBA's policy permits re-publication up to 4 p.m. London time). The limitation under ISDA terms is the reason for the optional reference to that timing in the LMA definition of "Screen Rate" quoted above.

"Security"

This definition is primarily relevant to the negative pledge (Clause 22.3) and is discussed in that context.

"Subsidiary"

The parties need to select an appropriate definition of Subsidiary, which determines which entities are included for the purposes of the Agreement in the "**Group**" (defined as the Company and its Subsidiaries for the time being).

The Investment Grade Agreements (based on the assumption that the Obligors are UK companies) provide the option to choose between the UK Companies Act 2006 definitions of "subsidiary" and "subsidiary undertaking".

Membership of the "Group" is important primarily because a number of the representations, undertakings and Events of Default in the template are expressed to apply to any member of the Group.

In practice

The UK statutory definition of "subsidiary" aims to capture entities over which a parent company has control. The term "subsidiary undertaking", as used in the UK Companies Act 2006 is of primary significance for accounting purposes. Consolidated accounts are the accounts of a parent undertaking and its subsidiary undertaking. It may include entities over which the Company cannot exercise full control.

Borrowers generally take the view that "Subsidiary" should reflect the statutory definition of "subsidiary" rather than "subsidiary undertaking". The latter includes a wider range of entities which it may not be practical or possible to monitor for the purposes of the representations, covenants and Events of Default (to the extent those provisions are agreed to apply to each member of the Group). This is usually acceptable to Lenders.

The alternative definition of "subsidiary undertaking" may, however, be appropriate where the term "**Group**" is used in the context of financial statements or accounting terms.

For non-UK groups, this definition will need to be adapted to reflect local law and practice.

"TARGET Day"

See comments under "**Quotation Day**" above.

"Termination Date"

This is the date on which the Facilities must be finally repaid.

Clause 1.2: Construction

Paragraph (e) defines the meaning of “*continuing*” in the context of Defaults and Events of Default. A Default is continuing until it has been remedied or waived. Two options are provided in relation to this definition in the context of an Event of Default. An Event of Default is continuing either until it is (i) waived or (ii) remedied or waived.

The defined term “*continuing*” is significant as it is used as a trigger for the exercise of certain rights by the Agent on behalf of the Lenders following a Default or Event of Default. For example, Clause 23.13 (*Acceleration*) provides the Agent with discretion to declare all Loans immediately due and payable if there is an Event of Default which is “*continuing*”. Utilisations are likewise dependent on there being no Default which is “*continuing*” (see Clause 4.2 (*Further conditions precedent*)).

In practice

If “continuing” is defined so that the Event of Default is continuing unless it has been waived, then the fact that it may have been remedied is of no consequence. In the absence of a waiver from the Lenders, the Agent would have the right to accelerate the Facilities notwithstanding that the Event of Default no longer exists at the point that decision is taken.

Borrowers will want an Event of Default to be defined as continuing if it has not been remedied or waived. This is agreed in most circumstances.

Clause 1.3: Currency symbols and definitions

This optional clause contains definitions of the major currencies (euro, dollars and sterling). A footnote highlights that definitions of additional currencies may be required if relevant.

The implications of a potential fragmentation of the Eurozone were analysed in some detail by loan market participants at the height of the Eurozone crisis. A key concern was to ensure that payment obligations in euro would remain in euro, and were not at risk of being re-denominated, should one or more countries decide to leave the euro and re-adopt a national currency.

Lawyers concluded that obligations in euro may be better protected if the contracting parties have made clear (for example, by defining the term “euro”) that they intend to contract in euro notwithstanding changes in its membership from time to time.

This optional clause was introduced as part of a package of relatively minor changes to the template introduced in response to the Eurozone crisis. It is generally treated as boilerplate and is not usually controversial.

Clause 1.4: Third Party Rights

The UK Contracts (Rights of Third Parties) Act 1999 (the “*CRTPA*”) gives a person who is not a party to a contract the right to enforce that contract, broadly speaking, if either the contract expressly so provides, or the contract purports to confer a benefit on him, and the parties intend him to be able to enforce it.

The Investment Grade Agreements offer the parties two options for dealing with the CRTPA. Option 1 is to exclude the CRTPA completely, with the effect that only the parties to the Agreement are able to enforce it. Option 2 is to exclude the CRTPA in part, such that entities who are not party to the Agreement are able to enforce directly certain provisions which confer benefits on them where the Agreement provides expressly to that effect.

In practice

Option 1 is safest from a Borrower’s point of view. Option 2 is, however, regularly preferred by Agents and is not usually problematic for Borrowers, although the consequences should be appreciated.

Option 2 provides that “Unless expressly provided to the contrary in a Finance Document” a person who is not a Party will not have any rights under the CRTPA. The Investment Grade Agreements contemplate rights being granted in favour of two categories of third party - the officers and employees of the Agent and, optionally, Reference Banks (to the extent they are not Finance Parties). The framework, however, is set up to allow users to create other third party rights, as required by individual transactions.

The background to the situation of officers and employees of the Agent is as follows. The agency provisions in the Investment Grade Agreements exempt the Agent from liability except in cases of gross negligence and wilful misconduct (see Clause 26.10 (*Exclusion of liability*)). The clause goes on to permit officers and employees of the Agent to rely on this exclusion of liability (see Clause 26.10(b)). Similar provision is made in relation to the role of the Reference Banks (see Clauses 26.18 (*Role of Reference Banks*) and 26.19 (*Third party Reference Banks*)).

Option 2 therefore offers protection to the employees and officers of the Agent/any third party Reference Banks on which they can rely.

Other third parties that might acquire rights within the framework of Option 2 include Affiliates of Finance Parties. Clause 14.1 (*Increased Costs*), for example, provides for the Borrower to “pay for the account of a Finance Party the amount of any Increased Costs incurred by that Finance Party or any of its Affiliates”. Although it would appear that this clause purports to confer a benefit on the Affiliates of Finance Parties, it may in this particular instance be arguable that, even if Option 2 is adopted, they would still have no rights of enforcement here, since the obligation to pay the Finance Party rather than its Affiliate suggests an intention that the indemnity should be enforceable by the Finance Party only. Third party rights may also arise for Affiliates of Lenders, if the Lenders’ rights to prepayment for illegality extend to circumstances where the illegality affects an Affiliate of the relevant Lender - which is an optional provision in Clause 8.1 (*Illegality*).

In any contract where third party rights are to be created, consideration should be given to the jurisdiction clause as there is a risk that a third party might argue that it was not bound by it. In loan documentation, however, the risk may be of little consequence from the Borrower’s perspective, as the choice of jurisdiction is generally non-exclusive for the benefit of the Finance Parties (see Clause 40.1 (*Jurisdiction*)).

Section 2: The Facilities

Clause 2: The Facilities

Clause 2.1: The Facilities

This clause describes the nature of the Facilities.

Facility A is a term facility (the “**Term Facility**”). The Term Facility is capable of multiple drawings (if that is the position commercially agreed), but once a Loan is repaid, it may not be re-drawn. Repayment may be in instalments or in full at the end of the life of the Facility, at the Termination Date. Interest is payable on the last day of each Interest Period. Borrowers have the option to switch the currency of a Term Facility Loan to a different currency at the start of each Interest Period. Borrowers can also elect to treat a Term Facility Loan as divided into two or more Loans.

Facility B is a revolving facility (the “**Revolving Facility**”). Each Revolving Facility Loan can be re-drawn at the end of its term, as long as (among other things) the total amount outstanding does not then exceed the amount of the Facility. The term of each Revolving Facility Loan is its Interest Period. Repayment is achieved either by scheduled reductions in the total amount of the Facility over time, or by all outstanding Loans being repaid on the Termination Date. Borrowers can select the currency of each Loan. A Revolving Facility Loan made to refinance another Revolving Facility Loan which matures on the same date as the drawing of the second Revolving Facility Loan is known as a Rollover Loan, if its amount is not greater than the first one and it is in the same currency and drawn by the same Borrower. The conditions for drawing a Rollover Loan are less onerous than for other Loans.

Clause 2.2: Increase

Clause 2.2 is a recent addition to the Investment Grade Agreements but has been a common feature of negotiated documentation for some years, having historically formed part of the Lehman provisions (see Part IV). Subject to conditions it provides for one or more “**Eligible Institutions**” (each an “**Increase Lender**”) to take on previously cancelled Commitments in certain circumstances. The Increase Lender assumes the cancelled Lender’s obligations relating to the relevant Commitments as if it had been an Original Lender in respect of those Commitments.

The LMA’s initial iteration of this clause in the Lehman provisions allowed the Borrower to cancel the undrawn Commitment of a Defaulting Lender or a Lender to whom the provisions of Clause 8.1 (*Illegality*) apply, and to arrange for that undrawn Commitment to be assumed by a new or existing Lender of its choice. Following representations by the ACT in 2011, the mechanism was extended to operate also in relation to the participations of Lenders whose Commitments have been cancelled as a result of a claim under Clause 13.2 (*Tax gross-up*), Clause 13.3 (*Tax indemnity*) or Clause 14.1 (*Increased costs*).

Acknowledging that the relevance of this clause extends beyond the management of Defaulting Lenders, the LMA decided in July 2017 to remove the clause from the Lehman provisions and incorporate the mechanism into the Investment Grade Agreements.

In practice

The incorporation of this commonly adopted clause into the Investment Grade Agreements is a welcome development. However, the procedure for the assumption of the cancelled Commitments by an Eligible Institution includes some points of detail which may be unattractive to Borrowers:

- The right to insert an Increase Lender is (optionally) limited in time to an agreed number of days following a relevant cancellation. In some circumstances, it may take more time to find a willing participant. More generally, the Borrower may appreciate the flexibility to increase the Facilities as required, rather than within a specified time.
- The definition of “Eligible Institution” specifies (optionally) that members of the Borrower Group may not be Increase Lenders. Some Borrowers may resist this limitation (see comments on the definition at Clause 1.1 (*Definitions*)). For more on debt buybacks in the context of LMA loan documentation, see Clause 24.1 (*Assignments and transfers by the Lenders*).

- The Agent is (optionally) entitled to claim from the Borrower its costs and expenses (including legal fees). The mechanics for the introduction of another Lender in this scenario should not be more onerous than those applicable on the addition of a new Lender following a secondary market purchase, so the Agent's need for a separate indemnity for costs is not clear.

Clause 2.3: Finance Parties' rights and obligations

This clause makes clear that the rights of each Lender under the Agreement are separate and independent. Each Lender is separately liable for its own Commitment and has an independent right to claim against an Obligor for non-payment under the Agreement.

In 2015, the lower courts in Hong Kong decided that a Hong Kong law governed and LMA-based facility agreement did not entitle individual Lenders independently to sue for their debt, which could only be enforced by the Lenders acting collectively¹¹. This was contrary to the position under LMA terms as generally understood under English law. There is perhaps some disincentive for an individual Lender to take independent enforcement action given its obligation to share any recoveries with the other Lenders (see Clause 28 (*Sharing among the Finance Parties*)), but LMA terms did not appear to most English lawyers to restrict them from doing so. Following the Hong Kong decision, the LMA (following discussions with the ACT) clarified the wording of this provision to ensure that the independent rights of each Lender are beyond doubt.

Lenders are generally keen to make sure these clarificatory amendments are included in all syndicated loan documentation.

Clause 3: Purpose

This provision contains blanks for the parties to specify the purpose to which each of the Facilities may be applied.

Clause 4: Conditions of Utilisation

Clause 4.1: Initial conditions precedent

Before the first Utilisation, the Company must provide all the items listed in Part 1 of Schedule 2 (*Conditions Precedent to initial Utilisation*) to the Agent, in form and substance satisfactory to it. This is to ensure that the Agent can be comfortable that the Original Obligors have the corporate capacity and all necessary authorisations to enter into the Agreement, borrow, guarantee and so on.

Part 1 of Schedule 2 requires delivery of the following documents in relation to each Original Obligor, each certified as true, correct and accurate by an officer of the Company:

- Copies of constitutional documents and board resolutions authorising the transaction plus shareholder resolutions in respect of each Original Guarantor.
- Signing authorities in relation to the transaction documents and any documents to be delivered pursuant to them (for example, any Utilisation Request).
- Specimen signatures of authorised signatories.
- A certificate signed by a director of the Company confirming that borrowing or guaranteeing, as appropriate, the Total Commitments will not cause any borrowing, guaranteeing or similar limit binding on any Original Obligor to be exceeded.

In addition, Part 1 requires the delivery of:

- Legal opinions confirming the capacity and authority of each Original Obligor to enter into the Agreement and the validity and enforceability of the transaction documents.
- Evidence that any process agent referred to in Clause 40.2 (*Service of process*), if not an Original Obligor, has accepted its appointment.

¹¹ *Charmway v Fortunessea (Cayman) Ltd & Ors* [2015] HKCU 1717.

- The Original Financial Statements of each Original Obligor.
- Evidence that any transaction fees, costs and expenses then due from the Company have been paid or will be paid by the first Utilisation Date (reflecting the customary position that the Borrower is responsible for the Finance Parties' transaction costs up to a pre-agreed amount).

The Agent is also entitled to add to this list such other evidence as the Agent considers to be necessary or desirable in connection with the transaction.

In practice

The documents listed in Part 1 of Schedule 2 broadly reflect the typical requirements for a straightforward corporate financing involving Obligors incorporated in England and Wales. Borrowers sometimes seek to ensure that the Agent should act reasonably in forming a view as to whether the documents provided are satisfactory in form and substance and in requiring further documentation.

Clause 4.2: Further conditions precedent

This clause specifies two additional tests that must be satisfied before any Utilisation is made.

Paragraph (i) provides that, in the case of all Loans except Rollover Loans, no Default must be continuing or result from the Loan.

The test is less onerous for Rollover Loans, which can be drawn even if there is a Default continuing or going to result from the Loan. See comments on Clause 2.1 (*The Facilities*) in relation to Rollover Loans.

Paragraph (ii) provides that, in addition, the Repeating Representations must be true in all material respects.

In practice

Paragraph (i) is standard for investment grade Borrowers, though (as discussed under Clause 1.2 (*Construction*)) it is important to ensure that the meaning of an Event of Default "continuing" is that it is "not remedied or waived". See Clause 1.1 (*Definitions*) on the meaning of Default (in traditional terms, a potential Event of Default).

Investment grade Borrowers usually obtain the concession reflected in the Investment Grade Agreements entitling them to draw a Rollover Loan where a Default (i.e. a potential Event of Default) is outstanding, although it can be argued that the Lenders should not advance funds if a potential Event of Default is outstanding.

Stronger credits have even argued that Rollover Loans should be advanced even if there is an actual Event of Default outstanding, on the basis that the Lenders' remedy in that situation is their right to accelerate: until the decision is taken to accelerate, the Rollover Loan should be advanced, because it does not increase the amount outstanding; also, if it is not advanced, the Borrower may be likely to default on the repayment which is due.

Paragraph (ii) is usually accepted by Obligors provided they are satisfied that the representations selected as the Repeating Representations - see comments on Clause 19 (*Representations*) - can properly and safely be repeated on each Utilisation Date. The qualification "in all material respects" is important comfort for the Obligors.

Clause 4.3: Conditions relating to Optional Currencies

The LMA's multi-currency facilities can be drawn in the Base Currency (the currency in which they are denominated) or, subject to specified conditions, an "Optional Currency". This clause contains the conditions to be satisfied if a particular currency is to be available for drawing as an Optional Currency. In summary, to be an Optional Currency, the currency in question has either to be listed at the outset, or approved by the Agent acting on the instructions of all (not only Majority) Lenders; in addition, it must be readily available and freely convertible into the Base Currency.

In practice

Borrowers may feel that the criteria set out here for a currency to qualify as an Optional Currency are rather restrictive. If a Borrower wishes to draw any other currency, it will not qualify as an Optional Currency until the consent of all the Lenders has been obtained. This may entail delay at the time of the proposed drawing, and means that a single Lender can block the availability of a currency. If certain Optional Currencies are likely to be regularly required, the Borrower should seek approval prior to the date of the Agreement. A list of committed Optional Currencies is usually helpful to the Borrower, though it can lead to difficulties in syndication, depending on the currencies in question and the institutions which have been approached by the Arranger.

Borrowers may also feel that, in the case of sterling, US dollars and euro, the Lenders do not need the additional stipulation that the currency should be readily available and freely convertible. They can point out that, in the event of an Optional Currency not being available, the Lenders have the protection provided by Clause 6.2 (*Unavailability of a currency*) (see below).

If the Optional Currency is a Non-LIBOR Currency, the Agreement will need to be amended to make provision for the interest rate that is to apply to drawings in that currency. This is discussed at Clause 9 (*Interest*).

Clause 4.4 (Maximum number of Loans)

A limit (to be agreed) applies to the maximum number of Loans that can be outstanding under each Facility at any one time.

Section 3: Utilisation

Clause 5: Utilisation

Clause 5.1: Delivery of a Utilisation Request

A Utilisation Request (the form of which is set out in Schedule 3) must be delivered by the “*Specified Time*”, which is blank to be agreed in Schedule 12 (*Timetables*).

In practice

The last time for delivery of a Utilisation Request is quite often set as follows:

- drawings other than in euro or sterling: 3 p.m. on the third Business Day before the Utilisation Date;
- drawings in euro: 3 p.m. on the third Target Day beforehand; and
- drawings in sterling: 3 p.m. on the Business Day beforehand.

However, the last date for delivery of a Utilisation Request does vary depending on syndicate size and logistics, as does the latest time, which may in some cases be as early as 9.30 a.m.

Clause 5.2: Completion of a Utilisation Request

Each Utilisation Request is irrevocable once despatched and must contain details of the Facility being drawn, the proposed Utilisation Date (which must be a Business Day during the Availability Period) and be in a currency and amount (and subject to an Interest Period) that otherwise complies with the terms of the Agreement.

Only one Loan can be requested in each Utilisation Request.

Note that although only one Loan may be requested in each Utilisation Request, there is no limit on the number of Utilisation Requests that may be made on any one day, subject to the limit on the number of Loans outstanding at any one time (see Clause 4.4 (*Maximum number of Loans*)).

Clause 5.3: Currency and amount

The currency specified in a Utilisation Request must be the Base Currency or an Optional Currency. This clause also contemplates that minimum amounts will apply to Loans in each currency.

Clause 6: Optional Currencies

Clause 6.1: Selection of currency

Borrowers must select the currency of a Loan in the Utilisation Request, when drawing a Loan, or in a Selection Notice, in relation to Interest Periods after the first one in the case of a Term Facility Loan. If a Borrower does not issue a Selection Notice in relation to a Term Facility Loan, it will remain denominated in the same currency for the next Interest Period.

Clause 6.2: Unavailability of a currency

This sets out the circumstances in which a Lender is not obliged to lend in the Optional Currency requested: either the Optional Currency is not readily available, or lending in it would be illegal. In this situation, the Lender is obliged to lend in the Base Currency instead.

The Borrower can be notified about unavailability or illegality up to a specified time (blank to be agreed) on the Quotation Day. This is often around 10 a.m. although the required time does vary.

Clause 6.3: Change of currency

The mechanism for currency-switching of Term Facility Loans is set out in this clause.

The “Base Currency Amount” of any Loan is fixed at Utilisation. It does not change subsequently, except to the extent that the Loan is repaid or prepaid or consolidated or sub-divided. It is fixed by reference to the Agent’s Spot Rate at 11 a.m. on the third Business Day before Utilisation.

As a result, if a Borrower delivers a Selection Notice requesting that a Term Facility Loan should be denominated in a different currency for the next Interest Period, and that currency is an Optional Currency, the amount of that Loan for the next period will be the amount of the Optional Currency equal on the Quotation Date for that period to the Base Currency Amount for that Loan.

The Borrower has to repay the Loan in the first currency, and the Lenders have to advance it in the new currency, although they can agree that the Agent will instead use the funding provided by the Lenders in the new currency to purchase an amount in the old currency to satisfy the Borrower’s obligation to repay. If there is a shortfall, the Borrower must make up the difference in the old currency; and if there is a surplus, in the new currency, the Agent must pay it to the Borrower.

Note that the currency-switching under this clause is subject to the same conditions precedent as a new Utilisation, and so will not take place if there is a Default continuing or any Repeating Representation is not true in any material respect. See comments on Clause 4.2 (*Further conditions precedent*) above.

Clause 6.4: Same Optional Currency during successive Interest Periods

Where a Term Facility Loan is to remain denominated in the same Optional Currency for two successive Interest Periods, the Agent is required to calculate the amount of the Loan in the Optional Currency for the second period: this will be the amount in the Optional Currency equal on the Quotation Date for the second period to the Base Currency Amount which was fixed at the time of the original Utilisation. If the amount in the Optional Currency for the second period is less than it was for the first, the Borrower is required to pay the difference to the Lenders; if more, the Lenders must pay the difference. However, if the amount of the increase or reduction is less than a specified percentage of the Base Currency Amount, the provision does not apply.

In practice

This provision is quite often omitted. Where included:

- Optional language requires the parties to settle whether the Lenders’ obligation to pay the difference (where applicable) will be subject to there being no actual Event of Default continuing, or no Default (i.e. no actual or potential Event of Default) continuing. Borrowers will prefer the former, which was the position in early versions of the Investment Grade Agreements.
- The specified percentage by which the Optional Currency amount for the second period differs from the amount for the original period must be agreed. It is quite often set around 5%.

Section 4: Repayment, prepayment and cancellation

Clause 7: Repayment

Please see the comments above on Clause 2 (*The Facilities*) regarding the nature of the Term and Revolving Facilities.

Clause 7.1: Repayment of Facility A Loans

This clause is blank to be completed to reflect the agreed repayment terms.

A bullet repayment facility could read here: “*The Borrowers shall repay all Facility A Loans on the Facility A Repayment Date*”.

Where repayments are to be made by instalments, which will generally start after the end of the Availability Period, a typical provision would read: “*The Borrowers shall repay all Facility A Loans outstanding at the end of the Availability Period in equal instalments on each of the Repayment Dates*”. A definition would be needed for Repayment Date (for example, every 6 months after the end of the Availability Period).

Clause 7.2: Repayment of Facility B Loans

A Facility B Loan (being a loan under the Revolving Facility) is repaid on the last day of its Interest Period. If the Facility B Loan is to be re-borrowed for a further period, this clause provides (optionally) for that to occur on a cashless basis (i.e. without payments being made).

In practice

It has long been market practice for revolving advances to be rolled over by book entry, without any cash payment. However, before the financial crisis, loan documentation did not make express provision for this to happen automatically. The insolvency of Lehman Brothers and other institutions highlighted a point of concern for Borrowers, that the liquidator or other insolvency officer appointed to a Lender might insist on repayment of the existing advance in cash, and then refuse to fund the new advance.

The optional wording in this clause (which was developed after the financial crisis) provides that where a Revolving Facility advance is to be made to refinance another Revolving Facility advance which (i) is due for repayment on the same day as the new advance is to be made and (ii) involves the same Borrower and the same currency, the advances will be netted to the extent possible, leaving cash payments to be made by either Lenders or Borrowers to the extent of the excess, if any. Borrowers will want to make sure that this optional provision is included, which has generally been the case in loan documentation signed since the Lehman provisions, discussed in Part IV, were published (and where this clause originally appeared).

Clause 8: Prepayment and Cancellation

Clause 8.1: Illegality

If it becomes unlawful for a Lender to perform its obligations under the Agreement or to fund or maintain its participation in any Loan, the Lender is given an option to exit the Facilities (subject to its obligation to mitigate the effects of any illegality, see Clause 16 (*Mitigation by the Lenders*)). The Borrower is required to prepay the relevant Lender on request and the Lender's Commitment is cancelled. This clause also makes provision, optionally, for the prepayment and cancellation of a Lender in circumstances where it would be unlawful for any Affiliate of that Lender (for example, its parent company) for the Lender to continue to participate.

In practice

The option to extend this provision to be triggered by unlawfulness stemming from laws applicable to Affiliates of the Lender, in addition to laws applicable to the Lender itself, is not always used. Its inclusion as an option is thought to have been prompted primarily by concerns about sanctions compliance (see paragraph 5 of Part II). For example, if the parent company of a banking group is subject to sanctions which prevent the provision of funds directly or indirectly to or for the benefit of

a sanctioned person, that could conceivably give rise to the possibility of an illegality event affecting a Lender's Affiliate (its parent company in this example), but not perhaps, the Lender itself.

Clause 8.2: Change of control

This clause provides, in outline, that a change of control of the Borrower can trigger the cancellation of Commitments and a requirement for the mandatory prepayment of outstanding Loans, as well as potentially operating as a drawstop.

This clause contains a number of options for the parties to negotiate. The first issue is whether a change of control should be an automatic drawstop (other than in the case of Rollover Loans). The parties are also required to select whether all outstandings will be repaid and all Commitments cancelled, or only those of Lenders opting to exit.

In the first version, on a change of control, the Majority Lenders can require the Agent to cancel the Commitments and declare the Loans due and payable to all the Lenders at the end of a notice period. In the second version, on a change of control, each Lender has the right during a limited period (to be specified), to require the Agent to cancel its Commitment and declare the Loans due to it due and payable at the end of a notice period. Accordingly, the parties must agree on whether cancellation and prepayment is to be on a Lender-by-Lender basis or a Majority Lender decision. Both options are provided.

In practice

Investment grade Borrowers, historically, were resistant to a change of control prepayment event along these lines, but such provisions are now almost universally applicable. Lenders generally take the view that their credit assessment and interest in the Group is dependent on current ownership. If Lenders wish to have the right to exit the deal on a change of control, it is probably preferable for Borrowers to have this provision in Clause 8 (*Prepayment and Cancellation*), rather than as an Event of Default, where it might be thought more likely to trigger the cross-default provisions in other debt documentation if it were exercised (although much will depend on the drafting of the relevant provisions).

As to whether the clause should be exercised on a Majority Lender or a Lender-by-Lender basis, the Borrower's preference is likely to depend on whether it feels its prospects of retaining funding will be maximised by a Majority Lender decision, or allowing Lenders to exit individually.

Lenders very often take the view that their right to exit the transaction on a change of control under this clause should be on an individual, rather than a Majority Lender basis, so that they are able to ensure that they remain in compliance with any regulatory or internal policy requirements. From the Borrower's perspective, it is debatable whether prepayment and cancellation following a change of control should be triggered on a Majority Lender or an individual Lender basis. If Majority Lenders must make a decision, that may feel like a higher threshold to cross, but once the decision has been made, the Facilities are prepayable in full. Individual Lender rights might be thought to be more easily exercisable, but if only a handful of Lenders choose to exit, the Borrower at least has the option of continuing with a smaller facility or potentially, replacing them (see comments under Clause 8.6 (*Right of replacement or repayment and cancellation in relation to a single Lender*)).

If the change of control provision enables the prepayment and cancellation of individual Lenders, Borrowers may seek to extend the mechanism in Clause 2.2 (*Increase*) to cover cancellation following a change of control and/or rights to replace the outgoing Lender pursuant to Clause 8.6 (*Right of replacement or replacement in relation to a single Lender*).

Whichever version of Clause 8.2 is agreed, Borrowers may suggest that each Lender's (or Majority Lenders') right to be prepaid and cancelled following a change of control should apply only after they have consulted with the Borrower for a certain period (for example, 30 days), with a view to continuing to participate in the Facilities. If, following the conclusion of any agreed consultation period, the relevant Lender or Lenders still choose to exit the Facilities, the Borrower should ideally negotiate as long a notice period as possible (for example, one or two months) to allow time to arrange replacement financing.

It is also worth noting that the Borrower's views on this clause, which is potentially a hindrance to any sale of the Group in certain circumstances, will depend on the likelihood (or desirability) of the Group being sold.

The definitions of “control” and “acting in concert” for the purposes of this clause need to be settled. Borrowers may wish to avoid using a cross-reference to tax legislation in the definition of “control”: using this legislation usually imports a wide measure of what constitutes control, which the Borrower may not be able to monitor. The clearest test, often favoured by Borrowers, is the definition of a subsidiary in section 1159 of the Companies Act 2006: this involves, in outline, a change in majority voting rights, or membership with the right to appoint a majority of the board, or membership with contract-based sole control of majority votes.

Clause 8.3: Voluntary cancellation

This provides that the Borrower can cancel the Term and Revolving Facilities on notice.

In practice

The notice period here is commonly about 5 Business Days, though it is sometimes less (and Borrowers may feel the period should not be too long).

Clause 8.4: Voluntary prepayment of Term Facility Loans

It is conventional to give Borrowers the right to prepay Term Loans on notice, after the end of the Availability Period.

In practice

The notice period is commonly 5 Business Days, though it can be useful to have a shorter period, such as 2 Business Days, for maximum flexibility.

Where Term Loans have to be repaid in instalments, Lenders to an investment grade Borrower usually require any amount which is prepaid to be set against the repayment instalments in reverse chronological order, i.e. repaying the last instalment first. Borrowers may, however, seek to have prepayments applied in chronological order, or *pro rata*, or even at their discretion. The Investment Grade Agreements leave the parties to settle the provision on a case-by-case basis.

Break Costs will be payable where the prepayment is not made at the end of an Interest Period. See Clause 11.6 (*Break Costs*).

Clause 8.5: Voluntary prepayment of Revolving Facility Loans

Borrowers are commonly permitted to prepay Revolving Facility Loans on notice.

In practice

The notice period is often between 2 and 5 Business Days.

Break Costs will be payable where the prepayment is not made at the end of an Interest Period. See Clause 11.6 (*Break Costs*).

Clause 8.6: Right of replacement or repayment and cancellation in relation to a single Lender

This clause provides for the replacement or repayment and cancellation of a single Lender where (in outline) the Borrower is required to gross-up that Lender pursuant to Clause 13.2 (*Tax gross-up*) or to indemnify that Lender pursuant to Clauses 13.3 (*Tax indemnity*) or 14.1 (*Increased Costs*). It also provides for the replacement of a Lender that asks to be prepaid pursuant to Clause 8.1 (*Illegality*).

If the Borrower elects to replace a Lender, the clause makes provision for the relevant Lender’s participation to be transferred at par to the replacement Lender.

In practice

Borrowers may wish to consider extending the scope of the provision to apply in other circumstances where individual Lenders have the right to be prepaid, for example and as already noted, as a result of the operation of Clause 8.2 (*Change of control*).

Clause 8.7: Restrictions

This clause sets out various restrictions in relation to repayments, prepayments and cancellations. These include that any prepayment/cancellation notices are irrevocable and that no Borrower may re-borrow any part of Facility A (the Term Facility) that is prepaid.

Clause 8.8: Application of prepayments

Any prepayments (other than expressly permitted prepayments of single Lenders) will be applied *pro rata* to each Lender's participation in the relevant Loan.

Section 5: Costs of utilisation

Clause 9: Interest

Clause 9.1: Calculation of interest

The rate of interest on each Loan advanced under an Investment Grade Agreement, for each Interest Period, is the percentage rate per annum which is the aggregate of the following:

- the “**Margin**”: a percentage rate per annum which is left blank to be inserted;
- the applicable floating rate component: “**LIBOR**”, “**EURIBOR**” (for loans in euro) or if the facilities are denominated in currencies for which LIBOR is not available (“**Non-LIBOR Currencies**”), a “**Benchmark Rate**” to be specified.
- optionally, “**Mandatory Costs**”.

In practice

See comments in relation to the definitions of “**Margin**”, “**LIBOR**”, “**EURIBOR**”, “**Benchmark Rate**” and “**Mandatory Costs**” in Clause 1.1 (*Definitions*).

As noted in Clause 1.1, market practice is generally to dispense with the optional concept of Mandatory Costs, the assumption being that to the extent necessary, Lenders will take account of such costs in pricing the Facilities.

Clause 9.2: Payment of interest

Interest is payable on the last day of each Interest Period. If the Interest Period is more than 6 Months (a defined term), it must also be paid at 6 Monthly intervals, in line with market practice. For more on Interest Periods, please see comments on Clause 10.1 (*Selection of Interest Periods*).

Clause 9.3: Default interest

Default interest at a rate to be agreed is payable on overdue amounts. Interest Periods for overdue amounts are set by the Agent.

In practice

The default interest rate is often set at 0.5% or 1% above the rate which would otherwise have applied. The Agent’s right to set Interest Periods on overdue amounts is on the basis that the Lenders have to continue funding the overdue amounts in the market. When the overdue amount is a Loan which becomes due on a day which is not the last day of an Interest Period, the Lenders will already have obtained funding to the end of the then current Interest Period. This means that the first Interest Period for the defaulted amount is the rest of that current Interest Period, and the rate is the rate which has already been fixed for that current Interest Period, plus the default rate. Compounding at the end of each Interest Period for the defaulted amount is market practice.

Clause 9.4: Notification of rates of interest

The Agent is obliged to notify the Borrower of the applicable rate of interest for each period promptly after it has been fixed.

Clause 10: Interest Periods

Clause 10.1: Selection of Interest Periods

The Borrower selects the length of Interest Period, either:

- in the Utilisation Request, in the case of the first Interest Period for a Term Facility Loan and for all Revolving Facility Loans, or
- in a Selection Notice, in the case of all subsequent Interest Periods for Term Facility Loans.

If a Facility is to be repaid or to reduce in instalments, Borrowers may select Interest Periods shorter than they would otherwise be allowed, to ensure that Loans of the necessary size mature on the relevant repayment or reduction dates.

The notice period required for a Selection Notice for Term Facility Loans is left blank. Where the Borrower does not deliver a Selection Notice, the Agreement determines the length of the Interest Period.

In practice

The permitted Interest Periods are often 1, 3 and 6 Months. Periods not specified in the Agreement will require the approval of all the Lenders. LIBOR fixings for 2-week, 4 month, 5 month, 7 month, 8 month, 9 month, 10 month and 11 month maturities were discontinued in 2013, so if Interest Periods of those lengths are selected, the optional definition of “Interpolated Screen Rate” and the consequential changes to the definition of LIBOR will be required (see Clause 1.1 (*Definitions*)).

If the syndicate includes, or is likely to include Treaty Lenders the Borrower should try to ensure that the Interest Periods selected allow sufficient time to file the relevant clearance forms with HMRC (as provided for in Clause 13 (*Tax Gross Up and Indemnities*)). This topic is discussed further at Clause 13 (*Tax Gross Up and Indemnities*) and at Clause 24 (*Changes to the Lenders*).

Borrowers will usually wish to ensure that Interest Periods, along with all the other provisions dealing with interest in the Agreement, match the provisions of their hedging arrangements.

The notice period required for a Selection Notice for Term Facility Loans is usually the same as the notice period required for a Utilisation Request (see Clause 5.1 (*Delivery of a Utilisation Request*)).

Borrowers may wish to discuss the length of the default Interest Period that applies if none is selected with the Agent. This is optionally one Month; longer periods may be chosen.

Clause 10.2: Changes to Interest Periods

This is an extension to the provision explained above. If a Facility reduces in instalments and a Borrower fails to select Interest Periods to coincide with repayment dates, the Agent will make the necessary adjustments to the Interest Periods. This means that the Agent selects which Loans are to be repaid, so Borrowers should not overlook this point.

Clause 10.3: Non-Business Days

If an Interest Period would otherwise end on a non-Business Day, it will instead end on the next Business Day in the calendar month in question, if there is one, or on the preceding Business Day, if there is not. This reflects the “modified following business day” market convention that is used in the calculation of ICE LIBOR and EMMI EURIBOR.

Clause 10.4: Consolidation and division of Term Facility Loans

Unless the Borrower specifies otherwise in a Selection Notice, the Agent will consolidate into a single Loan any Term Facility Loans in the same currency with the same Interest Period and the same Borrower.

The Borrower is permitted to request the division of a Term Facility Loan in a Selection Notice, subject to the constraints set out in Clauses 4.4 (*Maximum number of Loans*) and 5.3 (*Currency and amount*).

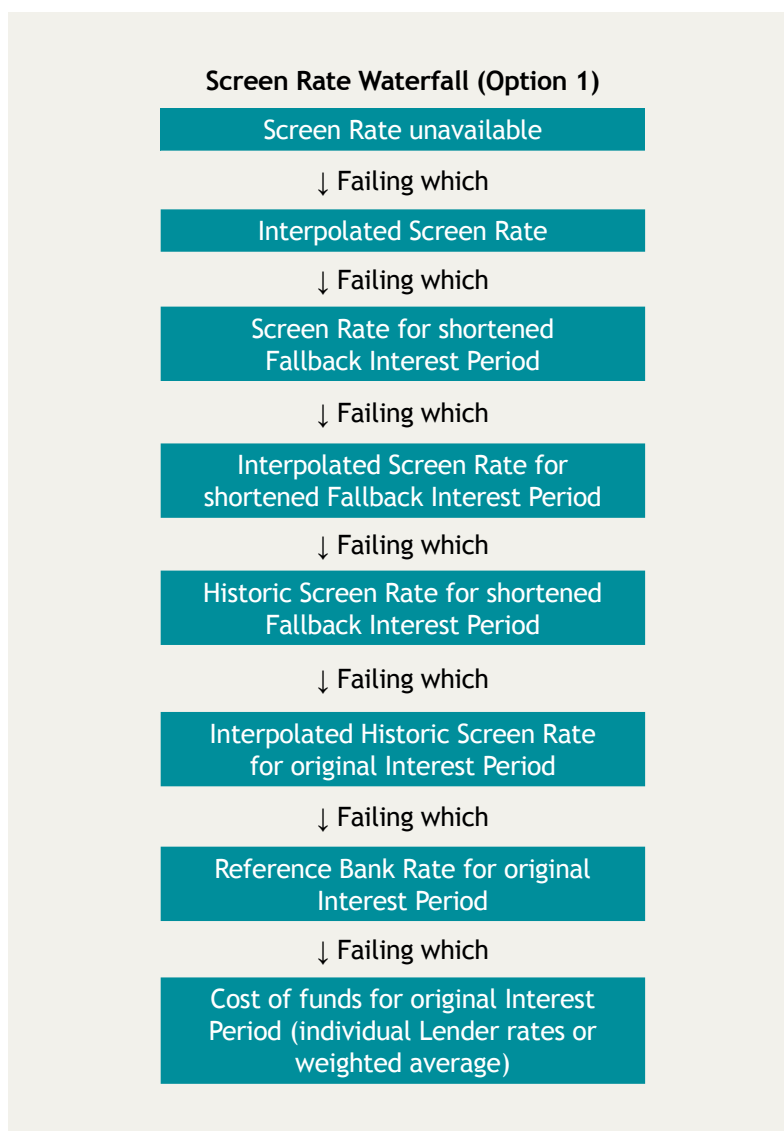
Clause 11: Changes to the Calculation of Interest

Clause 11.1: Unavailability of Screen Rate

As discussed in paragraph 4 of Part II, the provisions specifying the rates to be used if the Screen Rate is unavailable were comprehensively reviewed in 2014. As a result, the template provides two alternative versions of this clause for the parties to choose from.

Option 1 is quite complex, providing a “waterfall” of fallback rates. According to the waterfall (illustrated in the diagram below), should the Screen Rate be unavailable and interpolation impossible, rates for a shortened “**Fallback Interest Period**”, or failing that, “**Historic Screen Rates**” will be used. Only once those options have been exhausted does the rate revert (optionally) to a Reference Bank Rate. If a Reference Bank Rate is

not available (for example, the Reference Banks fail to provide a quote), the interest rate for the relevant Interest Period shall be based on each Lender's cost of funds, calculated in accordance with Clause 11.4 (*Cost of funds*).



Option 2 is simpler and closer to the pre-existing position. It provides for the use of Interpolated Screen Rates, or if interpolation is not possible, the optional default is the Reference Bank Rate. If Reference Bank Rates are unavailable, the last resort, as in the case of Option 1, is to set the interest rate for the relevant Interest Period by reference to each Lender's cost of funds, calculated in accordance with Clause 11.4 (*Cost of funds*).

In either case, if the Screen Rate is unavailable, the parties have the option, instead of relying on fallback rates, of agreeing a replacement rate. Clause 35.4 (*Replacement of Screen Rate*) allows the parties to set a replacement rate if Majority Lenders and the Company agree.

In practice

When these alternative options were first made available, the longer benchmark waterfall (Option 1) seemed to emerge as the more popular choice. Instinctively, it might seem preferable from the Borrower's perspective: Borrowers may be keen to stave off having to pay interest at a rate based on individual Lenders' cost of funds for as long as possible. The more complex waterfall of fallback rates in Option 1 should, in theory at least, have that effect. More recently, it seems that the shorter waterfall (the second option) is gaining ground. This could be simply because Lenders and Borrowers have decided that the risk of the Screen Rate being unavailable is not sufficiently material to warrant the greater complexity (and length) of the first option.

It is worth noting that contingency measures put in place by benchmark administrators may decrease the likelihood of contractual fallback options being triggered. The IBA's contingency plan for LIBOR specifies that if inputs are received from fewer than 4 banks (or no inputs are received), a new rate for that day will not be calculated. Instead, the LIBOR rate for the previous day will be re-published and treated as the LIBOR rate for that day. The EURIBOR Code of Conduct makes similar provision. These contingency plans potentially narrow the circumstances in which fallback provisions in a loan agreement might be invoked (although there remains some possibility of disputes as to whether contractually, a previous day's rate should be treated as the current day's rate).

If Option 1 is chosen, as noted in the comments on the relevant definitions in Clause 1.1 (*Definitions*), the intention is normally that the Fallback Interest Period should be relatively short, so that fallback rates are not relied on for too long (for example, a period of one week is quite commonly agreed). Similarly, Historic Screen Rates should not be too historic. The maximum number of days old the rate is permitted to be varies: a period of between one day and one week might be considered typical, with three Business Days a fairly common choice.

Borrowers who rely on interest rate hedging may wish to bear in mind that the use of fallbacks based on Historic Screen Rates is not reflected in current ISDA terms, which generally provide only for the use of a reference bank rate. However, to date many interest rate hedging arrangements have been unlikely to cater precisely for the more remote contingencies of the pre-existing position. For example, if sufficient reference bank quotes are unavailable, the rate according to the ISDA 2006 Definitions is the mean of the rates quoted by major banks selected by the Calculation Agent. Hedging by reference to Lenders' cost of funds would require bespoke drafting.

Clause 11.2: Calculation of Reference Bank Rate

This clause provides that if a Reference Bank does not quote when required, the Reference Bank Rate shall be calculated on the basis of the quotes from the other Reference Banks. If none, or only one of the Reference Banks supplies a quote, there shall be no Reference Bank Rate, and the interest rate for the relevant Interest Period shall be calculated in accordance with the next option in the relevant waterfall (normally, individual Lenders' cost of funds, see above).

In practice

This clause provides an optional cut-off of noon on the Quotation Day for determining the availability of the Reference Bank Rate.

Borrowers may wish to discuss with Lenders whether the optional cut-off time should be pushed forward from noon. Depending on the applicable rate, this provides only a short window for obtaining Reference Bank Rates. The publication time for LIBOR for example, in March 2017 moved to 11.55 a.m. (London time) each day. (The IBA moved the time forward from 11.45 a.m. to allow contributors more time to make the necessary checks on their submissions.)

It is possible of course, that the parties would know in advance of 11.55 a.m. that LIBOR is not available, but if not, to obtain a Reference Bank Rate by noon would seem challenging, in particular if the Reference Banks are not appointed by name in the Agreement, which is now often the case (see comments on definition of "**Reference Banks**" at Clause 1.1 (*Definitions*)).

The LMA User Guide notes that the deadlines given in this clause are suggestions and may need adjustment.

Clause 11.3: Market Disruption

So-called "market disruption" provisions allow the Lenders to pass on to the Borrower their cost of funds in place of the chosen benchmark rate in the event of significant market difficulties. This clause provides, as is customary, that if a specified percentage of Lenders notify the Agent that they are unable to fund their participation in the loan at the chosen benchmark, Clause 11.4 (*Cost of funds*) shall apply for the relevant Interest Period.

There are two options for specifying the basis on which Lenders' funding costs are measured for this purpose. Either the Lender must notify the Agent that the cost to it of funding its participation in the relevant Loan

from “whatever source it may reasonably select” is in excess of the relevant benchmark rate. The alternative is that the Lender must notify the Agent that the cost to it of funding its participation in the relevant Loan from “the wholesale funding markets for the relevant currency” is in excess of the relevant benchmark rate.

In practice

Prior to 2014, the equivalent clause in the Investment Grade Agreements used the relevant Lender’s cost of obtaining matching deposits in the relevant inter-bank market as the comparison measure. It was updated because, for a number of reasons, loan participations may not be funded in the inter-bank market. This change possibly has a limited impact on Borrowers in practice. It may even operate in the Borrower’s favour as Lenders may be able to fund at a rate closer to the agreed benchmark rate outside the inter-bank market. If the first option provided in the revised drafting is chosen and Lenders are free to select their funding source, they are required to act reasonably which provides some safeguard against the choice of an expensive funding source if the relevant Lender has access to cheaper alternatives.

More generally, the 2014 review of the market disruption provisions prompted renewed focus by some on the operation of this clause in light of changes in funding conditions since the Investment Grade Agreements were first published. It has long been the case that some banks are unable to fund themselves at LIBOR or EURIBOR, at least in the inter-bank market. Further, non-bank lenders who cannot fund themselves at LIBOR in any circumstances are participating in syndicated loans, although perhaps not on a widespread basis in the investment grade market.

As a result, the market disruption clause in many syndicated facilities may, in theory at least, be capable of operation regardless of any disruption in any market. There is a question as to whether that is a reasonable position for Lenders to take. The heading of the clause, “market disruption”, might suggest it contains provisions catering for the consequences of an adverse change in funding conditions. That, arguably, may no longer be the case.

The market disruption provisions also seem out of step with other cost-plus mechanics in the Investment Grade Agreements. For example, the tax gross-up and the increased costs clause are both primarily focused on entitling Lenders to be reimbursed costs incurred in the event of an adverse change *vis-à-vis* that Lender’s position on the date of the Agreement.

Clause 11.3 could be adjusted to incorporate an adverse change concept. For example, the clause could provide that a move to cost of funds may only be triggered as a result of individual Lenders’ funding costs if those costs have increased materially or as a result of a material and adverse change in funding conditions generally.

Lenders may not react favourably to any proposals along those lines. Lenders may point out that the clause as drafted requires Lenders representing a material proportion of the Loan in question to notify the Agent that they are unable to fund at the agreed benchmark, which in many cases should protect the Borrower from the clause being invoked by a minority of Lenders. However, although historically the agreed threshold here was often Lenders whose participations represent 50% of the Loan, there has been some downward pressure on this figure in recent years, with many deals at 35%. In light of the comments above, it is important for Borrowers to negotiate as high a threshold as possible.

In addition, Borrowers should consider the suggestions in the footnotes to Clause 11, which were added at the request of the ACT. They remind users to consider whether the Borrower should have rights to replace any Lender that notifies the Agent that it cannot fund at the agreed benchmark or to revoke a Utilisation Request relating to a Loan that subsequently needs to be priced on a cost of funds basis (see further comments at Clause 11.4 (*Cost of funds*)).

Finally, Borrowers should note that the Lehman provisions used to contain an alternative set of market disruption provisions that provided for the use of rates quoted by a set of “Alternative Reference Banks”, with pricing on a cost of funds basis used only as a last resort. These provisions are outlined very briefly in Part IV, as they were rarely used in investment grade loan agreements and were therefore deleted from the Lehman provisions in July 2017.

Clause 11.4: Cost of funds

Clause 11.4 describes how Lenders' cost of funds shall be calculated for Interest Periods where either Clause 11.1 (*Unavailability of Screen Rate*) or Clause 11.3 (*Market Disruption*) apply. The parties are given two options. Interest on the relevant Loan for the relevant Interest Period is payable either:

- at the rate notified to the Agent by the relevant Lender as the cost to it of funding its participation in that Loan from whatever source it may reasonably select (defined as its "**Funding Rate**"); or
- at the rate which represents a weighted average of all Funding Rates submitted by the Agent.

The clause also contains some optional contingency provisions, catering for what happens if a Lender fails to provide a Funding Rate. If Clause 11.3 (*Market Disruption*) applies, the parties must decide whether such Lenders should continue to receive the agreed benchmark rate or should instead receive interest at a rate calculated on the basis of the Funding Rates provided by the other Lenders. If Clause 11.1 (*Unavailability of Screen Rate*) applies, such Lenders cannot continue to be paid at the agreed benchmark, so will receive interest at a rate calculated on the basis of the quotations provided by the other Lenders.

If this clause applies, either the Agent or the Company can require the commencement of a thirty day negotiation period, during which the parties shall attempt to agree a replacement basis for determining the rate of interest.

In practice

It is understood that the option to use a weighted average rate was introduced in 2014 for operational reasons. The ability to apply a single rate to all Lenders may be preferred by Agents, although the individual Lender formulation is also used in practice.

The optional contingency provisions may require negotiation. Some Borrowers may object to Lenders who fail to notify the Agent of a Funding Rate in a market disruption scenario being entitled to receive interest at a rate based on the average of other Lenders' Funding Rates. Any such average rate is likely to be higher than the agreed benchmark rate (if it were not, Clause 11.3 (*Market Disruption*) would be unlikely to apply). Accordingly, Borrowers may argue that Lenders who fail to produce a Funding Rate should continue to receive the agreed benchmark in those circumstances.

The LMA's optional drafting also provides that any Lender whose Funding Rate notified to the Agent pursuant to Clause 11.3 (*Market Disruption*) is less than the agreed benchmark should continue to receive the agreed benchmark rate. Borrower may question why a Lender would notify a Funding Rate which is less than the agreed benchmark rate in these circumstances.

A footnote to this clause suggests that the parties may consider whether the Borrower should be entitled to revoke the Utilisation Request relating to any Loan in respect of which cost of funds applies. If it is agreed that the Borrower should have this right, the timing and notification provisions need to be considered carefully. Clause 11.3 (*Market Disruption*), for example, provides options for the cut-off time for the notification of Funding Rates. The cut-off time may be a specified number of Business Days after the start of the relevant Interest Period or close of business on the relevant Quotation Date or in either case, if earlier, within a specified number of Business Days before interest is due to be paid.

If any right to revoke a Utilisation Request is to be meaningful, it should be capable of exercise before the Loan is funded. This may be the case if the cut-off time is close of business on the Quotation Date, but will not be if the other options are included. If the Loan is in sterling, even close of business on the Quotation Date is likely to be too late, in which case an earlier cut-off time (e.g. midday) might be considered. The Agent's obligation to notify the Borrower that Clause 11.4 (*Cost of funds*) applies (see Clause 11.5 (*Notification to the Company*) below) is also relevant here.

Clause 11.5: Notification to Company

This clause obliges the Agent to notify the Company as soon as practicable if Clause 11.4 (*Cost of funds*) applies.

Clause 11.6: Break Costs

If a Borrower makes a prepayment of principal on any day other than the last day of an Interest Period, the Lenders are likely to incur “**Break Costs**”. This clause contains the Borrower’s obligation to pay Break Costs. Such costs are payable within three Business Days of demand. Each Lender can be required to provide a certificate confirming the amount of any Break Costs claimed.

In practice

The background to and qualification of “**Break Costs**” for the purposes of the Agreement is discussed in the context of the definition at Clause 1.1 (*Definitions*). The main point that Borrowers quite often take on this clause relates to the time for payment (stronger Borrowers may extend the period slightly, as noted in relation to other cost indemnities).

Stronger Borrowers sometimes also argue that they would like to see the basis on which Break Costs are calculated, not only the amount in any certificate and that such a certificate should be provided alongside any demand for payment, rather than only on request.

Clause 12: Fees

Clause 12.1 (*Commitment fee*) is a market standard provision for the payment of the commitment fee. Clauses 12.2 (*Arrangement fee*) and 12.3 (*Agency fee*) make provision for the payment of arrangement and agency fees to the Arrangers and the Agent as set forth in a separate Fee Letter, as is customary.

In practice

Commitment fees are typically set out in this clause as a percentage of the Margin (often around 30-40%). If other types of fee are payable in relation to the Facilities (for example, utilisation fees often apply to standby Revolving Facilities that are not intended to be drawn), this clause will need to be amended.

Section 6: Additional payment obligations

Clause 13: Tax Gross Up and Indemnities

Introduction

The thrust of this clause is that any tax that might be incurred by a Finance Party on payments under the Facilities or in relation to that Finance Party's participation in the Facilities generally will (subject to the Finance Parties' fairly limited mitigation obligations in Clause 16 (*Mitigation by the Lenders*)) be borne by the Borrower. In particular, market expectation is that the Borrower will make payments to the Finance Parties under the Agreement gross (i.e. without withholding tax).

In practice

The tax provisions are a key illustration of the principle of "cost plus" lending, which is generally reflected in the LMA templates on a modified basis. The Borrower's obligations to meet any tax payments are not entirely open-ended. Its obligation to gross-up payments for withholding tax is circumscribed in a manner which should enable the Borrower to mitigate the risk of incurring any liability for UK withholding tax quite significantly (see comments under Clause 13.2 (*Tax gross-up*) below). As a result, subject to some points of detail (outlined in the commentary on specific clauses below), the overall allocation of that risk has become broadly accepted in the market and in most cases, is not extensively negotiated. Other aspects of the tax provisions are less Borrower-friendly but, being rarely invoked, have not historically caused problems in practice.

Borrowers nevertheless need to turn their attention at the earliest possible opportunity to the tax issues arising in relation to any planned loan facility, preferably before the term sheet is signed. Tax advice should always be obtained. It is important in particular to be aware that the tax provisions of the Investment Grade Agreements are designed for UK tax resident Borrowers, despite representations from the ACT that they should, at least in outline, cater for international groups. Adaptation with the benefit of local tax advice is therefore needed where the Borrower group comprises or includes Obligor that are tax resident in other countries.

Clause 13.1: Definitions

This sets out the key definitions used in the tax clauses. Many of the points for negotiation relate to the definitions used to frame the extent of the Borrower's gross-up obligations. These are discussed at Clause 13.2 below.

Clause 13.2: Tax gross-up

Scope of gross-up obligation

The basic framework of this clause provides that the Borrower is required to make payments under the Agreement without any tax deduction, unless a deduction is required by law.

If a tax deduction is required by law, the Borrower must:

- withhold the tax (including on the gross-up amount) and pay it to the relevant taxing authority, and
- gross up the payment to the Lender, so the Lender receives the intended payment in full.

The Borrower's gross-up obligation is, however, subject to an important limitation: the Borrower does not have to gross up a payment to a Lender if the Lender is not (at the point the payment is made) a "**Qualifying Lender**" unless (in summary):

- the Lender is not, or has ceased to be, a Qualifying Lender as a result of a change in law; or
- the Tax Deduction would need to be made even if it were a Qualifying Lender.

To express this in another way, the Borrower will only be required to gross up payments to Lenders:

- who are “**Qualifying Lenders**”, or who have ceased to be Qualifying Lenders due to a change in law, or
- if the deduction would be required even if it the relevant Lender were a Qualifying Lender.

“**Qualifying Lender**” is a defined term, which is intended to capture Lenders who (on the basis of the current UK tax regime) can be paid free of withholding tax. In theory, if the Borrower is able to satisfy itself that each Lender in its primary syndicate is a Qualifying Lender, the risk of becoming obliged to gross up payments to Lenders for UK withholding tax should only arise if there is a change in law (a change in the UK tax regime)¹².

In practice

This clause broadly speaking reflects general market practice. The key point for the Borrower is that the definition of “**Qualifying Lender**” must reflect the criteria which have to be satisfied for the Borrower to be able to make interest payments without withholding tax.

The LMA definition of “Qualifying Lender” specifies four categories of Qualifying Lender:

- (a) UK banks and UK branches of overseas banks;
- (b) UK companies, or “**UK Non-Bank Lenders**”;
- (c) building societies; and
- (d) “**Treaty Lenders**”.

The criteria for Qualifying Lender status in relation to each of these categories are outlined below. The main weakness of the LMA’s definition of “**Qualifying Lender**” from the Borrower’s perspective relates to its description of “**Treaty Lenders**”.

The Borrower must also have a means for determining whether or not each Lender is a “**Qualifying Lender**”. If the Borrower pays gross on the basis that no deduction is required, and it subsequently transpires that deduction was indeed required, it will have to pay the tax it should have withheld.

How does the Borrower know whether or not a Lender is a Qualifying Lender?

Clearly this can be determined through discussions with the members of the primary syndicate. However, the Investment Grade Agreements give the Borrower limited contractual assurance. All Lenders are obliged to notify the Agent if a deduction is required, but that obligation is triggered only when the Lender becomes aware that withholding tax is applicable. Clause 13 provides only for “**UK Non-Bank Lenders**” (see further below) and Lenders who join the syndicate after the date of the Agreement (see Clause 13.5 (*Lender status confirmation*)) to give confirmations as to their Qualifying Lender status.

Some Borrowers are able to obtain a confirmation from all the Original Lenders in the syndicate that they are Qualifying Lenders.

Stronger Borrowers may also negotiate a provision to the effect that, if the Borrower pays interest gross where it should have made a tax deduction, then the recipient of the interest concerned should refund to the Borrower the amount that should have been withheld. In the absence of such a tax rebate clause, the Investment Grade Agreements give the Borrower no right to recover the amount of the tax from the Lender, unless it can show that the Lender was in breach of its obligation to notify the Borrower upon becoming aware of the need for a deduction as mentioned above.

Qualifying Lenders: UK banks and UK branches of overseas banks

The first category of Qualifying Lender is defined by reference to the so-called “banking exemption” from the requirement to deduct tax.

¹² The 2016 CJEU decision in *Brisal-Auto Estradas do Litoral SA and another v Fazenda Pública* (Case C-18/15) perhaps casts doubt on whether, under EU law, UK withholding tax can properly be imposed on a payment of interest made to a lender located in another member state. However, the point is not clear and of course the position under EU law may before long cease to be relevant in a UK context. Certainly the market continues to act on the assumption that the tax charge would be valid.

The background here is section 874 of the Income Tax Act 2007, which requires any company paying yearly interest to deduct withholding tax (currently at 20%). “Yearly interest” is generally considered to mean interest on a loan which is capable of being outstanding for a year or more: this will catch not only term loans for a year or more, but generally also revolving facilities where, although advances may be made for periods of less than a year, they may be rolled over, so that the economic nature of the arrangement is a loan capable of being outstanding for a year or more. Interest on advances made under a 364-day (or shorter) facility is not subject to withholding.

Section 879 of the Income Tax Act 2007 provides a potential exemption from the requirement to deduct withholding tax on yearly interest. This applies to interest paid on an advance made by a bank if at the time when the interest is paid the person beneficially entitled to the interest is within the charge to corporation tax in respect of it. The Borrower will therefore want to satisfy itself, in order to be able to pay gross, on two points: the advance in question must have been made by a bank, and the person beneficially entitled to the interest must be within the charge to corporation tax in respect of it.

The definition of a “bank” for these purposes cross-refers to the Financial Services and Markets Act 2000. Broadly speaking, it means UK banks and UK branches of overseas banks.

The second point takes into account the possibility of beneficial ownership of the interest being transferred. Following a loan sale by way of novation or assignment, the person beneficially entitled to the interest will be the purchaser and so for the banking exemption to apply following the sale, the purchaser must be liable to UK corporation tax on the interest. Note that novation is regarded as involving a repayment to the seller and a fresh advance by the purchaser, so that, in order for the banking exemption to apply following novation, the purchaser must qualify as a bank (as defined) in addition to being liable to UK corporation tax on the interest.

Qualifying Lenders: “UK non-bank lenders”

This category broadly comprises UK tax-paying companies and partnerships, known as “**UK Non-Bank Lenders**”. It is optional, reflecting the fact that when the Agreements were first published, some investment grade Borrowers did not wish to include this type of Lender in their syndicates. These days, it is customarily included.

Following a campaign by the LMA, withholding tax was abolished in the UK in 2001 on interest payments made to UK resident companies and to overseas companies where the recipient is within the charge to UK corporation tax as respects that income. The imposition of withholding tax had been one of the main obstacles to the inclusion of non-banks in lending syndicates.

The criteria for there being no withholding tax are set out in sections 929 to 938 of the Income Tax Act 2007. A company is not required to deduct withholding tax if one of the following conditions is satisfied:

- the person beneficially entitled to the interest is either a company resident in the UK or a partnership, each member of which is a company resident in the UK; or
- the person beneficially entitled to the interest is either (a) a company not resident in the UK which carries on a trade here through a branch or agency, and the payment falls to be brought into account in computing the company’s chargeable profits; or (b) a partnership in which a UK branch of a non-UK company as mentioned in (a) (together with other such branches, or UK resident companies) participates (and no one else does).

Unlike banks (discussed above), these Lenders are required under the Investment Grade Agreements to give a representation (a “**Tax Confirmation**”) to assure the Borrower that they meet the criteria for payment gross. This is because the relevant statutory exemption from withholding tax requires that the Borrower must have reasonable grounds for believing that the person beneficially entitled to the interest is within the categories described above. Each Lender to whom it applies will give this representation on the date it becomes a Lender (the date of the Agreement, in respect of Original Lenders).

Qualifying Lenders: Building Societies

Building societies (as defined in section 989 of the Income Tax Act 2007) have been included as a category of Qualifying Lender in the Investment Grade Agreements since 2004. The background is section 880 of the Income Tax Act 2007, which provides an exemption from UK withholding tax for interest paid on advances from a building society.

They are not often seen in lending syndicates in practice.

Qualifying Lenders: Treaty Lenders

Treaty Lenders are Lenders who rely on a double tax treaty between the UK and their home jurisdiction to receive interest free of withholding tax. The provisions relating to Treaty Lenders are the key aspect of the tax provisions for a Borrower to focus on as withholding tax is more likely to arise on payments to Treaty Lenders than to other categories of Lender. This is mainly because satisfaction of the criteria for exemption from withholding in the relevant treaty does not, of itself, entitle the Borrower to rely on that exemption. The relevant procedural formalities must be completed. This means that either (i) the Lender must hold a “passport” under HMRC’s DT Treaty Passport Scheme (the “DTTP Scheme”), with the Borrower obtaining a direction from HMRC in reliance on that passport, or (ii) an application for a direction must be made to HMRC and the relevant foreign taxing authority via the ordinary clearance procedure.

In the absence of a direction from HMRC for the Borrower to pay interest gross (under either the ordinary procedure or, where applicable, the DTTP Scheme), the Borrower must in principle withhold tax¹³.

The DTTP Scheme (discussed further below) provides the means to obtain a direction on an accelerated basis, which reduces significantly the risk that the first interest payment falls due before a direction is received from HMRC. If a Treaty Lender holds (and uses) a passport under the DTTP Scheme, some potential obstacles to the availability of relief under the relevant Treaty are also eliminated.

In practice

Ideally, a Borrower in a strong negotiating position would exclude Treaty Lenders from the Qualifying Lender definition, due to this and other risks presented by Treaty Lenders (which include change of law risk (likely to be greater than in the case of other Lenders), and the difficulties which arise from the multiplicity of Treaties, with varying provisions). This is, however, no longer general market practice. The tax risks arising from the inclusion of Treaty Lenders are often outweighed by the pricing and liquidity concerns which could arise from their exclusion.

“Treaty Lender” definition: criteria for eligibility for grossing up

The LMA definition of “**Treaty Lender**”, which determines the qualification of such Lenders as Qualifying Lenders, is incomplete and therefore must be settled on a case-by-case basis.

The LMA definition includes two conditions for Treaty Lender status:

- The first condition requires the Lender to be treated as a resident of a state which has a treaty with the UK providing full exemption from tax on interest.
- The second condition is that the Lender must not have a permanent establishment in the UK with which the loan is connected.

These conditions, however, do not cover any specific requirements which need to be satisfied (including by the Lender) if there is to be no withholding tax. The definition contains a blank, suggesting that it is up to the parties to determine the other requirements which may apply.

In practice

The existence of the third, blank, condition in the definition of “**Treaty Lender**” is unsatisfactory. The omission of the third condition from some signed Agreements means that Lenders can be entitled to grossed-up payments even though Treaty relief allowing the Borrower to pay without withholding may never become available. Treasurers should make sure that this additional condition is completed in their Agreements where Treaty Lenders are permitted.

What should the third condition be? The LMA notes that this is a complex area and that, “if appropriate”, additional wording should be inserted “to apportion risk as agreed by the Parties”. The suggestion in the LMA note to the definition is that “relevant treaties should be reviewed”. The difficulty with that, of course, is that the treaties that are “relevant” can be identified only if the Agreement limits the

¹³ This is subject to the practice point noted below in relation to the DTTP Scheme, where the Borrower submits Form DTTP2 online.

jurisdictions in which all original and future Lenders can be found. In the absence of such a restriction more general wording is appropriate to ensure that risks that are properly Lender risks are apportioned to them.

Possible wording is as follows (although each Borrower will need to address its own circumstances):

“(iii) meets all other conditions in the Treaty for full exemption from tax imposed by the United Kingdom on interest relating to:

- (a) the identity or status of the Lender (including its status for tax purposes);*
- (b) the circumstances which are particular to the manner in which it holds its rights and obligations under the Facilities;*
- (c) the length of the period during which the Lender holds its rights or obligations under the Facilities;*
- (d) the reasons for its acquisition of rights or obligations under the Facilities, except where it became a Lender on the date of the Agreement; and*
- (e) the nature of any arrangements by which the Lender turns to account its rights under the Facilities.”*

A shorter alternative might read:

“(iii) meets all other conditions in the Treaty for full exemption from United Kingdom taxation on interest which relate to the Lender (including its tax or other status, the manner in which or the period for which it holds any rights under this Agreement, the reasons or purposes for its acquisition of such rights and the nature of any arrangements by which it disposes of or otherwise turns to account such rights).”

It would be helpful if wording along these lines were included in the definition of Treaty Lender in the Investment Grade Agreements in place of the blank.

Treaty Lenders: procedure for obtaining direction to pay gross

Having settled the definition of Treaty Lender in a manner that ensures that such a Lender should be eligible for relief under the Treaty, Treaty clearance must be sought, in the form of a direction from HMRC. Clause 13.2 (*Tax gross-up*) provides only that Lenders and Borrowers shall co-operate to complete the relevant procedural formalities for obtaining Treaty clearance.

In practice

This is a weak obligation from the Borrower’s point of view. It essentially requires Treaty Lenders merely to co-operate with the Borrower in completing any Treaty application forms and similar procedural requirements. Read strictly, it does not require Lenders to initiate the completion of any procedural requirements or otherwise to be proactive, possibly implying that it is incumbent on Borrowers to identify the relevant Treaties and to provide the relevant forms to Lenders for completion. Strong Borrowers may ask for a clearer undertaking from Treaty Lenders. Sometimes Treaty Lenders will be required to complete the procedural formalities for obtaining a direction for the Borrower to pay gross “as soon as reasonably practicable” or “promptly”.

Another way for Borrowers to protect against the risk that a direction is not received before an interest payment is required to be made is to ensure that the first Interest Payment Date is fixed at a date not earlier than (say) 6 months after signing. Even then there remains the risk of transfers to Lenders occurring shortly before an Interest Payment Date¹⁴.

See also comments at Clause 10.1 (*Selection of Interest Periods*).

¹⁴ Though see the discussion of paragraph (c) of Clause 24.3 (*Other conditions of assignment or transfer*), below.

The DTTP Scheme

The most significant changes to the LMA tax provisions in recent years were due to the introduction of the DTTP Scheme, which became operative on 1 September 2010. Provisions catering for the operation of this scheme were added to the Investment Grade Agreements in December 2011. Under the DTTP Scheme, Treaty Lenders can (but are not required to) apply for a passport which confirms their eligibility for treaty relief. Passports are valid for five years and will cover all loans entered into by the passport holder in that period. If the Lender holds a passport and wishes to use it in relation to a particular loan, it is able to take advantage of an accelerated clearance process.

The Borrower therefore needs to know whether any Treaty Lenders in the syndicate are DTTP Scheme passport holders. To that end, HMRC maintains a searchable online database of DTTP Scheme passport holders¹⁵. However, the Investment Grade Agreements stipulate that the Borrower may only submit a Form DTTP2 in relation to a Treaty Lender if the relevant Lender has confirmed to the Borrower that it holds a passport and wishes the DTTP Scheme to apply to the Agreement. Accordingly, Borrowers must await confirmation from each Treaty Lender that it (a) holds a passport and (b) wishes to use it, before filing any Form DTTP2. The Investment Grade Agreements make provision for this in relation to the primary syndicate by requiring syndicate members to confirm their passport status in the Schedule to the Agreement (Schedule 1) where their names appear. Lenders who acquire their participation after the date of the Agreement are asked to make the relevant confirmation in the Transfer Certificate, Assignment Agreement or Increase Confirmation (see Schedules 5, 6 and 13).

Clause 13.2 (*Tax gross-up*) does not specifically oblige the Borrower to file the Form DTTP2. If, however, the Borrower fails to do so within 30 days of the date of the Agreement or other date on which the Treaty Lender becomes a Lender (having been provided with the relevant information by the Lender) or if it files the DTTP2 but it is rejected or no direction is forthcoming, the consequence is that the “ordinary” Treaty clearance procedure applies.

In practice

The DTTP Scheme was a welcome development for the syndicated loan market. The process of obtaining clearance is considerably simpler in relation to Treaty Lenders who have applied for and obtained a passport. Most (though not all) banks that are regular members of lending syndicates have by now acquired passports.

The key point is that even if the Borrower duly complies with its obligation under the Agreement to submit Form DTTP2 within 30 days of the date of the Agreement or other date on which the Treaty Lender becomes a Lender, there is no guarantee that it will receive a direction in time.

In the past, HMRC’s DTTP guidance implied that a direction should be issued within 30 working days of HMRC’s receiving Form DTTP2. But there was no such indication in revised guidance that HMRC published on 6 April 2017.

If the direction is not received in time, the Borrower must decide whether to withhold. The revised guidance was unclear as to HMRC’s expectations here. It is understood that it may be amended so as to state clearly that a Borrower submitting Form DTTP2 online and then receiving an acknowledgement of submission can assume treaty relief is available and therefore make no withholding where the applicable treaty rate is nil. It will of course be helpful if HMRC operate such a practice on a consistent basis, although a Borrower paying gross in these circumstances will be taking the risk of learning after the event that it should in fact have withheld.

The scope of the DTTP Scheme has very recently been extended such that, for loans entered into on or after 6 April 2017, the parties need no longer be corporates. Assuming the relevant conditions are satisfied it can now be used if the UK Borrower is a partnership, an individual or a charity or if a Treaty Lender is a sovereign wealth fund, pension fund or partnership (or other tax-transparent entity), provided in the last case that the beneficial owners of the interest are entitled to the same treaty benefits under the same treaty.

¹⁵ www.hmrc.gov.uk/cnr/dtpp-register.pdf.

Clause 13.3: Tax indemnity

The tax indemnity given by the Company is very wide. It purports to cover the Finance Parties for any cost (other than tax on net income) that the Finance Party determines, in its absolute discretion, “will be or has been (directly or indirectly) suffered for or on account of tax” in respect of the Loan. There is a carve-out for amounts covered by the gross-up provisions of Clause 13.2 (*Tax gross-up*).

In practice

Despite some fairly strenuous objections by Borrowers to the scope of this indemnity over the years, a broad-ranging tax indemnity of the kind included in the Investment Grade Agreements is common, though stronger and more determined Borrowers are usually able to negotiate away its worst excesses.

The justification for the indemnity is chiefly the view among Lenders that tax liabilities suffered by them in connection with their lending - except for their general corporate taxes on net income - should be for the account of the Borrower: the gross-up provisions cater only for withholding tax, so, the Lenders’ argument continues, the risk of other tax liabilities needs to be covered by an indemnity. The basis for this view is the Lenders’ “cost-plus” approach to lending: costs which might erode their profit should not be for their account.

Moreover Arrangers may sometimes try to argue that amending Clause 13.3 can cause problems in syndication and subsequently in the secondary market, and therefore the overall balance of advantage to Borrowers may be in giving it.

However, there is no justification for seeking an indemnity for costs that may never in fact be incurred. Nor, if a Lender is from the outset taxed in its jurisdiction by reference to something other than net income, is it obvious why the Borrower should be responsible.

Ideally the tax indemnity would present a more balanced approach to the allocation of risk as between the Borrower and the Lenders in line with other cost-plus indemnity obligations under the Agreement, for example, Clause 14 (*Increased Costs*). A more balanced tax indemnity would cover only taxes that have (i) actually been suffered and (ii) result from some characteristic of the Borrower (such as its tax residence) or from a change in law. The following wording would achieve this:

“The Company shall...pay to a Protected Party an amount equal to any loss, liability or cost suffered for or on account of Tax by the Protected Party in respect of a Finance Document which would not have been so suffered but for:

- (a) a change after the date on which it became a Finance Party in (or in the interpretation, application or administration of) any law or Treaty or any published practice of any taxing authority; or*
- (b) a connection between the Borrower and the jurisdiction under the law of which the Tax is imposed.”*

All that said, it is extremely rare for Lenders to seek to claim under the indemnity and it is never suggested that the wording should be taken at face value. Borrowers may conclude that the practical exposure is therefore low.

Clause 13.4: Tax Credit

This clause provides, in broad terms, that if a Lender receives a benefit for withholding tax payments made by the Borrower, credit should be given to the Borrower. Specifically, if a Lender decides that a Tax Credit is attributable to a payment made by an Obligor, and that it has received and used that Tax Credit, it will pass it back to the Obligor.

In practice

This provision is fairly standard, although in practice Borrowers rarely obtain any benefit from it in particular in light of Clause 27 (*Conduct of Business by the Finance Parties*). This provides that Lenders are not obliged to make a claim for a Tax Credit or relief, or make any changes to the way they arrange their tax affairs, or disclose any information about them. Lenders are generally unlikely to be willing to make any changes to Clause 27. Stronger borrowers are sometimes able to insist that Treaty Lenders

make a claim to HMRC for a refund of any tax withheld, since there is no obvious reason for them not to do so.

Clause 13.5: Lender status confirmation

This provision requires any Lender acquiring a participation after signing to indicate in the transfer documentation whether or not it is a Qualifying Lender and, if it is, whether or not it is a Treaty Lender and whether or not it holds a passport under the DTTP Scheme. If it fails to do so, it will be treated by the Borrower as if it is not a Qualifying Lender.

In practice

Although potentially helpful on a practical level, this provision does not give much assistance to the Borrower from a legal perspective, as the status confirmation is given expressly without liability, a point which Lenders are generally reluctant to negotiate. Moreover, if an incoming Lender fails to provide the required confirmation, while the Borrower is not obliged to treat it as a Qualifying Lender, the Borrower may not know whether a deduction is required to be made.

Borrowers should also note that they are protected from incurring any tax risk as a result of Lenders coming into the facility on the secondary market by two other provisions of the Investment Grade Agreements:

- Each Lender's right to transfer or assign its participation in the Facilities is subject (within limits) to the Borrower's consent (see Clause 24 (*Changes to the Lenders*)).
- Although it may have to withhold tax, the Borrower is not obliged to gross-up payments to an incoming Lender unless payments to the outgoing Lender were also grossed up (see Clause 24.3 (*Other conditions of assignment or transfer*), at paragraph (c)); the same provision limits the Borrower's exposure under the tax indemnity too.

Clause 13.7: VAT

The essence of this clause is that the cost of any irrecoverable VAT in respect of supplies made by or to a Finance Party under any of the Finance Documents, and the irrecoverable VAT element of any costs and expenses for which a Finance Party is entitled to be reimbursed or indemnified, is not borne by the relevant Finance Party but is passed on to the Company or the Obligors as appropriate.

In practice

Like many other aspects of the tax provisions, this clause is not commonly negotiated.

Clauses 13.8: FATCA information and Clause 13.9 FATCA Deduction

What is FATCA?

As outlined in paragraph 7 of Part II, FATCA requires foreign financial institutions ("FFIs") to provide detailed information on their US account holders to the US Internal Revenue Service ("IRS"). As the US Government does not have direct jurisdiction over most FFIs, FATCA encourages FFI compliance primarily via the imposition of a 30% withholding tax on, *inter alia*, US source income paid to FFIs who do not comply with FATCA's reporting requirements.

Whether a FATCA withholding obligation applies to a payment depends on the status of the person making the payment, the status of the recipient and the source of the payment. The withholding tax regime can therefore affect FFIs as either recipients or makers of payments. Accordingly, in order to determine the extent to which FATCA might affect a syndicated loan transaction two key issues to determine are a) the FFI status of the parties and b) whether any payments under the Finance Documents will constitute US source income.

“FFI” is a broad concept designed to catch any foreign entity, which is, as defined, a financial institution. There are three general types of activity that cause an entity to be regarded as an FFI: accepting deposits in the ordinary course of banking or similar business, holding financial assets for the account of others and engaging primarily in the business of investing, reinvesting or trading in securities. Insurance companies providing policies which constitute “financial assets” (such as life assurance) are also regarded as financial institutions, as are holding companies of groups which include such an insurer. Accordingly, in the context of syndicated loans, FFIs may exist in the Borrower Group as well as among the Finance Parties.

A payment of interest under a loan agreement will in general be US source income for an FFI if it is made by a US Borrower or by an Agent or Guarantor on behalf of a US Borrower. Where an Obligor has a US trade or business, interest paid by that trade or business will also have a US source.

FATCA’s withholding tax regime may also eventually extend to “foreign passthru payments” made by certain FFIs. This concept caused considerable alarm when it was initially proposed as the payments would not themselves need to have a US source; they would need merely to be “attributable” to US source payments. However, the commencement date of withholding on foreign passthru payments has been pushed back to the latest of 1 January 2019 or six months after final regulations are published in the Federal Register. So it will be some time before the scope of the rules on foreign passthru payments is known. In any event, foreign passthru payment withholding will not apply to payments by or to an FFI in a Model I IGA jurisdiction such as the UK (see below).

FATCA and syndicated loans

The FATCA legislation is complex but its impact on the syndicated loan market has been much less significant than was initially feared; one reason for this is that after an awkward couple of years, Lenders were able to become comfortable that FATCA should in most cases be a risk they are able to manage themselves, rather than pass on to the Borrower (as it was in the US).

If there is no FFI in the Group and the Finance Parties will not be receiving (or making) US source payments, the transaction is likely to have little or no exposure to FATCA. Moreover, the development of bilateral inter-governmental agreements (“IGAs”) between the US and other jurisdictions has eased FATCA concerns considerably for FFIs by making compliance far easier and all but eliminating the threat of withholding for FFIs in relevant jurisdictions. The global spread of IGAs has reduced very substantially the number of FFIs that would need to make - or would ever suffer - the withholding imposed by FATCA.

Since the UK signed the first IGA in 2012, IGAs have come into force in 75 jurisdictions; and another 38 jurisdictions are treated as having an IGA in effect, even though they have not yet completed all the stages to give effect to it. The IRS is keen to apply pressure to get those jurisdictions to bring their IGAs into force and has threatened to remove their “in effect” status if they are unable to show they are working towards full implementation. Affected jurisdictions were given 60 days from 1 January 2017 to do so. The removal of “in effect” status would put the relevant jurisdiction in the same position as any other non-IGA jurisdiction and would increase the risk of FATCA withholding.

The UK/US IGA is a Model I IGA, the effect of which is that financial institutions in the UK (which includes UK branches of overseas institutions but not overseas branches of UK financial institutions) are able to report information on their US account holders to HMRC rather than the IRS. Such institutions are “deemed compliant” for FATCA purposes. There is no FATCA withholding on payments to a deemed compliant FFI, and payments made by a deemed compliant FFI are safe too unless the FFI has elected to assume primary withholding responsibility (a scenario which does not often arise in practice). A Lender in a country which does not have the benefit of an IGA should therefore be able to lend via a branch in an IGA jurisdiction and thereby remove any risk of FATCA withholding.

Allocation of FATCA risk

As discussed in paragraph 7 of Part II, the LMA provided guidance to the market in the form of a note to members which contained alternative options for the allocation of FATCA withholding risk between the Finance Parties and the Borrower (the “**FATCA Riders**”). Rider 3, the most borrower-friendly of the options, was incorporated into the Investment Grade Agreements (with minor modifications) in 2014.

The key features of the FATCA provisions in the Investment Grade Agreements are as follows:

- All parties are entitled to make any required FATCA withholding (see Clause 13.9 (*FATCA Deduction*)), but should withholding arise, no party will be obliged to gross up any other party in respect of the relevant deduction (this is achieved by excluding “FATCA Deductions” from the definition of “Tax Deduction” for the purposes of the gross-up provisions, see Clause 13.1 (*Definitions*)).
- The possibility of claims relating to any FATCA withholding being pursued against the Borrower via the tax indemnity (Clause 13.3) or the increased costs clause (Clause 14) is also excluded.
- Each Party is required to confirm its FATCA status to the others to facilitate compliance and there is a mechanism for replacing the Agent if its involvement risks triggering FATCA withholding (see Clause 13.8 (*FATCA information*) and Clause 26.12 (*Resignation of the Agent*)).

In practice

The acknowledgement by the LMA that the risk of FATCA withholding should fall on the Lenders in most circumstances is helpful for Borrowers. The text of the FATCA provisions in the Investment Grade Agreements tends not to be negotiated, subject to some very minor points of detail. FATCA still requires discussion, however, in transactions involving lenders in non-IGA jurisdictions (for example, certain Middle Eastern and Asian countries). There remains some variation in the agreed position here and Lenders may press for the inclusion of one of the LMA’s FATCA Riders 1 and 2, which both involve the Borrower taking on the risk of FATCA withholding to some extent. In such situations, US tax advice may be required.

Borrowers should be aware that in August 2014 the LMA published a “Guidance Note on FATCA for Agents in Model II IGA jurisdictions”. In summary, IGAs take two forms; Model I and Model II. Where an Agent is located in a Model II IGA jurisdiction, there is (according to the LMA) a risk that Agent could itself have to withhold on account of FATCA. Clause 13.9 (*FATCA Deduction*) protects the Agent in that instance from any gross-up obligation, but the LMA’s note suggests that an Agent in that position might also look for specific indemnification should it incur liability for a failure to withhold caused by a Lender failing to provide the Agent with up-to-date or accurate information about its FATCA status. The note contains a suggested form of indemnity (from the Lenders to the Agent) for this purpose. This is not being used on a widespread basis, but may be relevant in some instances.

A note on the OECD Common Reporting Standards

A more recent development that may require parties to a loan agreement to share information on their tax status is the OECD’s set of Common Reporting Standards (“CRS”). The CRS is sometimes referred to as “global FATCA” but, unlike FATCA, it is simply an information exchange regime, there is no withholding obligation.

It is not currently anticipated that the CRS will require changes to loan documentation. Clause 13.8 (*FATCA information*) requires each Party to confirm its FATCA status to the other parties and supply such information as is required for the purpose of that other party’s compliance with FATCA or any other law, regulation or exchange of information regime. This reference to other regimes is designed to enable compliance with the CRS.

Clause 14: Increased Costs

Clause 14.1: Increased Costs

The essence of this provision is that if a Lender suffers a cost or loss in relation to the Facilities as a result of a change in law or regulation, the Borrower should indemnify it. The Lenders’ reasoning here is again based on the “cost-plus” approach to lending discussed above under Clause 13.3 (*Tax indemnity*).

In outline, Clause 14 allows a Finance Party to recover the amount of any Increased Cost (which is defined quite broadly) incurred as a result of compliance with a change in law or regulation which occurs after the date of the Agreement.

Definition of “Increased Costs” (Investment Grade Agreements)

“*Increased Cost*” means:

- “(i) a reduction in the rate of return from the Facility or on a Finance Party’s (or its Affiliate’s) overall capital;*
- (ii) an additional or increased cost; or*
- (iii) a reduction of any amount due and payable under any Finance Document,*
- which is incurred or suffered by a Finance Party or any of its Affiliates to the extent that it is attributable to that Finance Party having entered into its Commitment or funding or performing its obligations under any Finance Document.”*

The Finance Parties’ ability to claim Increased Costs under Clause 14 is subject to certain exceptions, which cover claims which are addressed under the tax provisions and costs which are attributable to the wilful breach by the relevant Finance Party or its Affiliates of any law or regulation.

The scope of the increased costs clause has been a key topic for discussion between Borrowers and Lenders over the past decade, first as a result of the implementation of Basel II and then, following the financial crisis, Basel III. The regulatory background is outlined briefly below.

Basel II

The 1988 Basel Capital Accord (“**Basel I**”) was replaced by the International Convergence of Capital Measurements and Capital Standards published by the Basel Committee on Banking Supervision (“**BCBS**”) in June 2004 (“**Basel II**”). Basel II formed the basis for the EU Capital Requirements Directive (2006/48/EC and 2006/49/EC¹⁶) and its implementation in the UK.

Under Basel II (as under Basel I), banks were required to meet a solvency ratio (capital to risk-weighted assets) of a minimum of 8% and Total Tier 1 capital may not be less than 4%. Tier 1 capital includes ordinary shares and disclosed reserves (“**Core Tier 1**”), preference shares and certain other hybrid debt instruments and “innovative securities” (“**Non-Core Tier 1**”). Core Tier 1 may not be less than 2%. Under Basel II, bank regulators are, however, obliged to consider if a higher capital ratio should be required, and the UK regulators have applied higher benchmarks for the purposes of stress tests used as part of its ongoing supervisory regime.

Basel II brought in significant changes to the risk-weighting of assets. Under Basel I, the risk-weighting applied to each asset depended simply on the category it fell into. A loan to a corporate borrower was 100% risk weighted, regardless of its credit rating, so that £8 of capital was required for every £100 lent, unless secured with recognised collateral. The capital cost attributable to a loan to a borrower was constant over the life of a loan facility, and the same for all banks.

Basel II introduced a requirement for banks to use external credit assessments where available (the “**Standardised Approach**”), while banks with advanced risk management capabilities may be permitted to use an internal ratings-based approach (the “**IRB Approach**”), using their own models. Thus, under Basel II, assessments of a borrower’s creditworthiness may vary from bank to bank, depending on which of the approaches is used. The capital cost attributable to a loan may also vary over the life of the facility if the borrower’s creditworthiness alters. In addition, during the life of the facility a bank’s assessment techniques can change, for example if it changes the parameters of its internal model.

Basel III

In December 2010, the BCBS published a further set of bank capital requirements aimed at strengthening existing standards, and rules imposing two new liquidity standards and a new leverage ratio (imposing a 3% cap on banks’ balance sheets as a proportion of their Tier 1 capital) in two documents: “Basel III: A global regulatory framework for more resilient banks and banking systems” and “Basel III: International framework for liquidity risk measurement, standards and monitoring” (subsequently revised in January 2013 as “Basel III: The Liquidity Coverage Ratio and Liquidity risk monitoring tools”) plus a Guidance Note “Guidance for national authorities operating the counter-cyclical capital buffer”. These rules, together with “Globally systemically important banks: assessment methodology and additional loss absorbency requirement - rules text” which was published in November 2011 and contains certain supplementary rules applicable to “global systemically important banks” (“**G-SIFIs**”), have collectively become known as “**Basel III**”.

¹⁶ As amended, *inter alia*, by Directives 2009/111/EC, 2010/76/EU and 2016/36/EU.

Basel III did not change the general approach to capital regulation in Basel II, but the rules are more onerous and thus have increased the costs of compliance. In summary, although the basic 8% solvency ratio is unchanged, common equity (ordinary shares and retained earnings) must be the predominant form of Tier 1 capital (when Basel III is fully implemented, the minimum common equity ratio will rise from 2% to an effective 7% of risk-weighted assets including the capital conservation buffer) and the bank capital is required to be of higher quality, among other things as a result of stricter definitions for Core Tier 1 and Non-Core Tier 1 capital. “Innovative securities”, for example, can no longer be included in Tier 1 capital. In addition, banks are required to build up capital buffers in good times that can be drawn down in periods of stress.

Liquidity standards have been introduced to reflect the central role of liquidity for banks. These comprise a liquidity coverage ratio (“**LCR**”) requiring banks to hold a stock of highly liquid assets sufficient to survive short-term liquidity stress and a net stable funding ratio (“**NSFR**”) requiring banks to maintain sufficient sources of stable funding over a longer period. In addition, Basel III introduced a new regulatory regime in the form of the leverage ratio, which did not form part of Basel I or Basel II.

Basel III has been implemented into EU and national law around the world. In the EU, this has been achieved via the fourth Capital Requirements Directive¹⁷ and the Capital Requirements Regulation¹⁸, together, “**CRDIV**”). The Capital Requirements Regulation did not require implementation in the UK through legislative means or rules of the Prudential Regulation Authority (“**PRA**”) as EU Regulations are directly applicable in all EU member states. It has applied since 1 January 2014, other than Articles 8(3) and 21 (liquidity requirements) and Article 451(1) (disclosure of leverage information), which applied from 1 January 2015; and Article 413(1) (stable funding), which applied from 1 January 2016. The revised Directive has required UK legislative measures and amendments to the Handbook of the FCA and the Rulebook of the PRA. The revised Directive has applied since 1 January 2014, other than the provisions relating to capital buffers (which applied from 1 January 2016). Much of the core detail including, crucially, in relation to the LCR, is or will be set out in Level 2 legislation, some of which is yet to apply in the UK.

The LCR and the loan market

The first elements of the LCR came into effect on 1 January 2015 and it is required to be fully implemented by 1 January 2018. The LCR is an element of Basel III that has been focused on closely by loan market participants. It requires a bank to hold high quality liquid assets in a quantity sufficient to meet its anticipated net cash outflows (including a specified proportion of its undrawn lending commitments which are available for drawing over the next 30 days) over a 30 day stressed period. The amount of liquid assets that the LCR requires a bank to hold is calculated by reference to an assumed drawdown rate which varies according to the nature of the facility. The LCR therefore potentially gives rise to increased costs for all types of lending commitments, but the drawdown rate applicable to liquidity facilities such as swingline loans and to loans extended to financial institutions and “financial corporates” is higher than the rate applied to other types of facility. The cost impact of the LCR for banks may therefore be greater in relation to these types of facilities. When first announced, whether changes should be made to affected loan documentation to facilitate Lenders’ compliance with the LCR generated a fair amount of attention. For example, there was a question as to whether borrowers might be required on an ongoing basis to monitor and report to Lenders their swingline facility requirements (the extent of planned or maturing commercial paper issues or drawings within the next 30 days). However in the event, the lending community appears to have concluded such provisions are unnecessary and the initial implementation of the LCR has had a limited impact on documentation terms.

In practice

The scope of the increased costs clause, as noted above, is discussed in most transactions. Borrowers are quite often able to weaken this provision in some respects, although what is achieved and the nature of any limitations tends to vary quite widely. Points commonly addressed include the following:

¹⁷ Directive 2013/36/EU.

¹⁸ Regulation 575/2013.

- The clause provides only for the exclusion of any Increased Cost arising from a change in law or regulation which is attributable to the “wilful breach” by a Lender of law or regulation. A Borrower may argue that it should not only be breaches which are wilful that are excluded. It should not have to prove wilfulness. While this might seem a fair point, only stronger Borrowers tend to have much success with this argument.
- A Borrower may feel that there should be a limited window (for example, six months) following the incurrance of the relevant costs within which Lenders are able to claim. This is quite often achieved by investment grade Borrowers.
- A carve-out for Basel II costs is quite commonly included although, as explained below, the risk of Increased Costs claims arising out of Basel II is no longer substantial.
- Most Borrowers also believe that any Increased Costs arising out of Basel III should be excluded from the scope of this clause, now that the Basel III regime has been implemented across the EU.

The treatment of Basel III costs is often the focal point of negotiations on the scope of the increased costs clause. Amendments are often instigated by Lenders: as Basel III may no longer constitute a “change in law” for the purposes of the LMA clause, Lenders are seeking on a fairly widespread basis to adjust the LMA clause to provide that Basel III costs are recoverable, regardless of whether they constitute a change in law. The background to this and how Borrowers might respond is discussed below.

Basel II and Increased Costs

The Investment Grade Agreements provide, optionally, for the exclusion of Basel II costs from the scope of the increased costs clause in a footnote to Clause 14. Most investment grade Borrowers have been including this exclusion in their increased costs provisions for a number of years.

Basel II has been fully implemented in the EU for almost a decade, and thus some Lenders may question whether it remains necessary to exclude it from the increased costs clause (which applies only to Increased Costs arising out of changes in law after the date of the Agreement).

There are two main reasons why the exclusion of Basel II costs from increased costs clauses remains justifiable. The first concerns claims for the costs of the initial implementation of Basel II. The likelihood of claims of this kind would appear to be diminishing, since Basel II has now been widely implemented. However it has not been universally implemented. Notably it has not been fully implemented in the US, a point acknowledged in the LMA’s footnote to Clause 14. The second concerns the ongoing implementation of Basel II, and arises because Clause 14 is very broadly drafted, covering not only changes in law and regulation, but also changes in the application, administration and interpretation of law and regulation. For example, arguably a change in the Borrower’s credit rating, or a change in a Lender’s methodology, could be categorised as a change in the interpretation or administration or application of the Basel II regime. Borrowers may feel that where a Margin ratchet triggered by a change in credit rating applies to the Facilities, Lenders should not need to make an Increased Costs claim. Changes in methodology may be less likely than was the case when Basel II was first being implemented, but cannot be ruled out. Against this background, Borrowers should continue to consider whether it is appropriate in the circumstances of their transaction to seek to exclude Basel II costs.

If the parties have agreed to exclude Basel II from the scope of the increased costs clause but it is commercially agreed that Basel III will **not** be excluded (see below), a further complication arises. The LMA highlights in its footnote to Clause 14 that as elements of Basel III operate as amendments to Basel II, care should be taken to clarify that the Basel II carve out does not operate to exclude Basel III, and goes on to provide some optional language to that effect.

Basel III and Increased Costs

Lenders are entitled to recover “**Increased Costs**” from the Borrower, in summary, to the extent they arise out of a change in law that occurs after the date of the Agreement. As noted above, CRD IV, the legislation implementing Basel III in the EU has been in force for some time, indicating that costs relating to Basel III and CRD IV should fall outside the scope of the increased costs indemnity in the Investment Grade Agreements. In light of the phased implementation of the various elements of Basel III, it has become common for Lenders to seek to reserve their rights to claim increased costs, whether or not such costs are attributable to a change in law. This approach, while not universally

applicable, has become sufficiently widespread for the LMA to add a footnote to the Investment Grade Agreements, to highlight that users may wish to supplement the clause to address the extent to which both Basel III costs and CRD IV costs are intended to be within, or outside, its scope.

Borrowers may argue that despite the fact certain detailed aspects of CRD IV remain work in progress, implementation is sufficiently advanced that most banks in the EU should by now be able to quantify their Increased Costs. Accordingly, Borrowers should be entitled to assume that Basel III costs have been factored into the pricing of the Facilities (as was the case when Basel II was implemented). However, the low Margins achieved by many in the investment grade market in recent years has possibly made Lenders more reluctant to concede their ability to recoup (at least in theory) their increasing operational costs from the Borrower.

Some Borrowers may accept this, valuing the pricing on offer above a more favourable contractual arrangement on Increased Costs. They may also feel that their lending relationships are such that the risk of claims being made in practice is unlikely, and do not pursue the point on that basis. Others, however, feel strongly that this is not consistent with the concept of relationship lending and may choose to pursue an exclusion of Basel III costs from the scope of the clause entirely.

What is achievable is variable and may often depend on relationships and bargaining strength rather than the policies of individual Lenders. Stronger Borrowers with a close bank group or who borrow bilaterally are sometimes able to persuade Lenders that a “carve-in” in respect of Basel III costs is unnecessary (meaning that Lenders would have to satisfy the “change in law” criteria to make a claim). An express carve-out for Basel III costs remains rare in syndicated facilities to date.

In the face of general resistance from Lenders to the concept of excluding Basel III/CRD IV costs, the focus for Borrowers has shifted to ways to mitigate the likelihood of and limit the scope of any claims.

A reasonably common compromise in the context of Basel III/CRD IV, is to permit the Finance Parties to claim costs relating to Basel III/CRD IV only to the extent such costs were not reasonably foreseeable on the date of the Agreement. There is logic to this position. It acknowledges the Lenders’ point that the impact of some aspects may not be precisely quantifiable in all respects as well as the Borrower’s point, that many of the key elements have been implemented already. Another possibility that has gained some traction is to provide that Lenders may claim Increased Costs arising out of Basel III/CRD IV only to the extent they have adopted a general policy of claiming such costs where entitled to do so.

There are, however, multiple other ways to address the point. For example, a general time limit on Increased Costs claims of the type described above is potentially helpful in the context of Basel III.



BREXIT NOTE: Increased Costs claims

All EU laws that currently form part of UK law, including the CRD IV regime, will need to be replaced with domestic laws when the UK leaves the EU. Whether that process could give rise to Increased Costs that are recoverable from the Borrower under Clause 14, remains to be seen. As the shape of any UK legislation that replaces currently applicable EU laws such as CRD IV becomes clearer, it is possible that Borrowers might start to think about whether any Increased Costs resulting from the “Great Repeal” need to be excluded from the scope of Clause 14. However, for now, this is not an issue that is generally being discussed.

Clause 14.2: Increased cost claims

This clause requires a Finance Party making an Increased Costs claim to notify the Agent (who will notify the Borrower). The Finance Party can be obliged to provide a certificate confirming the amount of the relevant costs if the Agent requests.

In practice

This clause is quite rarely adjusted but some Borrowers will want the Lender’s certificate to show the calculation as well as the amount.

Clause 15: Other Indemnities

Clause 15.1: Currency Indemnity

A sum due in one currency may need to be converted into another currency in order to make a claim or enforce a judgment, thus exposing the Lenders to exchange rate fluctuations. A currency indemnity is standard.

Clause 15.2: Other Indemnities

This clause includes indemnities intended to cover costs and losses incurred, broadly speaking, as a result of some fault on the part of the Borrower. It includes:

- An indemnity for costs incurred as a result of an Event of Default.
- An indemnity for costs resulting from a failure to pay on the due date (justified on the grounds that the indemnity for costs incurred as a result of an Event of Default does not cover costs incurred during a grace period).
- An indemnity for costs resulting from an advance not being made, although requested by a Borrower. The Borrower is liable unless the fault is a Lender's.
- An indemnity for costs resulting from an advance not being prepaid in accordance with a notice of prepayment given by the Borrower or the Company.

In practice

This clause is rarely adjusted given that it is intended to cover costs and losses incurred through some fault on the part of the Borrower. Some Borrowers may seek to limit the costs and losses indemnified here to those reasonably incurred or incurred as a *direct* result of the events specified.

Clause 15.3: Indemnity to the Agent

Pursuant to this Clause, the Borrower agrees to indemnify the Agent in relation to matters which are deemed to be within the Borrower's control or are accepted to be a Borrower risk for example, investigating potential Defaults and transaction, enforcement and amendment costs (see Clause 17 (*Costs and expenses*)).

The indemnities in this clause cover:

- The costs of the Agent in investigating any event which it reasonably believes is a Default.
- The Agent's costs in any foreign currency sale or purchase that it needs to make for the purposes of currency-switching under Clause 6.3 (*Change of currency*).
- The Agent's liabilities incurred as a result of acting on any notice, request or instruction which it believes to be genuine and appropriately authorised.
- The Agent's costs of instructing lawyers and other advisers or experts as permitted under the Agreement.

The final limb of this indemnity, which relates to the costs of instructing advisers was added after the financial crisis as the role of the Agent and the extent of its responsibilities were highlighted in a wave of restructurings. It was part of a package of changes to the Agency provisions in the LMA templates, the background to which is discussed in more detail at Clause 26 (*Role of the Agent and the Arranger [and the Reference Banks]*).

It is worth noting here that the equivalent provision in other of the LMA's templates was also altered in the wake of the financial crisis, but in a different way which makes the indemnity much broader in scope. The Borrower's indemnity to the Agent in the Leveraged Agreement, for example, extends specifically to any other cost, loss or liability incurred by the Agent in acting as Agent under the Facilities. Further, the Borrower is required to reimburse any Lender for any payment that Lender makes to the Agent pursuant to the Lenders' indemnity to the Agent (Clause 26.10 (*Exclusion of liability*)) in the Investment Grade Agreements. This difference in approach is in large part because the Agent's need for indemnity protection is likely to be greatest in the context of amendments, waivers and restructurings. Leveraged loans are most likely to be amended or restructured due to the sub-investment grade status of the Borrower, the extensive nature of

the typical covenant package and often longer tenor. Further, the likelihood that a leveraged loan will be held more widely means that the administrative input required from the Agent (and the risk of liability in the absence of contractual protection) is generally more significant. An indemnity along these lines is not usually considered appropriate or necessary in an investment grade loan agreement.

In practice

Costs of instructing advisers

Borrowers may wish to build some protection into the final limb of this indemnity in relation to the costs of instructing advisers, along the lines that the Agent may instruct advisers at the Borrower's cost only if the Agent, in its reasonable opinion, deems this to be necessary. (This is really a consistency point. This protection is included as standard in Clause 26.7(d), which entitles the Agent to appoint its own independent lawyers, but the template does not place any limitation on the Agent's ability to instruct advisers on behalf of the Lenders; Clause 26.7(c) provides that the Agent is generally entitled to do so at its discretion.)

In transactions where specialist types of advice might be required during the life of the Facilities, the obvious example being in real estate financing where valuations might be required from time to time, it is customary to make express provision for who is to bear the costs of such advice. The Lenders might be entitled to appoint such advisers at the Borrower's cost in specified circumstances and/or a specified number of times. Where applicable, care must be taken to ensure that the Borrower's general indemnity obligations do not cut through any more specific provisions.

Other points

Other points which the Borrower might take in relation to this provision include the following:

- Borrowers may want to ensure that the causal link between the cost and the event is direct, not just indirect.
- Borrowers might also want to restrict the third limb to situations where the notice, request or instruction turns out not to be genuine or properly authorised, on the basis that if it is, any costs should be covered by the agency fee.

A note on mandate terms

When negotiating the indemnity provisions in the Agreement generally, Borrowers should remember that loan mandate letters often include indemnity obligations which survive entry into the Agreement and can be broad ranging. It is important to ensure that any such indemnity obligations are drafted such that they are superseded by overlapping obligations in the Agreement, and do not, in effect, override any limitations agreed in the loan documentation itself.

Clause 16: Mitigation by the Lenders

Here the Lenders undertake that in certain circumstances, such as if an Obligor has to gross-up a Qualifying Lender under Clause 13.2 (*Tax gross-up*), the Lender will take all reasonable steps to mitigate the circumstances causing this. Mitigation is often achieved by a transfer of the Loans to an Affiliate, or a different Facility Office.

In practice

This clause protects a Lender by excusing it from mitigating in any way which would, in its opinion (acting reasonably), be prejudicial to it. Borrowers should note that the Lenders are given very substantial similar protection by Clause 27 (*Conduct of Business by the Finance Parties*). They may therefore argue that the Lenders do not need both clauses. Borrowers should note that Clause 27 does not require the Lenders to act reasonably. Borrowers may also want the Lenders to be obliged to notify it if any of these circumstances arise.

In practice, however, this clause is rarely amended.

Clause 17: Costs and Expenses

This clause sets out the customary costs indemnities covering the Agent's and the Arrangers' transaction costs and expenses (including legal fees) (Clause 17.1), the Agent's costs and expenses relating to amendment and waiver requests (Clause 17.2) and any costs and expenses incurred by the Finance Parties in connection with the enforcement or preservation of their rights under any Finance Document (Clause 17.3).

The Company is required to pay transaction costs "promptly on demand", and both amendment and enforcement costs, within three Business Days of demand.

In practice

Borrowers may be able to replace the obligation to pay transaction expenses promptly on demand with an obligation to pay within a fixed period. Investment grade Borrowers are regularly permitted periods from around 5 Business Days upwards for payments pursuant to this provision. Borrowers may also take the view that 3 Business Days is too short a time-frame for payment of amendment costs. It is generally more difficult for obvious reasons to extend the time limit for the payment of enforcement costs.

In relation to all components of this clause, Borrowers sometimes seek to require that claims should be accompanied by reasonable supporting evidence explaining how the costs have been incurred.

Section 7: Guarantee

Clause 18: Guarantee and Indemnity

The Investment Grade Agreements contemplate that the Facilities will be guaranteed by members of the Group. The guarantees, in either case are generally structured as joint and several cross-guarantees. In other words, each Guarantor guarantees the obligations of each other Borrower.

The guarantee provisions in the Investment Grade Agreements are technical and market standard.

In practice

For stronger Borrowers, guarantees may be required only to ensure the parent company of the Group provides credit support for the obligations of the Borrowers under the Facilities. For Borrowers towards the lower end of the investment grade spectrum, upstream guarantees from their Subsidiaries may be required.

Where upstream credit support is required, Lenders may impose a Guarantor coverage ratio. This normally takes the form of an undertaking, to the effect that entities in the Group whose EBITDA and/or assets represent a certain minimum percentage of the Group's consolidated EBITDA or gross assets must accede to the Agreement as Guarantors, and (often) that certain "Material Companies" within the Group must be Guarantors. Guarantor coverage ratios vary, but quite commonly require Material Companies and members of the Group representing around 75-85% of the Group's consolidated EBITDA or gross assets (or other appropriate measure) to be Guarantors.

The concept of "Material Companies", which is also used for other purposes, is discussed further in the comments introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) below.

Guarantors should note that the guarantee payment obligation is, "whenever a Borrower does not pay any amount when due", to pay "immediately on demand". Very strong Guarantors are occasionally able to adjust this obligation so that the guarantee payment is due within a fixed number of Business Days of demand.

Other adjustments to this clause are unusual unless the result of legal limitations applicable to Guarantors incorporated overseas. If there are Guarantors that are not incorporated in England and Wales, local legal advice will be required on the terms of the guarantee.

Section 8: Representations, Undertakings and Events of Default

Introduction

The key objective of most Borrowers in relation to this Section of the Investment Grade Agreements, which contains most of the commercial terms, is to ensure that each clause is framed in a manner that is operationally workable. Negotiation is expected here: many of the representations, undertakings and Events of Default in the Investment Grade Agreements contain blanks or options and Borrowers must pay close attention to the type of qualifications and exceptions that the business of the Group is likely to require.

In some cases, operational workability can be achieved by the application to the relevant term of some kind of qualification, for example, by reference to materiality or the Company's knowledge. In others, any concerns that the Borrower may have with regard to the practicalities of monitoring compliance with the relevant obligation may be addressed by limiting its application beyond the LMA's typical default position of all members of the Group. These techniques are discussed further below.

In relation to a number of provisions, however, in particular some of the general undertakings, the Borrower may find that specific exceptions are required for certain of its activities. These exceptions will need to be crafted to fit the Borrower's circumstances. Some of the exceptions that are commonly relevant are discussed in the commentary on individual clauses.

It is also worth emphasising that the Investment Grade Agreements suggest only representations, undertakings and Events of Default on the topics that are generally included in all types of "plain vanilla" loan. As such, outside the very top end of the investment grade market, their subject matter is quite often treated as a minimum requirement and Lenders will seek to add representations, undertakings and (less commonly) Events of Default that extend beyond those in the Investment Grade Agreements. Additional requirements tend to fall into four broad categories:

- *Credit-driven*: Lenders will want to keep a closer eye on lower quality Borrowers and will therefore (in particular) impose a more restrictive covenant package. For example, restrictions on Financial Indebtedness of some sort are quite often imposed on Borrowers at the lower end of the investment grade spectrum and beyond. Clearly the application and stringency of any financial covenant tests will also be credit-driven.
- *Jurisdiction-driven*: The Investment Grade Agreements are designed for English Obligor. Supplemental provisions are often prompted by the nationality of the Obligor (for example, if there is a US Obligor, US regulatory provisions, that can be quite extensive, may be necessary).
- *Sector/business-driven*: Additional provisions may be driven by the nature of the business. Examples of quite widespread application here include representations and undertakings in relation to environmental matters and insurance requirements which are often applicable to businesses with real estate assets. Financial covenants tend also to be quite sector-specific.
- *Policy-driven*: Some representation and undertakings are put forward because a Lender has adopted a policy of doing so across its loan book. These often relate to regulatory or compliance issues. The topics on which additional contractual provisions are most often suggested are sanctions and anti-corruption laws (see sections 5 and 6 of Part II).

Some requests can fall into a number of these categories. The likely nature and scope of any supplemental provisions is an important topic for treasurers embarking on a new financing to discuss with their legal advisers.

Scope of representations, undertakings and Events of Default

Many of the representations, undertakings and Events of Default in the Investment Grade Agreements are expressed to apply to each member of the Group. For example, a number of representations are expressed to be given by each Obligor in relation to itself and all other members of the Group. For obvious reasons, this tends to be the Lenders' starting point. However, there can be good reasons why many should be limited to a smaller pool of entities within the Group. The key point here is that the Lenders' credit assessment is primarily based on the strength of the Obligors. That being the case, how important is it for the Lenders to monitor the position of other members of the Group?

Stronger Borrowers often argue that the commercial terms of the Agreement, in general, should apply only to the Obligors. While it may be reasonable, for example, for Obligors to give some representations in relation to themselves and their Subsidiaries, on the basis that they should have relevant knowledge of their own Group, some Obligors may not feel it is reasonable that they should be required to give representations in relation to the activities of each member of the wider Group.

However, Lenders may feel they need some comfort in relation to the activities of other material entities in the Group too, in particular in relation to certain important provisions. Designating certain entities within the Group as “Material Companies” is the technique most commonly used to achieve this. A “Material Company” is typically a member of the Group which exceeds certain financial thresholds. A common approach is to define a Material Company as a member of the Group whose EBITDA or gross assets exceed a certain percentage (often 5% or 10%) of the Group’s total EBITDA or gross assets. This device is often used to determine which members of the Group are obliged to be Guarantors (see comments on Clause 18 (*Guarantee and Indemnity*)), and also to limit the insolvency Events of Default (see comments at Clause 23 (*Events of Default*)).

Materiality and knowledge qualifications

Qualifications by reference to materiality or the Company’s or the Obligors’ knowledge are often employed to make various obligations and restrictions more palatable from the Borrower’s perspective.

In the Investment Grade Agreements, a number of the commercial terms are qualified by reference to materiality and most Borrowers will negotiate further qualifications. While the operation of any qualification must be considered in context, Borrowers may find it helpful to use the concept of a Material Adverse Effect (discussed at Clause 1.1 (*Definitions*)), rather than simply inserting the word “material”, as the precision of the definition provides greater certainty of meaning. In appropriate cases, monetary thresholds can be a more helpful measure of materiality (for example, where it is necessary to identify “material” litigation or an amount of permitted indebtedness).

Qualifications by reference to knowledge are likely to be most relevant to the representations and also, wide-ranging undertakings such as those relating to sanctions (see paragraph 5 of Part II). None of the representations set out in the Investment Grade Agreements is qualified by reference to the knowledge of any Obligor, other than Clause 19.13 (*No proceedings*). Borrowers often seek to amend representations so that they are given “so far as it is aware”. It is important, however, to appreciate the potential difficulties here. The first is the issue of the individuals whose knowledge may be taken in this context to constitute that of the relevant company. Directors may be taken to fall into this category, and also possibly other senior personnel, and in some cases the company’s advisers. If possible, therefore, it may be preferable to express an awareness qualification by reference to named individuals. Another issue may be imputed knowledge, fixing the company with knowledge of, for example, documents in its possession. Accordingly, Borrowers may seek to limit the awareness qualification to actual awareness.

De minimis baskets

A *de minimis* “basket” exception is often agreed in relation to certain key restrictive covenants as well in relation to certain Events of Default. Such baskets permit the Borrower to take the restricted action provided the value of that action, when aggregated with other restricted actions undertaken in reliance on the basket, does not exceed a particular limit (which may be an overall or an annual limit). The limit may be a monetary amount, or set by reference to a financial measure, for example, an amount equal to a percentage of the Group’s net worth or gross assets.

The Investment Grade Agreements contemplate that a *de minimis* basket will apply to the negative pledge (Clause 22.3), the covenant restricting disposals (Clause 22.4) and the cross-default Event of Default (Clause 23.5). The nature of the baskets normally applicable in these contexts is addressed in the comments under the relevant clause below. Baskets are also used in other contexts in negotiated agreements, for example, as an exception to any covenant restricting Financial Indebtedness.



BREXIT NOTE: Baskets and foreign currency amounts

As noted in paragraph 10 of Part II, the referendum result and the prospect of Brexit have had a significant impact on the value of sterling against other major currencies, which might prompt Groups with foreign currency exposures to consider whether this could have any implications under their loan documentation.

Baskets are generally set in the currency of the Facility (or in the Base Currency “or its equivalent” in multi-currency Facilities). For example, a default under Financial Indebtedness will not trigger the cross-default Event of Default (to paraphrase) if the amount of Financial Indebtedness in default, when aggregated with all other Financial Indebtedness in default, is less than [] (or its equivalent in another currency or currencies).

If a member of the Group wishes to undertake the relevant restricted action, it will be necessary (on the assumption that another exception does not apply) to determine whether there is sufficient capacity within the basket. If the restricted action is denominated in a foreign currency, it would seem that to do this, the basket (and any other amounts incurred in reliance on it) should be converted into the currency of the restricted action. Exchange rate movements therefore have the potential to increase or decrease basket capacity. LMA terms do not prescribe an exchange rate at which any foreign currency amounts which fall within the basket should be taken into account for this purpose, so it should be open to the Borrower to determine an appropriate rate.

Where the impact of exchange rate movements on baskets or other monetary limits are of particular concern, Borrowers sometimes try to negotiate contractual protection against an inadvertent breach (for example, a provision along the lines that no threshold or limit under the Agreement shall be breached as a result of exchange rate movements).

Clause 19: Representations

The representations included in Clause 19, each to be given by each Obligor, cover a variety of legal and factual issues.

The significance of the representations is as follows:

- If any representation is untrue or misleading in any material respect on the date upon which it is expressed to be given, the misrepresentation will be an Event of Default (see Clause 23.4 (*Misrepresentation*)).
- In addition, it is a condition precedent to any Utilisation that the Repeating Representations (see Clause 19.14 (*Repetition*)) are true in all material respects.

It is therefore important for Borrowers not only to take great care in settling the text of these representations at the outset but also to have in place systems which ensure that the accuracy of each representation is checked before it is made or deemed repeated.

Lenders seek representations in order to address particular risks in relation to the transaction.

The representations set out in the Investment Grade Agreements will be relevant for most transactions, and further representations (or carve-outs or additions to representations) specific to the transaction in question may be required. Materiality qualifications and other restrictions are commonly agreed, for example limiting the application of certain representations to certain entities and qualifying the scope of certain representations by reference to the knowledge of the representor.

Representations are made on the date the Agreement is signed, and in addition, specified representations will be classified in the Agreement as Repeating Representations. These will be deemed repeated on certain dates.

The dates on which representations are deemed repeated are the date of each Utilisation Request, the first day of each Interest Period and the date on which any new Obligor is accepted. Clause 4.2 (*Further conditions precedent*) makes it clear that, in addition, on the date of each Utilisation the Repeating Representations must be true in all material respects in order for the Utilisation to be made. Please see the comments below on the question of which representations should be Repeating Representations.

Clause 19.1: Status

This is a customary representation which confirms the legal status and capacity of the Obligors and their Subsidiaries and their power to own their assets and carry on business. It is given by each Obligor in relation to itself and each of its Subsidiaries.

In practice

This representation is usually a Repeating Representation.

Clause 19.2: Binding obligations

Clause 19.2 confirms that each Obligor's obligations under the Finance Documents are legal, valid, binding and enforceable. It is given by each Obligor in relation to its own obligations.

A legal opinion will usually be required to be delivered as a condition precedent. This will confirm to the primary syndicate that the Finance Documents are valid, binding and enforceable. It will, however, contain a number of reservations which operate to qualify the opinion as to the enforceability of the Finance Documents. Accordingly, the representation is qualified by the reservations in the legal opinion.

In practice

This representation involves some (albeit limited) legal risk for the Borrower. The legal opinions are delivered as conditions precedent and speak only at the date at which they are given. As a result, when the representation is repeated, it will only be qualified by reference to the legal position as at the date of delivery of the opinion. If there were a relevant change in law after the date of the opinion, the representation may no longer be accurate. It is customary, however, for the parties to agree that this legal risk will be borne by the Borrower.

This representation is often a Repeating Representation.

Clause 19.3: Non-conflict with other obligations

This representation confirms that implementation of the transaction does not conflict with other legal or contractual obligations. It is widely drafted to cover non-conflict with:

- any law or regulation applicable to the relevant Obligor;
- its constitutional documents and those of its Subsidiaries; and
- any agreement or instrument binding upon it or any Subsidiary or its assets or those of any Subsidiary.

In practice

This provision requires the co-operation of lawyers and the personnel of the Obligors to check that by entering into the transaction, they will not be in breach of any law, constitutional document or contract binding on them or any Subsidiary. The first point to check is that the borrowing will not breach any borrowing limits in the company's constitutional documents, or any other relevant contract.

The Borrower will often try to limit the application of this representation to Obligors only, and unless it is in a position to review all agreements and instruments to which every Subsidiary is a party, qualify the reference to a conflict with "any agreement or instrument" by reference to a Material Adverse Effect. This qualification is often acceptable to Lenders.

This representation is usually a Repeating Representation.

Clause 19.4: Power and authority

Each Obligor represents here that it has the requisite power and authority to enter into the transaction.

In practice

This representation is usually a Repeating Representation.

Clause 19.5: Validity and admissibility in evidence

The Obligors confirm they have complied with any applicable consent and filing requirements.

In practice

The LMA User Guide acknowledges that the second limb of this representation, in which each Obligor represents that all steps have been taken to ensure that the Agreement can be produced as evidence in court, is not required to be given by companies incorporated in England and Wales.

This representation is usually a Repeating Representation.

Clause 19.6: Governing law and enforcement

The Obligors represent that the choice of English law will be effective, and that a judgment obtained in England will be enforced in their home jurisdiction.

In practice

As the LMA User Guide acknowledges, the Lenders do not need these statements from Obligors which are English companies. However all Obligors (whether or not English companies) might argue that these topics are not suitable material for representations: they are technical legal points which are usually dealt with in a legal opinion. If the Lenders insist on obtaining these representations in addition to a legal opinion, Obligors should ensure that they are qualified by reference to the reservations in the legal opinion, as applicable to Clause 19.2 (*Binding obligations*).

Where these representations are to be given, Obligors will want to resist repeating them, as the legal opinion will not be updated. However, as mentioned under Clause 19.2 (*Binding obligations*), this type of legal risk is customarily borne by the Borrower.

Accordingly, this representation is usually a Repeating Representation.

Clause 19.7: Deduction of Tax

Here, each Obligor represents that it is not required to withhold tax from payments to Qualifying Lenders, subject to certain conditions.

In practice

Historically, Clause 19.7 contained a much wider statement that withholding tax is not applicable, which potentially amounted to another gross-up provision, but with none of the exceptions set out in the tax gross-up provision proper (see Clause 13.2 (*Tax gross-up*)).

UK Obligors were warned not to give such a representation and to argue that the Lenders have all the protection they need in Clause 13 (*Tax Gross Up and Indemnities*). Lenders should no longer seek the older version of this representation. It does not provide any protection to the Borrower in the context of, for example, the difficult issues surrounding Treaty Lenders where, as discussed under Clause 13 (*Tax Gross Up and Indemnities*), the avoidance of withholding tax depends on action taken by the Lenders.

Borrowers should not normally be expected to repeat this representation; the allocation of tax risks is set out in detail in Clause 13 (*Tax Gross Up and Indemnities*), and a repetition of this representation is liable to cut across that provision (a point that is acknowledged in the LMA User Guide).

Further, the LMA's User Guide acknowledges that this obligation is not usually required from Obligors that are English companies.

Where the Obligors include any non-English companies, amendment to this representation is likely to be required.

Clause 19.8: No filing or stamp taxes

Here the Obligors provide reassurance as to filing and stamp taxes in their jurisdiction.

In practice

As the LMA User Guide comments, this is not needed from English corporate Obligors. In addition, all Obligors can take the view that the stamp duty indemnity set out in Clause 13.6 (*Stamp taxes*) means that the Lenders do not need reassurance on this point, and that concerns about filing requirements and so on are covered by Clause 19.5 (*Validity and admissibility in evidence*).

The Lenders should not insist on the repetition of this representation (if it is included at all).

Clause 19.9: No default

Each Obligor represents that:

- no Event of Default is continuing or might reasonably be expected to result from the making of a Utilisation; and
- no default is outstanding under any contract (including contracts made by its Subsidiaries) which might have a Material Adverse Effect.

In practice

Note the meaning of “continuing” discussed under Clause 1.1 (*Definitions*): if it has the narrow meaning of “not waived”, then if an Event of Default has been remedied but not waived, it will qualify as “continuing”. This means that if the representation were later repeated, and the Event of Default remained unwaived, there would be a further Event of Default.

Note that this representation is correctly limited to Events of Default (i.e. actual Events of Default). If it were amended to cover Defaults (i.e. to include potential Events of Default), the process of repetition on drawdown could turn a potential Event of Default into an actual Event of Default. The Lenders would then be able to accelerate on the basis of a potential Event of Default, a situation which would not be acceptable.

Borrowers may object to the forward-looking part of the first statement (“might reasonably be expected to result”), on the grounds that a prediction of this kind is very uncertain in particular given the use of the word “might”.

Borrowers may also object to the range of the second limb of this representation, in applying to all contracts, even though it applies only to a breach that might have a Material Adverse Effect. The Lenders’ concerns about breaches of contract are also addressed, in different ways, by Clause 19.13 (*No proceedings*), Clause 23.12 (*Material adverse change*) (if included) and Clause 23.5 (*Cross default*). On this basis, it is sometimes possible to delete the second limb.

Please see comments at Clause 1.1 (*Definitions*) in relation to the definition of “Material Adverse Effect”.

Clause 19.10: No misleading information

This representation relates to the accuracy of the information provided by any member of the Group for the purposes of the Information Memorandum prepared by the Arrangers of the transaction. The representation includes confirmation:

- of the accuracy of the factual information provided;
- of the quality of the information and assumptions on which the financial projections are based; and
- that the information provided is not untrue or misleading.

In practice

These representations may be omitted in clubbed deals or in refinancing transactions which do not involve the preparation of an Information Memorandum. Where included, these statements are usually negotiated. The focus of the Borrower needs to be on verification. This process is assisted if the representations are limited to written and factual information, only authorised personnel provide this, and they keep a record as they do so.

Points commonly taken by Borrowers include the following:

- These statements should be made by the Company alone, and may be limited to its knowledge (a topic discussed in the comments introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above).
- The confirmation with regard to the accuracy of the factual information provided should be limited to information contained in the Information Memorandum (the LMA wording extends this to any information provided for the purposes of the Information Memorandum).
- The LMA's drafting requires each Obligor to represent that the assumptions on which the financial projections are based are reasonable. The focus of discussion here is often the objectivity of the standard. Borrowers often seek to confirm that the directors consider the assumptions reasonable.

Borrowers often argue that these representations should not be repeated (which is normally agreed).

Clause 19.11: Financial statements

Each Obligor represents to the effect that:

- the financial statements provided at signing (the “**Original Financial Statements**”) were prepared in accordance with GAAP consistently applied (save as expressly disclosed to the Agent prior to the date of the Agreement);
- the Original Financial Statements “fairly represent” the Obligor’s financial condition and its results of operations during the relevant financial year (save as expressly disclosed to the Agent prior to the date of the Agreement); and
- there has been no material adverse change in its business or financial condition (in the Company’s case, the business or financial condition of the Group) since a date to be specified.

The term “**GAAP**” is defined in Clause 1.1 (*Definitions*) as “generally accepted accounting principles in []”, with an option to continue “including IFRS” if any of the Original Financial Statements are IFRS-compliant.

Thus, whether the Original Financial Statements are prepared under IFRS (as defined) or a national GAAP, the representation as to the method of preparation reflects proper practice; preparation is usually in accordance with not only the applicable legal requirements but also with the body of principles and guidelines peripheral to the core legal requirements which are accepted as guidance as to good practice in the relevant jurisdiction.

In practice

These are important representations from the Lenders’ perspective.

As drafted, they should not need to be Repeating Representations. Borrowers can argue that they should not need to be as the Lenders have the comfort of the undertakings set out in Clause 20.3 (*Requirements as to financial statements*).

If the first two limbs of this representation are to be repeated, it needs to be clear that in the future this will be with reference to the financial statements most recently delivered (an adjustment that is reasonably often made by Lenders).

The inclusion of a “no material adverse change” representation is fairly standard, and is given at signing, measured against the most recent set of audited accounts. Borrowers are not usually required to repeat this representation, as the Lenders may have the protection of the “material adverse change”

Event of Default (discussed under Clause 23.12 (*Material adverse change*)). If the “no material adverse change” representation were to be repeated, focus would be needed on the date against which change is measured.

The “no material adverse change” representation can sometimes be restricted so as to catch only an adverse change which is material in the context of the operations of the Group as a whole, and/or which has or will have a Material Adverse Effect (see comments at Clause 1.1 (*Definitions*)).

See also comments at Clause 1.1 (*Definitions*) in relation to the definitions of “GAAP” and “IFRS”.

Clause 19.12: Pari passu ranking

This statement provides the essential comfort for unsecured Lenders that their claims rank equally with the claims of all other unsecured and unsubordinated creditors, other than those mandatorily preferred by law.

In practice

This representation is usually a Repeating Representation.

Clause 19.13: No proceedings

The first limb of this representation applies (in summary) to actual or threatened litigation of which the Obligors are aware. Litigation is not caught by the representation unless it might reasonably be expected, assuming the counterparty sued successfully for the full amount of its claim, to have a Material Adverse Effect.

At the end of 2016, the LMA added a second limb to this representation in a number of its templates, including the Leveraged Agreement, to ensure that it captures expressly proceedings that have been concluded, as well as proceedings that have been started or threatened. An equivalent provision was added to the Investment Grade Agreements in July 2017. This new limb (b) provides that no judgment or order of any court, arbitral body or agency which might reasonably be expected to have a Material Adverse Effect has (to the best of the representor’s knowledge and belief) been made against the representor or any of its Subsidiaries.

In practice

The first limb of this representation captures litigation that has a reasonable likelihood of a Material Adverse Effect if adversely determined. It does not address the likelihood of an adverse determination. Accordingly, Borrowers usually seek to change this representation so that it looks to the reasonably likely outcome of the litigation, rather than the worst case scenario. Also, Borrowers may prefer to specify a threshold amount for the reasonably likely outcome, to avoid the uncertainty of the concept of Material Adverse Effect.

Borrowers may similarly prefer the materiality threshold in the second limb to be expressed as a fixed monetary threshold, for the same reasons as in relation to current or threatened litigation.

This representation is not usually repeated, as any issues that arise during the term of the Facilities are covered by the information undertaking set out in Clause 20.4 (*Information: miscellaneous*).

Clause 19.14: Repetition

Please see the discussion of this topic in the introduction to Clause 19.

In practice

Care is needed in considering which representations will be the Repeating Representations. The Lenders’ view as to which these should be can vary quite considerably from one Borrower and deal to another, and may start from the position that they should all be Repeating Representations. The Obligors can usually argue successfully that representations will not be repeated if they are specific to the circumstances of signing (dealing with for example the Information Memorandum) or they address a concern also covered by an undertaking or an Event of Default, so that there is an overlap (for example, material adverse change).

If an Investment Grade Agreement is supplemented to include representations relating to compliance with sanctions and anti-corruption laws (see sections 5 and 6 of Part II), Lenders will quite often insist on such representations being repeated.

Clause 20: Information Undertakings

These undertakings set out the requirements for information to be delivered to the Lenders during the life of the Facilities.

Clause 20.1: Financial Statements

Clause 20.1 provides for the delivery of annual and half-yearly accounts to the Lenders.

In practice

A requirement to deliver financial statements semi-annually is standard practice in the investment grade market. Borrowers at the lower end of the investment grade spectrum and cross-over credits may be asked to deliver quarterly reports, which are the norm in the sub-investment grade market.

The period allowed by the Lenders for delivery of accounts varies. However, audited accounts are commonly required within 4 to 6 months of the end of the financial year (120 to 180 days), and half-yearly accounts within 2 to 4 months (90 to 120 days) of the end of the half-year. For listed companies, the shorter periods here are in line with the timings imposed by the Disclosure and Transparency Rules. For unlisted UK companies, these timings are tighter than the applicable statutory requirements. Part 15 (Reports and Accounts) of the Companies Act 2006 requires the accounts of a private company to be filed at Companies House within 9 months of the end of the financial year (6 months for public companies).

Clause 20.2: Compliance Certificate

Compliance Certificates are required to be delivered with each set of accounts. Their purpose is to confirm compliance with the financial covenants in Clause 21 (*Financial Covenants*), which are tested by reference to each set of accounts delivered to the Lenders. This clause is optional because if no financial covenants apply, it is not needed.

This clause requires Compliance Certificates to be signed by two directors of the Company. The Investment Grade Agreements go on to provide that the certificate delivered with the audited accounts will also be signed by the auditors, or reported on by them in an agreed form.

In practice

For convenience, some Borrowers alter the requirement for two directors to sign off to a requirement that a single director may do so. If that approach is agreed, care should be taken to ensure that the clause does not refer to a single person (for example, the finance director as opposed to any director) which could present a problem should that person be unavailable.

The requirement for auditor sign-off is optional and is often omitted in the investment grade market. If included, Borrowers should be aware of the background to this clause.

A guidance statement issued by the Institute of Chartered Accountants in 2000, advises accountants that Compliance Certificates should be signed only by the Borrower, and that a firm of accountants should not report to Lenders on the Borrower's covenant compliance without first entering a separate engagement letter with the Lenders. They are advised to report only on the extraction of figures by the Borrower in the certificate, the accuracy of the arithmetic, and compliance with the relevant definitions. As a result, if it is agreed that the auditors will report on Compliance Certificates, they should be involved at an early stage, to ensure that the exact nature of their remit is settled before signing. The form of their report also needs to be settled.

Borrowers may take issue with the statement in paragraph 3 of the form of Compliance Certificate set out in Schedule 9 that no Default is continuing. The statement covers Default on any point, not just the financial covenants, and the Lenders are already protected by Clause 20.5 (*Notification of default*)

which requires the Obligors to notify the Agent of any Default promptly. Also, it is not clear whether the confirmation is intended to be as at the testing date or the date of the certificate.

Clause 20.3: Requirements as to financial statements

This clause sets out the requirements of the Lenders in relation to the financial statements delivered:

- Paragraph (a) provides that each set of financial statements delivered shall be certified by a director of the relevant company as fairly representing its financial condition.
- Paragraph (b) obliges the Borrower to ensure that each set of financial statements is prepared using GAAP (as it changes from time to time).
- Paragraph (c) is an optional provision which can be used instead of paragraph (b) in facilities which include financial covenants. Under the “frozen GAAP” provision in paragraph (c), each set of financial statements has to be prepared on the same basis as the Original Financial Statements, unless there has been a change in GAAP. In that case, they are required to reflect the changes in GAAP, but in addition the auditors must provide a description of the changes necessary for them to reflect the principles and practices on which the Original Financial Statements were prepared, and sufficient information to enable the Lenders to determine whether the financial covenants have been met on the basis on which they were set.

In practice

There are a few points to consider in relation to this clause.

If the representations regarding financial statements (Clause 19.11 (*Financial statements*)) are repeated, Borrowers may argue that the Lenders do not need in addition a director's certificate. Where (as is often the case) the director's certificate is to be given, care is needed to ensure that the text of the confirmation conforms to the text of Clause 19.11 (*Financial statements*). For example, Clause 19.11 contemplates the disclosure of exceptions.

In relation to loans which contain financial covenants, the parties have to agree here whether the financial statements will be prepared on the basis of “frozen GAAP” or “non-frozen GAAP” (adopting either paragraph (b) or paragraph (c)).

In general, the frozen GAAP option (paragraph (c)) is preferred. The point here is that financial covenant provisions are usually set based on the Original Financial Statements. If there is a change in accounting standards that alters the Company's position materially and which was not possible to foresee or cater for at the time the financial covenants were set, the result may (arguably) be a covenant breach, notwithstanding that the credit position of the Group has not actually changed. In 2005, for example, when IFRS became compulsory, a number of companies found that the terms of their financial covenants had to be re-set to accommodate some of the changes, for example, the requirement to fair value certain assets and liabilities.

More recently, the publication of IFRS 16 (see paragraph 8 of Part II) has given rise to similar concerns.

Accordingly, the “frozen GAAP” provision is generally preferred for the convenience and certainty it provides in enabling the financial covenants to be measured on a consistent basis. However, frozen GAAP is not a long term solution, (as noted in paragraph 8 of Part II in relation to IFRS 16). It effectively requires the preparation of two sets of accounts following a change in accounting practices or principles, which may not be sustainable over the life of the Facilities.

It may therefore be advisable to include an additional clause, under which the parties agree to negotiate in good faith to settle any amendments to the Agreement which may be required. In the context of the switch to IFRS in 2005, the LMA and ACT agreed the following wording:

“If the Company notifies the Agent of a change in accordance with [paragraph ([]) of Clause []] (Requirements as to financial statements)] the Company and the Agent shall enter into negotiations in good faith with a view to agreeing any amendments to this Agreement which are necessary as a result of the change. To the extent practicable these amendments will be such as to ensure that the change does not result in any material alteration in the commercial effect of the obligations in this Agreement. If any amendments are agreed they shall take effect and be binding on each of the Parties in accordance with their terms.”

Borrowers may wish to provide additionally that the parties will negotiate for a minimum period, such as 30 days. A provision of this kind should provide the necessary basis for dialogue between the parties, though it should be appreciated that, as an agreement to agree, its meaning is not sufficiently certain for it to be legally enforceable.

The LMA definitions of “GAAP” and “IFRS” are discussed under Clause 19.11 (*Financial statements*).

Clause 20.4: Information: miscellaneous

This provision contains a number of information requirements including notification of any material litigation (any litigation, arbitration or administrative proceedings that are current, threatened or pending against any member of the Group, which might, if adversely determined, have a Material Adverse Effect) and a general requirement to supply the Agent with any information reasonably requested.

In practice

Borrowers may prefer the materiality threshold for notification of litigation and claims to be expressed as a fixed minimum amount, and otherwise to be expressed in a manner that is consistent with the related representation (Clause 19.13 (*No proceedings*)).

In July 2017, the LMA added an additional paragraph (d) to this clause. This additional limb ensures the Company is obliged to notify the Agent of proceedings that have been concluded (judgments or orders made against the any member of the Group which might have a Material Adverse Effect), as well as proceedings that have been started or threatened. It tracks the wording of the related representation (see comments on Clause 19.13). Borrowers may prefer the materiality threshold in paragraph (d) to be expressed as a fixed minimum amount, for the same reasons as in relation to current, threatened or pending litigation and claims.

The general requirement to provide further information is quite often limited by investment grade Borrowers, for example, to such information as can be provided without material cost to the Group (at least prior to the occurrence of an Event of Default).

Clause 20.5: Notification of default

This clause obliges each Obligor to notify the Agent promptly upon becoming aware of the existence of any Default. As drafted, each Obligor is required individually to notify the Agent of any Default (unless it is aware that another Obligor has already done so). It goes on to provide that the Company will on request supply the Agent with a certificate confirming that no Default is continuing (or if it is, specifying the Default and the steps being taken to remedy it).

In practice

The notification requirement in the first limb of this clause is customary. Borrowers may wish to provide that the notification requirement is triggered promptly upon the relevant Obligor becoming aware of any Default. Borrowers may object to the inclusion of the second limb, requiring them to notify the Agent on request, not least because Lenders have the ability via the Agent to request information (acting reasonably) under Clause 20.4 (*Information: miscellaneous*).

Clause 20.6: Use of websites

This provision means that, if the Agent and the Borrower agree, the Borrower can post any information required to be delivered under the Agreement on a website.

In practice

The Lenders are not obliged to agree to the use of the website; Borrowers should note that posting information on the website satisfies their obligations only in relation to those Lenders who have individually agreed to receive it electronically. However, in general, processes are such that this does not appear to present a problem in practice.

Clause 20.7: “Know Your Customer” checks

These provisions require the Obligors to provide information to the Agent for the purpose of satisfying “know your customer” or “KYC” requirements imposed by anti-money laundering laws and regulations.

KYC checks on each Obligor will need to be carried out by the Original Lenders before signing. Clause 20.7 requires the Obligors to provide KYC information in any of three situations:

- a change in law or regulation after signing;
- a change in the status of an Obligor or of a Holding Company of an Obligor, after signing; or
- a proposed assignment or transfer by a Lender of its participation to an entity which is not already a Lender.

This obligation is limited in that a Lender or prospective Lender is entitled to request the information only where it is obliged to carry out KYC checks. The request may not be made where the information is already available to the Lender or prospective Lender, as would be the case if the Agent were willing to pass on information already in its possession. In addition, the information may only be requested in order for the Lender to satisfy itself that it has complied with applicable law. Finally, the Obligor is not obliged to comply unless the request is reasonable.

KYC requirements for UK Lenders

Money Laundering Regulations 2007

The wording in Clause 20.7 (“Know your customer” checks) originally addressed matters arising from the Money Laundering Regulations 2007 which formed part of the UK framework to combat money laundering and terrorist financing. On 26 June 2017, the Money Laundering Regulations 2007 were repealed and replaced by the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2017/692) (the “2017 Regulations”), which transposed the EU Fourth Money Laundering Directive (2015/849) into UK law.

In summary, any Lender with a UK Facility Office which is proposing to lend to a Borrower is required by the 2017 Regulations to apply, on a risk-sensitive basis, “customer due diligence” (or “KYC”) measures. In practice this entails identifying the Borrower and then verifying the Borrower’s identity on the basis of documents, data or information obtained from a reliable and independent source. In the case of unlisted corporate Borrowers, it also means identifying any individual beneficial owners (including individuals who own or control more than 25% of the shares or voting rights in the Borrower or otherwise exercise control over the management of the Borrower).

The 2017 Regulations allow for a less onerous, or “simplified”, due diligence regime in relation to certain limited categories of Borrowers that present a low degree of money laundering risk. This includes a Borrower that is a company whose securities are listed on a regulated market and which is subject to specified disclosure obligations. In practice this means that Lenders should not require detailed information in order to verify the identity of a listed Borrower for KYC purposes.

They also allow for a formal reliance regime which enables financial institutions to place reliance on customer due diligence carried out by certain other persons, and in particular by banks which are authorised or are otherwise subject to the 2017 Regulations or equivalent legislation in other EEA (and some non-EEA) jurisdictions.

Any Lender with a UK Facility Office is also required by generally applicable proceeds of crime legislation to know its Borrower and its Borrower’s business. Obligations under the UK financial sanctions regime might also require consideration.

The initial KYC measures are required to be carried out before the Lender enters a business relationship or one-off transaction with the Borrower. Ongoing monitoring must then follow that initial identification and verification exercise. Non-compliance is potentially a criminal offence.

JMLSG Guidance

The Joint Money Laundering Steering Group has for many years published guidance (the “JMLSG Guidance”) on how financial sector firms should seek to comply with these and other anti-money laundering requirements. The JMLSG Guidance sets out industry best practice for financial sector firms in relation to both the 2017 Regulations and the generally applicable proceeds of crime legislation.

After consultation, the JMLSG amended its guidance to align it with the 2017 Regulations, publishing a final amended version on 23 June 2017. Part II of the Guidance includes sector-specific guidance on syndicated lending. The secondary debt market is specifically addressed, noting that a lender purchasing debt in the secondary market, whether by novation, assignment or sub-participation, must consider the extent of its obligations to identify, and verify the identity of, the Borrower.

When carrying out customer due diligence, the JMLSG suggests that each Lender should have regard for the ‘risk-based approach’ required by the 2017 Regulations and further advocated in the JMLSG Guidance. Moreover, the JMLSG Guidance confirms that Lenders may wish to take account of or rely on the due diligence carried out on the Borrower by the Arranger or the Agent.

The JMLSG Guidance also states that the obligation to identify, and verify the identity, of beneficial owners of the Borrower does not apply to a listed Borrower or to any Borrower which is a majority-owned and consolidated subsidiary of a listed company. A simplified due diligence process may be applied to other regulated financial services firms in low risk jurisdictions.

In practice

This clause is fairly standard. Borrowers will need to be guided by the Agent here as to the detail of what is required as the applicable KYC rules will depend on the location of each Lender. The regime applicable to a Lender with a UK Facility Office is outlined briefly above. Lenders with Facility Offices elsewhere will be subject to different regimes, though those in EEA jurisdictions should be similar.

In summary, the combined effect of the regulatory regime, JMLSG Guidance and LMA provisions should be as follows:

- Listed Borrowers should not need (before or after signing) to provide UK-based Lenders with KYC information beyond confirming basic details, unless after signing there is a change in law or regulation, or the Borrower’s status changes (for example, a de-listing); the JMLSG Guidance suggests that money laundering risk in relation to listed Borrowers should be regarded as low.
- Unlisted Borrowers are likely to be subject to KYC checks from UK-based Lenders before signing; this would be due to the Lenders’ statutory and regulatory duties rather than any contractual obligation.

After signing, an unlisted Borrower is required by the terms of this clause to provide KYC information for any prospective Lender which is required to perform KYC checks, or if there were a change in law or in the Borrower’s status or, in some cases, if there were a change in the composition of its shareholders.

An unlisted Borrower may find that in addition, its Lenders want to have the right to request KYC information following a change in the composition of the shareholders of the Borrower or of the Borrower’s Holding Company. A change of significant (i.e. 25%+) shareholdings may require a Lender to carry out further KYC checks after a loan agreement has been signed, though not necessarily in all cases (the beneficial owner test relates to individuals owning or controlling more than 25% of a corporate borrower). This point is not addressed in the LMA drafting but is highlighted in a footnote to this clause in the LMA templates.

Adjustments to this clause from the Borrower’s perspective are rarely sought or conceded.

Clause 21: Financial Covenants

What are financial covenants?

“Financial covenants” is the catch-all term used to describe a variety of financial ratios or limits employed by Lenders to measure and monitor the Borrower’s financial condition. The purpose of these tests is to

ensure that any deterioration in the Borrower's financial circumstances which would impact its ability to service the Loans is brought to the attention of the Lenders prior to the occurrence of a payment default. Financial covenants are designed to provide Lenders with an early warning of potential financial difficulties.

The financial covenants are just one aspect of the Lenders' contractual protection in a typical commercial lending transaction. The Lenders will have the benefit of representations, covenants and events of default covering a broad range of other issues. They are, however, usually among the most important protective provisions in loan documentation from the Lenders' perspective because the test results provide (or should provide) a reasonably clear route to the Lenders' remedies on default, with no need to analyse whether (for example) a material adverse change has occurred. As a result, many waiver and restructuring processes are triggered by a breach of financial covenant. From the treasurer's perspective, it is therefore crucial to ensure the financial covenants are both set at a level which can be realistically complied with and carefully crafted to reflect the nature of the Group's operations and accounting policies.

The Investment Grade Agreements provide no guidance on the typical shape of this clause or indeed when it might be applicable. The financial covenants clause in the Investment Grade Agreements is blank and if required, must be drafted from scratch. The clause is blank because the financial covenant provisions depend heavily on the circumstances, including the nature of the Group's business and its credit quality.

The nature, function and approach to financial covenants in the investment grade loan market is outlined briefly below.

When are financial covenants required?

Financial covenants are traditionally the preserve of riskier credits. Unrated or sub-investment grade corporate Borrowers will generally only be able to borrow on terms which include financial covenants. They are therefore a standard feature of leveraged financing documentation.

In the investment grade loan market, although Lenders historically relied on external ratings rather than financial covenants as a measure of the creditworthiness of the Borrower, in recent years, the number of Borrowers able to access loan finance without giving any financial covenants at all has diminished. The nature and extent of the financial covenants in a loan to a rated corporate will, however, be limited, and the terms, in general, less restrictive than would apply to a leveraged or unrated financing.

Types of financial covenant

Which financial covenants are appropriate in any given situation will vary, depending on, among other things, the quality of the credit, and the nature of its business, its accounting policies and systems and the purpose and tenor of the financing. However, most financial covenant provisions comprise variations on one or more of five basic types of ratio: interest cover, leverage, controls on cash flow or liquidity, limits on capital expenditure and minimum net worth or net asset value requirements.

The types of covenant most often seen in corporate loans are interest cover ratios and leverage ratios. Other asset-based covenants, in particular, relating to tangible net worth are also encountered with reasonable frequency. The general nature of each of these tests is explained below.

Interest cover

An interest cover ratio ("ICR") focuses on whether the Group is generating sufficient profit to support the interest payments on its debt. An ICR usually compares the group's operating profit (often a defined concept of EBITDA) to its interest obligations or "Finance Charges" during the relevant period. For example, an ICR might be expressed as a requirement that the ratio of EBITDA: Finance Charges must not be less than 2:1.

In a corporate loan facility, the ICR is likely to be constant. This is in contrast to the ICR in a leveraged financing, which is more likely to be expressed on a sliding scale, reflecting the lenders' expectation that over time the EBITDA of the Group will increase and interest payments will fall (as the debt is paid down).

A minimum ICR in a leveraged deal might be set at around 2:1, often tightening year on year to around 4:1 towards the end of the life of the facility. A loose minimum ICR in an investment grade corporate loan might be set at 2:1. An ICR of around 3:1 might be considered not unusual.

As mentioned above, most financial covenant provisions are variations on a few basic ratios. For example, in a financing for a real estate-heavy retail group, the lenders might adapt the ICR to take into account rental

income and expenses. The definitions will be slightly different, and a different testing methodology may apply, but the aim and mechanic of such a ratio is the same as the basic ICR.

ICRs are probably the covenants that appear with most frequency in the investment grade loan market. If stronger Borrowers are required to accept a single financial covenant, the requirement will quite often be a loose ICR. For less strong Borrowers, the ICR may be accompanied by a leverage test or some other ratio.

Leverage (Debt Cover)

A leverage ratio compares the borrower group's financial debt to its operating profit. The purpose of a leverage ratio (also sometimes referred to as a "debt cover" ratio), is to determine whether the borrower group is generating sufficient profit to support its debts.

Leverage is often formulated as a requirement that the group's financial debt or "Borrowings" must not exceed a multiple of its operating profit or "EBITDA" during a specified period. In a leveraged loan agreement, the maximum permitted leverage ratio will usually decrease over time. The reason for this is that the financial model (see further below) will assume that the EBITDA of the acquired business will grow over the life of the facility as its debt (the other side of the ratio) is paid down. For example, Total Debt: EBITDA might be required not to exceed 4:1 during the first year of the facility, but the ceiling might tighten to 2:1 in later years.

If a leverage covenant is used in a corporate financing, it is often formulated in a similar manner as would apply to a leveraged loan, but the ratio will usually be expressed as a single non-ratcheting ratio, to be maintained during the life of the transaction. For example, the covenant might require that the group's Total Debt to EBITDA does not exceed a ratio of 3:1. Leverage ratios are a common feature of corporate loan agreements, often applicable to Borrowers towards the lower end of the investment grade spectrum into the sub-investment grade space.

It is also worth noting that a leverage ratio may have an impact beyond the financial covenant provisions. In leveraged financings, the margin generally depends on leverage during the period. Dividends and other covenant restrictions may apply only until a specified leverage target is reached and leverage will determine the percentage of the group's excess cash flow that is required to be applied to mandatory prepayment. In a corporate financing, the leverage ratio may not have such broad relevance, but is quite often used (in particular in loans to unrated Borrowers) as the basis of a Margin ratchet provision, see comments on the definition of "**Margin**" at Clause 1.1 (*Definitions*).



BREXIT NOTE: Leverage ratios and exchange rate movements

As noted in paragraph 10 of Part II, the referendum result and the prospect of Brexit have had a significant impact on the value of sterling against other major currencies, which might prompt Groups with foreign currency exposures to consider whether this could have any implications under their loan documentation.

Exchange rate fluctuations may have an impact on the Group's results, and therefore any financial covenant calculations prepared on the basis of the Group's results. A particular concern arises in relation to financial covenants such as Leverage ratios, which compare a balance sheet measure (a Total Debt number based on "Borrowings") with an income statement measure ("EBITDA"). This is because the income statement shows profits and losses during the relevant period and therefore uses average exchange rates to convert the specified amounts into the currency of the Group's financial statements. The balance sheet is a snapshot as at a given date and so uses a spot rate of exchange as at the balance sheet date to convert any foreign currency amounts.

Thus, if the currency from which the Group is converting its figures has strengthened during the period such that the spot rate on the testing date is much higher than the average during the period, that may increase the amount of Total Debt by an amount that is out of proportion to the corresponding increase in EBITDA. The result may be a breach of covenant.

This was an issue for a number of companies during the dollar/sterling/euro fluctuations that occurred during the 2007-9 financial crisis. As a result of that experience, many companies have since added "exchange rate equalisation" provisions to their financial covenant terms. The substance of such provisions varies depending on the currency being converted, but the intent is to make sure that balance sheet numbers and income statement numbers employed in the same financial covenant ratio are

converted using the same exchange rates. Such a clause might provide, for example, that the rate used to convert non-sterling into sterling for the purpose of the Leverage ratio shall be the average rate used for same period to convert non-sterling amounts in the EBITDA calculation, rather than the applicable spot rate.

Minimum net worth/net assets

In sectors where the value of the business is more heavily focused on its balance sheet rather than its cash flows, Lenders regularly impose some kind of financial covenant which measures its net worth from time to time. Minimum net worth or minimum net asset requirements, for example, typically require the Group to maintain a minimum level of tangible net worth or shareholders' funds and reserves, excluding goodwill and other intangible assets. Alternatively, Lenders may look for a gearing ratio, which compares the group's debt to its net worth.

Examples of sectors in which net worth and gearing covenants are fairly common include retail and other businesses which have significant real estate assets, and other asset-heavy industries such as infrastructure, shipping, transport and construction.

The LMA financial covenant provisions

The LMA does not publish financial covenant provisions for general corporate lending but its library does include a number of provisions that are quite often adapted for the general loan market.

The LMA's first set of financial covenant provisions were produced specifically for the Leveraged Agreement. These provisions, which have been revised only in relatively minor respects since publication, reflect the typical suite of financial covenants traditionally seen in private equity-backed leveraged financings, with provision (as is typical in that market) for quarterly testing. They comprise the following covenants:

- Interest Cover (EBITDA to Net Finance Charges);
- Leverage (Total Net Debt to EBITDA);
- Cashflow Cover (Cashflow to Net Debt Service); and
- Annual limits on Capital Expenditure.

These were the only LMA financial covenant provisions until 2011/12, when the LMA first published further recommended forms of facility agreement for more specialist types of asset financing including:

- various recommended forms of facility agreement for real estate finance transactions; and
- a recommended form of facility agreement for pre-export finance receivables financing transactions (the "**PXF Agreement**").

Each of these contain financial covenants appropriate for the sector and type of financing at which the agreements are respectively aimed, which are specialist areas. However, some of the provisions have broader relevance. Of particular note is the "minimum tangible net worth" covenant in the PXF Agreement, a type of covenant also used in other contexts and which is helpful to have available in a format which fits into an LMA-based document.

Approach to drafting

Over the past few years, financial covenant provisions in corporate loan agreements have in general become more detailed. This may in part be due to the market having become familiar with the LMA financial covenant provisions, elements of which have been adapted for use outside their originally intended context. The financial covenant provisions in the Leveraged Agreement, for example, are not designed for, and would not be appropriate in their entirety for an investment grade corporate loans. However, the structure of these provisions and aspects of the definitions are regularly adapted for use in other contexts.

This has been the case for some time, to the extent that the LMA decided in 2007 to publish these provisions as a standalone set of clauses with their own user guide, so parties could pick and choose

from the suite in other types of transaction. Accordingly, perhaps without realising it, many Borrowers, even in the investment grade market, will have become familiar with covenant terms and definitions along LMA lines.

Treasurers tasked with understanding and monitoring these covenants may legitimately question whether such detailed financial covenant provisions are necessary.

The LMA's financial covenant provisions are very intricate because they evolved from the world of structured finance. All of the capitalised terms are defined in some detail. In a leveraged financing, where a group is taking on a significant amount of debt, the lenders lend against a financial model, built to assess the group's ability to service its debt over the life of the facility based on detailed assumptions. The covenants are set to provide the business with some headroom to underperform the base case model. The covenant definitions are complex because they are crafted to benchmark this base case financial model, and are tailored closely to the assumptions used in it.

In a corporate financing transaction, the basis of the lenders' credit assessment is likely to be the group's financial statements. If the financial covenants are set based on the format, policies and practices adopted in the group's accounts, it is possible to adopt a more straightforward approach which allows the ratios to be calculated by reference to the relevant line (for example EBITDA) in the Group's accounts, with adjustments where necessary.

Treasurers should discuss with their legal advisers whether the financial covenant provisions in their Agreement should follow the granular definitions used in the LMA's financial covenant provisions, or a simpler, more bespoke formulation which tracks the lines in the Borrower's accounts more closely. There can be advantages in using elements of these LMA provisions as a starting point. The form is familiar to the market and the more granular financial covenant definitions used in the leveraged market can be helpful as they prompt focus on each element of calculation. There is generally less scope for uncertainty with regard to the components of a particular item. However, the level of detail the LMA provisions provide may be more than is necessary in a vanilla corporate loan and treasurers may find a simpler formulation easier to test and monitor.

As with many aspects of loan documentation, whether the Borrower's preference prevails will depend on its circumstances. There is often a relationship between the length and specificity of any financial covenant provisions and the quality of the Borrower. In many cases, Lenders will insist on more detailed definitions.

How are financial covenants tested?

The information undertakings oblige the Borrower to deliver specified financial statements to the lenders (see Clause 20 (*Information Undertakings*)). The financial covenants will be assessed against the most recently delivered financial statements.

In corporate loan transactions, as already noted (see Clause 20.1 (*Financial statements*)), the Borrower is usually obliged to deliver half-yearly and annual accounts, and financial covenant testing therefore usually takes place half yearly. In sub-investment grade and leveraged transactions, financial covenants are generally tested quarterly.

Most financial covenants are tested at set intervals on a historic basis, although forward-looking covenants are occasionally used. Tests are usually on a 12-month rolling basis, so on each testing date the last 12 months' figures are examined.

Compliance with the financial covenants is usually evidenced by the delivery of a Compliance Certificate to the Lenders together with the relevant financial statements, which confirms that the tests have been met (see Clause 20.2 (*Compliance Certificate*)). Accordingly, a breach of financial covenant will not be confirmed until some point after the testing date, when the relevant calculations have been finalised. Borrowers should be aware therefore that unless a contractual provision specifies the circumstances in which a breach would be deemed to be cured (for example, if the Lenders have taken no action in response to a breach and the covenant is complied with when next tested), a financial covenant breach may be considered an Event of Default, which will be "continuing" (see comments at Clause 1.2 (*Construction*)) until waived by Majority Lenders. Borrowers should therefore consult their advisers as soon as they become aware of a potential financial covenant breach to discuss their options.

General points for Borrowers in relation to financial covenant testing include the potential impact of changes in accounting standards on the outcome of financial covenant tests (discussed at Clause 20.3 (*Requirements as to financial statements*) above).

A note on “covenant-lite” loans

Financial covenants are used in the majority of transactions as a means of monitoring the borrower group’s performance on an ongoing basis. The covenants comprise financial ratios or limits which the Borrower is required to maintain throughout the life of the facility and which are tested at regular intervals.

“Covenant-lite” loans have been a feature of the US loan market for some years, but until more recently have not been widely used in Europe. They take a different approach to financial covenant tests. The European covenant-lite product is still evolving, but in general, the term is used to describe an English law leveraged term facility that incorporates a New York law set of high yield bond covenants in place of the typical financial maintenance and other negative covenants. Thus rather than requiring compliance on an ongoing basis, covenant-lite loans use financial ratios as incurrence tests, meaning that the covenants are tested only upon the occurrence of particular events which have the potential to increase the Lenders’ credit risk. For example, the Lenders may accept that the Group can incur further debt, but above a certain limit, that debt will have an impact on the group’s ability to service its obligations to the Lenders. An incurrence covenant provides a check on the Borrower’s ability to incur further debt (or take other restricted actions), by making incurrence conditional upon compliance with an appropriate financial ratio.

Although conceptually similar, the financial definitions and types of ratio used as incurrence tests in the high yield and the covenant-lite loan market differ from those used in the fully covenanted loan market.

The covenant-lite trend began in the sponsor-led leveraged loan market, but the technology has been adopted by sub-investment grade corporate issuers, sometimes because they have issued high yield bonds and are keen to align their obligations across their loan and bond documentation as far as possible.

Clause 22: General Undertakings

The general undertakings set out in Clause 22 constitute a set of basic, albeit stringent, restrictions on the operations of the Borrower group.

Treasurers should be aware that in contrast to a representation, an undertaking remains in force continuously for the life of the Facilities. Breach at any time will therefore be an Event of Default, subject to the expiry of any applicable grace period.

Though usually supplemented by a number of deal-specific and Borrower-specific undertakings, these provisions are also usually heavily negotiated. Some of the negotiating points of broad application in relation to each clause are noted below.

Clause 22.1: Authorisations

This covenant requires each Obligor to obtain and supply copies to the Agent of all Authorisations (for example any regulatory consents and approvals) required to enable it to perform its obligations under the Finance Documents and to ensure their legality, validity and enforceability and admissibility in evidence.

In practice

Borrowers may seek to qualify this covenant, limiting the obligation to Authorisations whose absence would be materially prejudicial to the Finance Parties.

Clause 22.2: Compliance with laws

This is a customary undertaking on the part of the Obligors to comply with all laws, to the extent that failure to comply would materially affect their ability to comply with the Agreement.

In practice

Sometimes Borrowers prefer to qualify this undertaking by reference to where a failure to comply with relevant laws would have a “**Material Adverse Effect**”. Whether this is preferable to the LMA’s formulation depends on the definition of that term (see Clause 1.1 (*Definitions*)).

Clause 22.3: Negative pledge

In an unsecured loan facility, the purpose of the negative pledge is to prevent the Borrower from creating any security over its assets, save for listed exceptions, and thus to preserve the pool of assets available for unsecured creditors. It is therefore an important protection for Lenders.

The basic, broad covenant given by each Obligor is not to create “**Security**”, and not to allow any Security to exist, over its assets. The definition of Security in Clause 1.1 (*Definitions*) covers security interests such as mortgages and charges, as well as “any other agreement or arrangement having a similar effect”. The prohibition applies whether or not the amount secured is Financial Indebtedness; Security granted in favour of, for example, trade creditors is prohibited as well.

The clause also restricts what is termed “**Quasi-Security**”: transactions which may not fall within the definition of Security but which are usually regarded by banks in that light, such as sale and repurchase or leaseback, debt factoring on recourse terms, and set-off arrangements, including intra-group netting and set-off of bank accounts. There is a final and very broad category catching any other arrangement that has a preferential effect. In each case the arrangement is not caught unless the primary aim is to raise Financial Indebtedness or finance the acquisition of an asset.

These restrictions are subject to a list of exceptions, plus a blank in square brackets to accommodate further exceptions as required. The list of exceptions presented as standard in the Investment Grade Agreements include categories regularly approved by Lenders, notably set-off and netting for hedging purposes, and retention of title arrangements.

In practice

Scope of restriction

As well as restricting the actions of the Obligors, the Company is obliged to ensure that no other member of the Group will create Security or Quasi-Security in breach of this clause. Depending on the nature of the Group, the Borrower may argue that only certain Material Subsidiaries, or only the Obligors, should be caught by this restriction (as discussed in the commentary introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above), although that can be difficult to achieve in this context.

In relation to the scope of this covenant, Borrowers should also note that the definition of Security is very wide. It covers not only the classic forms of security such as mortgages and charges, but also “any other agreement or arrangement having a similar effect”. This last phrase may catch a wide range of arrangements, such as set-off, sale and leaseback, debt factoring, retention of title and so on. Borrowers may be concerned by the breadth of this definition, and may want to restrict it by deleting the words quoted.

The bulk of negotiations, however, usually focus on the scope of the exceptions in paragraph (c), the categories of security which are to be permitted; the Borrower needs to ensure at the outset that it will be able to trade and to carry on business on the basis contemplated with its Lenders without the need to obtain their consent for routine funding arrangements.

Borrowers are well advised to devote time to ensuring that the exceptions to the negative pledge will permit them to arrange their future funding requirements in the ways that they are envisaging, and to ensure that their Lenders understand their plans and expectations. Detailed discussion is often necessary. Lenders can be reluctant to make general exceptions, such as for security granted “in the ordinary course of business”.

Exceptions provided by the LMA

The exceptions provided by the LMA are as follows:

- **Existing Security:** it is envisaged that all Security or Quasi-Security existing at the time the Agreement is signed can be exempted by being listed in Schedule 10, though Lenders may allow only certain forms of existing Security or Quasi-Security to be permitted in this way. Borrowers should note that the exemption will not apply if the amount of the debt secured exceeds the amount stated in Schedule 10.
- **Netting and set-off in the ordinary course of banking arrangements:** The LMA's negative pledge as drafted will prohibit a broad range of set-off and netting arrangements with banks, finance houses, suppliers and others. There is an exception for set-off and netting, but it permits only arrangements made "in the ordinary course" of the company's "banking arrangements", and only if they are made "for the purpose of netting debit and credit balances". Borrowers often need this exception to be relaxed further. In particular, Borrowers usually need to refer instead to the ordinary course of their financing arrangements. Often the exception needs expressly to cover netting and set-off arrangements under derivatives contracts and cash management arrangements. Sometimes it may be helpful to refer to a bank's standard terms of business and ISDA terms.
- **Other netting and set-off in hedging transactions:** Set-off and close-out netting arrangements in hedging transactions are permitted where they are entered for the purpose of:
 - hedging any risk to which a Group member is exposed in its ordinary course of trading; or
 - the company's interest rate or currency management operations in the ordinary course of business and for non-speculative purposes.

Collateral provided by way of credit support for hedging is excluded from this permission. Borrowers should consider whether this is a factor which is or could become likely to be relevant to their hedging arrangements and, if so, discuss with the Lenders how to address it in the Agreement. Whether Borrowers are permitted under the Investment Grade Agreements to collateralise derivative exposures is an issue that crops up increasingly frequently, due to the impact of the European Market Infrastructure Regulation and other regulatory developments affecting the derivatives industry.

- **Liens:** under English law, a lien is a form of security which arises by operation of law to allow an unpaid creditor to retain possession of an asset until he is paid. Borrowers are sometimes able to alter this exception so that it permits liens and rights of set-off arising by operation of law and in the ordinary course of business.
- **Assets acquired after signing:** Security over assets acquired after the date of the Agreement is permitted, but only subject to conditions: the Security must not be provided in order to finance the acquisition, the amount secured must not be increased, and the Security or Quasi-Security must be discharged within a fixed period, such as 6 months. This permission does not permit, for example, Security being granted over an asset in order to finance its acquisition.

Historically, in the case of strong credits, Lenders have agreed in some cases to permit Security for funding acquisitions, but only (for example) if the asset is purchased at a fair market value and on an arm's length basis, and the amount secured meets a loan to value ratio and is not increased after the date of the acquisition.

A similar exception is provided in respect of Security over the assets of a company whose share capital is acquired by a Group member.

- **Security created pursuant to the Finance Documents:** this is permitted, where applicable, for obvious reasons.
- **Retention of title etc.:** Retention of title and similar arrangements are permitted in respect of goods supplied in the ordinary course of trading and on the supplier's standard terms.

Other exceptions

The final sub-paragraph of this clause is left blank by the LMA for the parties to settle any further exceptions that may be required. Examples of exceptions that are quite commonly required and accepted (in some cases, for the avoidance of doubt) include:

- Security for trade finance, for example pledges of goods and documents of title to a financial institution providing a letter of credit, and assignments of insurance policies.
- Security over land and buildings to secure the cost of building or improvements.
- Intra-group Security.
- Debts factored on a recourse basis as part of the Group's day-to-day cash collection procedures rather than as a means of raising finance.
- Payments into court or security for costs given in connection with legal proceedings which are being contested.
- Rent deposits for leasehold premises where a Group member is a tenant.

De minimis basket

The LMA's clause also contemplates that a *de minimis* basket will apply for the purposes of this clause. This allows the Borrower to create security which is not permitted under other exceptions, up to a certain aggregate amount of indebtedness. The Borrower will need to ensure that the amount of indebtedness which can be secured here is high enough. For stronger credits, the basket is typically set as a percentage of the Group's consolidated net worth or gross assets. The basket is more commonly capped at a monetary amount for less strong credits.

In relation to *de minimis* baskets generally, see the commentary introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above.

Clause 22.4: Disposals

The basic prohibition here is very wide-ranging: no Obligor may sell, lease or dispose of any asset, and the Borrower must ensure that no member of the Group makes any disposals. Borrowers should note in this context the broad and non-exhaustive definition of “*assets*” in Clause 1.2 (*Construction*), which “*includes present and future properties, revenues and rights of every description*”.

In practice

Scope of restriction

Strong credits are generally able to loosen this covenant quite significantly. For example, it may be limited to apply only to disposals of material assets or all or a material part of their assets, or even “all or substantially all of their assets”. Another option for listed Borrowers, which in effect imposes a reasonably substantial materiality threshold, is to apply the covenant only to disposals which constitute Reverse Takeovers or (more commonly) Class 1 Transactions for the purposes of the UK Listing Rules.

If it is not possible to delete the clause in its entirety (which is achieved by a few top tier Borrowers), or to loosen it as described above, the focus is generally on the scope of the exceptions.

Exceptions provided by the LMA

The exceptions offered by the LMA here are as follows:

- Exceptions in the ordinary course of trading: Borrowers usually want to extend this to refer to the wider concept of disposals in the ordinary course of business.
- Assets exchanged for comparable or superior assets. This does not include the exchange of non-cash assets for cash (according to a clarification to the wording of this exception added in July 2017).
- A blank, anticipating further exceptions to be negotiated (see further below).
- A basket for other disposals of assets of a value up to a stated amount each year. Stronger borrowers tend to set the basket by reference to a percentage of their gross assets or net worth. Borrowers lower down the investment grade spectrum are likely to be subject to a basket in a monetary amount. In either case, and as in relation to the equivalent provision in the negative pledge, the threshold

needs to be set at a sufficiently high level to enable the Borrower to run the business without having to make regular requests for waivers or amendments.

In relation to *de minimis* baskets generally, see the commentary introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above.

Other exceptions

The level at which the basket needs to be set will often depend on the extent to which the Borrower is able to achieve more general exceptions. For example, many Borrowers ask for an exception for disposals “for fair value and on arm’s length terms” or similar. This will permit many disposals, and may obviate the need to extend the permission in the template noted above beyond disposals in the ordinary course of trading.

Other exceptions that are often negotiated and agreed include:

- Disposals of obsolete or redundant assets.
- Intra-group transfers of assets. The Borrower can point out that the Lenders are protected by several other provisions against major changes in the business; for example, Clause 22.6 (*Change of business*), and Clause 23.9 (*Ownership of the Obligors*).
- Disposals to which Group members are committed prior to signing, and exceptions required by the nature of the Group’s business and operations. These might include, for example, disposals of book debts in the context of factoring or discounting arrangements.

It is also common for Borrowers to seek an express exception for disposals of cash and payments of dividends in a manner that is not otherwise restricted under the Agreement. Opinions differ as to whether an exception for disposals of cash and dividends is actually required: is an interest payment or cash dividend a “disposal” of cash? While cash qualifies as an asset (see the definition in Clause 1.2 quoted above), some may take the view that it is less clear whether spending cash (for example, on wages or a political donation, an interest or dividend payment) counts as a disposal. Whichever interpretation is correct, in the investment grade market (where there are typically no controls on cash leaving the Group or on the payment of dividends) an exception along these lines is quite often included for the avoidance of doubt.

Clause 22.5: Merger

This extremely broadly worded covenant prohibits any amalgamation, demerger, merger or corporate reconstruction by any member of the Group. An exception applies to the extent such a transaction would constitute a disposal that is not restricted under Clause 22.4 (*Disposals*).

In practice

The scope of this covenant is somewhat unclear. For example, there may be uncertainty as to what the terms “merger” and “demerger” mean as a matter of English law. In addition, in contrast to the negative pledge and the disposals covenant in the Investment Grade Agreements, it is not subject only to a limited exception for permitted disposals.

As a result, Borrowers will often seek to delete it entirely (achieved by stronger Borrowers), or otherwise seek to limit its application. It is common, for example, for this provision to be limited to Obligors only (rather than any member of the Group). Borrowers may also argue that it should be applicable only in circumstances where an Obligor is not the surviving entity which results from the restricted merger or other transaction.

More generally, Borrowers may seek to qualify this undertaking by reference to materiality or Material Adverse Effect (discussed in the introduction to Clause 19 (*Representations*) above).

Certain kinds of reorganisation such as solvent liquidations or reorganisations are another commonly sought exception to this provision (and provided as an optional exception to the equivalent undertaking in the Leveraged Agreement).

Clause 22.6: Change of business

The Borrower undertakes here not to make any substantial change to the general nature of its business or that of the Group.

In practice

To avoid questions arising in the future with regard to the scope of this provision, some Borrowers like to extend it to include, without limitation, a general description of the nature of the business of the Group as at the date of the Agreement.

Clause 23: Events of Default

This clause lists the events which qualify as Events of Default.

For commentary on the consequences of an Event of Default, please see Clause 23.13 (*Acceleration*) below.

Clause 23.1: Non-payment

This is the non-payment Event of Default, catching any payment failure on the due date.

There is an exception for failure to pay as a result of administrative or technical error, provided this is remedied within a fixed grace period to be agreed. There is also a grace period which is expressed to apply in the event of major operational disruption.

In practice

Practice in relation to this provision is surprisingly variable. While it is common to settle grace periods for non-payment due to administrative or technical error and a Disruption Event (discussed below), not all Facilities follow the LMA pattern. For example, some Borrowers negotiate different grace periods for payments of interest and principal (for any reason), with a separate grace period applying if the non-payment is due to administrative or technical error. Other Borrowers negotiate a short general grace period, with separate grace periods applying in the case of administrative or technical error or a Disruption Event.

The grace period agreed for non-payment as a result of an administrative or technical error is usually between three and seven Business Days.

Where a general grace period is agreed in addition, this is normally quite short, for example around three Business Days.

It is common for the same grace period to apply to Disruption Events as to administrative or technical errors, although Borrowers may feel that where there is a Disruption Event the grace period should last as long as the event is continuing. The use of a simple grace period of a fixed number of Business Days might not be sufficient.

Borrowers should note that the Disruption Event grace period does not apply to the cross-default Clause. See further Clause 23.5 (*Cross default*).

Major operational disruption

Following 9/11, the Government commissioned a report on the potential impact of major disruption in the financial system. The Report of the Task Force on Major Operational Disruption in the Financial System, published in 2003, concluded that market participants should ensure that their contracts cater for major operational disruption. Against this background, the LMA and the ACT settled some changes to the Investment Grade Agreements:

The specific grace period was added for payment failure on the part of the Borrower when this is due to a Disruption Event as referred to above.

An optional provision was added (Clause 29.10 (Disruption to payment systems etc.)) enabling the Agent to respond pragmatically to a Disruption Event. For further information, please see the comments on that Clause.

Clause 23.2: Financial covenants

There is an Event of Default if any of the financial covenants are not satisfied.

In practice

The template presents no grace period here, reflecting the view that financial covenant breaches are not generally considered to be capable of cure, see comments at Clause 21 (*Financial Covenants*).

Clause 23.3: Other obligations

This clause provides that there will be an Event of Default if there is a breach of any other obligation (i.e. other than non-payment or a breach of the financial covenants). The LMA contemplates that grace periods will be agreed.

In practice

Borrowers can usually negotiate reasonable grace periods (such as between 15 and 30 days). Stronger Borrowers may also seek to provide that the time starts to run from the date on which the Agent serves notice on the Borrower.

Clause 23.4: Misrepresentation

There is an Event of Default if any representation made by an Obligor proves to have been incorrect or misleading in any material respect.

In practice

This Event of Default is wide-ranging: it covers any representation made or deemed to be made by an Obligor in the Finance Documents or in any other document delivered by or on behalf of any Obligor under or in connection with any Finance Document (without specifying to whom). Borrowers may seek to limit its application to representations made or deemed to be made by an Obligor to the Finance Parties in the Finance Documents (which themselves touch on the accuracy of information delivered to the Finance Parties, for example Clause 19.10 (*No misleading information*)).

This provision is softened by a materiality qualification: a representation has to be inaccurate in a material respect for there to be an Event of Default. However Borrowers are often able also to settle a grace period equivalent to that applicable for a breach of covenant, to cure a misrepresentation which is capable of remedy (or more accurately, to address the event or circumstance which gave rise to the misrepresentation).

Clause 23.5: Cross default

Under this provision, a default under any other Financial Indebtedness of any Group member is an Event of Default under the Agreement.

This is a topic on which Borrowers usually spend some time in negotiation with the Lenders. The aim of the cross-default clause from the Lenders' point of view is to ensure that they are on an equal footing with all the other financial creditors of the Group: if another lender is not paid and accelerates their facility, demanding repayment at once, or if another lender has the right to accelerate, the Lenders wish also to be able to accelerate repayment of the Facilities (even if the Borrower has not otherwise defaulted under the Agreement), in order not to be at a disadvantage. The Borrower however needs to restrict the circumstances in which the Lenders can demand repayment under the Agreement on the basis of defaults under other financing arrangements.

In practice

Scope of clause

The clause focuses on defaults relating to Financial Indebtedness. See comments at Clause 1.1 (*Definitions*) above in relation to the scope of that term.

It applies to defaults by any member of the Group. Stronger Borrowers quite often succeed in restricting the cross-default provision to defaults by Obligors only, or Material Subsidiaries (as discussed in the introductory commentary to Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above).

Payment defaults

Paragraphs (a) and (b) of this clause provide that if some other Financial Indebtedness is not paid when due, or becomes due and payable prior to its specified maturity as a result of an event of default (however described), there will be an Event of Default under the Agreement. In general, this is hard to dispute.

Some Borrowers argue that non-payment of other Financial Indebtedness should not constitute a cross-default under the Agreement until the end of the longer of any applicable grace period under that other indebtedness and the grace period applicable for payment defaults under the relevant Agreement. Without such a provision, the Lenders might be able to accelerate on the basis of a grace period which is shorter than the grace period they have agreed with the Borrower for payment defaults under the Agreement.

Cancellation/suspension

Paragraph (c) provides for cross-default if another lender cancels or suspends its commitment as a result of a default. A strong Borrower may be able to argue successfully that the cancellation of an undrawn commitment should not be a cross-default, in particular if the cancellation of the facility in question has no impact on its ability to pay its debts as they fall due.

Cross-default/cross-acceleration

Paragraph (d) provides for cross-default if another lender is merely entitled to accelerate. The Borrower will say the Lenders do not need to be able to accelerate under the Agreement unless the other creditor also actually accelerates (as in paragraph (b)) or is not paid (as in paragraph (a)). The inclusion of paragraph (d) makes the clause a “cross-default” clause; if it were deleted, the clause would be a “cross-acceleration” clause. Strong Borrowers may be able to restrict Clause 23.5 to cross-acceleration.

De minimis basket

Paragraph (e) is a useful carve-out, providing that there is no Default under this Clause 23.5 if the amount of the Financial Indebtedness owing to other creditors which is in default is less than a specified figure. This can provide a reasonable degree of comfort if the threshold amount is satisfactory.

In relation to *de minimis* baskets generally, see the commentary introducing Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above.

Derivatives

Borrowers who are unable to negotiate appropriate limitations to paragraphs (a) to (d) will need to bear in mind that the definition of Financial Indebtedness includes both financial debt and also (at paragraph (g)), derivatives transactions. As discussed under Clause 1.1 (*Definitions*) in relation to “Financial Indebtedness”, derivatives transactions can become terminable or come to an end, or obligations under them can be suspended, as a result of circumstances affecting the Obligor’s counterparty, in addition to events affecting the Obligor itself.

If paragraphs (a) to (d) of the cross-default Event of Default are triggered as a result of circumstances affecting an Obligor’s counterparty, the *de minimis* threshold in paragraph (e) may not be sufficient to avoid an Event of Default, in particular if the swap has not actually been terminated. As a result, Borrowers may try to limit the application of this Event of Default in relation to derivatives transactions. It might be argued (for example) that only paragraph (a) of the cross-default Event of Default should apply to derivatives transactions (i.e. a cross-default Event of Default should occur only if an Obligor fails to pay a swap counterparty an amount that has become due).

Defaults resulting from Disruption Events

There is no grace period under Clause 23.5 for defaults under other contracts due to a Disruption Event, although there is a grace period in Clause 23.1 (*Non-payment*) for payment default under the Investment Grade Agreements due to a Disruption Event. As a result, where there is no grace period under another contract for payment default due to a Disruption Event, the cross-default clause under Agreement can be triggered by a payment default due to a Disruption Event under the other contract. If a Borrower is not able to convince its banks that the cross-default provision in the Agreement should have a Disruption Event grace period, it will need to consider other ways of preventing chains of cross-defaults arising by virtue of a Disruption Event. One solution is to insert a Disruption Event grace period for payment default in all new facilities (or refinancings) so that, over time, all the Borrower's debt documentation (including bilaterals and financial instruments) will include this grace period.

The insolvency Events of Default

The insolvency Events of Default in the LMA templates (quoted below) are very broadly worded. Careful analysis of the proposed wording is required and it is often negotiated. Many of the points taken on the LMA's drafting stem from the possibility that these Events of Default, as drafted, might be capable of being triggered in a range of circumstances that extend beyond what the Borrower might consider to be an insolvency situation (at least, under English law).

There are a number of detailed and technical points that Borrowers' lawyers might make on these provisions. The commentary below outlines a few of the issues that are very commonly raised.

These Events of Default are designed to accommodate the UK insolvency regime and are likely to require adjustment if any of the Obligors are not English.

Clause 23.6: Insolvency

The essence of Clause 23.6 is to provide for an Event of Default on the insolvency of any member of the Group on either a cash flow basis (where it is unable to pay its debts as they fall due) or a balance sheet basis (where the value of its assets is less than the amount of its liabilities, taking into account contingent and prospective liabilities). As drafted, this Event of Default will be triggered by the insolvency (or other stated events) of any member of the Group.

Clause 23.6 (Insolvency) (Investment Grade Agreements)

“(a) A member of the Group:

- (i) is unable or admits inability to pay its debts as they fall due;*
- (ii) suspends making payments on any of its debts; or*
- (iii) by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors (excluding any Finance Party in its capacity as such) with a view to rescheduling any of its indebtedness.*

(b) The value of the assets of any member of the Group is less than its liabilities (taking into account contingent and prospective liabilities).

(c) A moratorium is declared in respect of any indebtedness of any member of the Group.”

In practice

The first paragraph of this clause provides for an Event of Default if a member of the Group is unable or admits its inability to pay its debts as they fall due, which largely tracks the statutory test for cash flow insolvency in section 123(1)(e) of the Insolvency Act 1986. However, it also provides that an Event of Default can be triggered if a Group member suspends payment on any one of its debts or, by reason of actual or anticipated financial difficulties, commences negotiations with a single creditor with a view to rescheduling any of its debts. Borrowers often seek to negotiate the detail of these additional elements on the grounds that they provide for too early a trigger.

The second paragraph provides for an Event of Default if the value of the assets of any member of the Group is less than its liabilities. This could be construed (when applied to UK Obligors) as a reference to the balance sheet test for insolvency in section 123(2) of the Insolvency Act 1986, although that is arguable, given that the statute is not referenced. Accordingly, some consider the meaning to be somewhat unclear and try to omit or clarify the drafting. The argument may run along the lines that an Event of Default, the limits of which are uncertain, is unhelpful because it is a) difficult for the Borrower to monitor and b) therefore difficult for Lenders to rely on. Lenders should instead look to the financial covenants and the other aspects of the insolvency and insolvency proceedings Events of Default, which provide adequate protection.

In addition to focusing on the detail of this Event of Default, many Borrowers seek successfully to limit its application, for example to Obligors and/or Material Companies only. The concept of Material Companies is discussed in the introduction to Section 8 of the Agreement (*Representations, Undertakings and Events of Default*) above.

Clause 23.7: Insolvency proceedings

This Event of Default is triggered essentially by action being taken which would lead to the opening of insolvency proceedings in relation to any member of the Group in any jurisdiction. As in relation to Clause 23.6 (*Insolvency*), Borrowers often seek to amend the drafting, which is unacceptably broad. Without amendment, this Event of Default is liable to be triggered very early.

Clause 23.7: Insolvency proceedings (Investment Grade Agreements)

“Any corporate action, legal proceedings or other procedure or step is taken in relation to:

- (a) the suspension of payments, a moratorium of any indebtedness, winding-up, dissolution, administration or reorganisation (by way of voluntary arrangement, scheme of arrangement or otherwise) of any member of the Group other than a solvent liquidation or reorganisation of any member of the Group which is not an Obligor;*
 - (b) a composition, compromise, assignment or arrangement with any creditor of any member of the Group;*
 - (c) the appointment of a liquidator (other than in respect of a solvent liquidation of a member of the Group which is not an Obligor), receiver, administrative receiver, administrator, compulsory manager or other similar officer in respect of any member of the Group or any of its assets; or*
 - (d) enforcement of any Security over any assets of any member of the Group,*
- or any analogous procedure or step is taken in any jurisdiction.*

This Clause 23.7 shall not apply to any winding-up petition which is frivolous or vexatious and is discharged, stayed or dismissed within [] days of commencement.”

In practice

The opening of Clause 23.7 is vague: “Any... procedure or step is taken in relation to...” and Borrowers do succeed in amending this clause so that an Event of Default is only triggered on the occurrence of specific events. It is also problematic in a way mentioned in the commentary on Clause 23.6 (*Insolvency*): in its unamended form it can be triggered by the relevant proceedings being initiated in relation to any member of the Group and by reference to a single creditor or single debt.

The LMA’s drafting provides some exceptions but these also require attention:

- Paragraph (a) of this Event of Default contains an exception for the solvent liquidation or reorganisation, and paragraph (c) the solvent liquidation, of any member of the Group which is not an Obligor. Borrowers may prefer to address this point using the approach in the Leveraged Agreement, which excludes such solvent liquidations and reorganisations (and other matters according to its defined term “Permitted Transactions”) from the entirety of the insolvency proceedings Event of Default rather than just specific paragraphs. Otherwise, it is conceivable that, for example,

a transaction such as a solvent creditor's scheme of arrangement that would arguably not fall foul of paragraph (a) by virtue of the carve-out, but might nonetheless fall foul of paragraph (b).

- Paragraph (d), which provides for an Event of Default if Security over the assets of any member of the Group is enforced, is often revised so that any enforcement of security is made subject to a minimum value threshold or qualified in some other way by reference to materiality.
- A general carve-out is specified for “frivolous or vexatious” winding-up petitions which are discharged, stayed or dismissed within a number of days to be agreed. In the equivalent provision in the Leveraged Agreement, 14 days is the suggested time limit, although Borrowers often seek a much longer period, such as 30 or even 60 days. In addition, as the aim of this carve-out is to ensure that an Event of Default does not occur as a result of a petition which is swiftly discharged etc., Borrowers may wish to consider striking out the additional condition that the petition is “frivolous or vexatious”, which could be uncertain in its interpretation.

Clause 23.8: Creditors' process

This Event of Default is triggered where any asset of any Group member with a value in excess of a stated minimum becomes subject to a creditor's process such as execution, which is not discharged within a fixed period.

In practice

In order that the Event of Default should apply only in appropriate circumstances it is important to ensure that the materiality threshold is fixed at a sensible level. Borrowers often obtain a 30-day time limit in which to discharge the process.

Clause 23.9: Ownership of the Obligors

There is an Event of Default if any Obligor ceases to be a Subsidiary of the Company.

The implications of a change of control of the Company are addressed in Clause 8.2 (*Change of control*).

Clause 23.10: Unlawfulness

There is an Event of Default if it becomes unlawful for an Obligor to perform any of its obligations.

Clause 23.11: Repudiation

There is an Event of Default if an Obligor repudiates a Finance Document or shows an intention to do so.

A party to a contract repudiates it by indicating that it does not intend to perform its obligations.

If, therefore, an Obligor repudiates the Agreement, the Lenders will have the right to accelerate.

Clause 23.12: Material Adverse Change

The precise wording of this Event of Default is left blank in the Investment Grade Agreements for the parties to negotiate.

In practice

Inclusion of this Event of Default (the “MAC”) is now fairly common in the investment grade market generally, but a reasonably significant number of stronger Borrowers manage to argue successfully that it should be deleted. Borrowers can argue persuasively that the Lenders are adequately protected by all the other representations, covenants and Events of Default, and do not need in addition the ability to accelerate or stop a drawing on the grounds that there has simply been a material adverse change. On the other hand, although Borrowers often feel that that this Event of Default is too vague to be acceptable, its lack of certainty may make it difficult for the Lenders to rely on.

English case law¹⁹ indicates that a MAC clause cannot be triggered in reliance on an event of which the parties were aware on the date the contract was entered into (although the clause could be invoked should conditions worsen or change in a way that makes them materially different in nature). However, more generally, whether a MAC is triggered is heavily fact-specific as well as dependent on the wording of the agreement (given that the agreed form of a MAC provision is typically negotiated and therefore varies). Accordingly, the determination must be made in the context of the agreement and the Group in question and the formulation of the MAC is all-important.

A MAC can be formulated in a number of ways. In the Leveraged Agreement, for example, this Event of Default is triggered on the occurrence of an event or circumstance that “in the reasonable view of Majority Lenders” has or may be reasonably likely to have a Material Adverse Effect. If a formulation along those lines is proposed, Borrowers usually seek to ensure that the wording is changed so that the test is objective, and not dependent on the Majority Lender view. They also seek to restrict the definition of a Material Adverse Effect as discussed at Clause 1.1 (*Definitions*).

It is important to consider the MAC in conjunction with the related representation, Clause 19.11(c) (see the comments on that clause).



BREXIT NOTE: Impact of Brexit on continuity of contracts

A question that has come up more recently is whether Brexit might prejudice the continuity of the loan agreement (for example, by triggering an Event of Default or prepayment event). LMA style Events of Default do not include events that might obviously be triggered by Brexit. As a result, focus has fallen on whether Brexit could trigger a “Material Adverse Change” or “MAC” Event of Default, where applicable.

While the indirect effects of Brexit (its effect on the economy and/or trading conditions and therefore, on the financial condition of a Borrower) could conceivably trigger a MAC, the likelihood of Brexit of itself being cited as a MAC would seem relatively low. As always, much depends on the circumstances and the drafting of the clause, but a key consideration here (on the basis of current English law as noted above) might be that the possibility of Brexit has been known since 2013 (David Cameron announced the referendum date on 20 February 2016, but pledged to hold the referendum in January 2013).

Clause 23.13: Acceleration

The essence of this provision is that if an Event of Default occurs, the Lenders are entitled to demand immediate repayment and/or declare that the Loans are repayable on demand, and/or cancel their Commitments.

In practice

In the Investment Grade Agreements the Lenders’ right to accelerate the Facilities is triggered by the occurrence of an Event of Default “[which is continuing]”. Use of square brackets in the Agreements indicates optional language. In this instance, however, the Investment Grade Agreements may be out of line with market practice, as these words are almost invariably included in loan facilities for sub-investment grade Borrowers as well as investment grade Borrowers. If these words were not included, the Lenders would be able to accelerate once an Event of Default had occurred, even if it were no longer continuing.

In this context, please see the comments on “continuing” under Clause 1.1 (*Definitions*): the Borrower will want it to be defined as “not remedied or waived”, otherwise an Event of Default will count as continuing even after it has in fact been remedied, unless and until formally waived.

¹⁹ Grupo Hotelero Urvasco SA v Carey Value Added SL & Anor [2013] EWHC 1039 Comm.

Section 9: Changes to the Parties

Clause 24: Changes to the Lenders

This clause sets out the procedure and conditions applicable to the assignment and/or transfer of participations in the Facilities by the Lenders.

Trading in the secondary loan market usually takes one of three legal forms:

- novation (commonly referred to as a transfer);
- assignment; and
- sub-participation.

Following a novation, the purchaser assumes the rights and obligations of the seller, and thus enters a contractual relationship with the Borrower. An assignment transfers rights only, but gives the purchaser a claim directly against the Borrower. A sub-participation, by contrast, is a back-to-back contract between seller and purchaser, under which the purchaser has no direct relationship with the Borrower. As a result, while transferees and assignees become Lenders of record, a sub-participant does not.

Loan documentation has conventionally imposed restrictions only in relation to transfers and assignments, as sub-participants do not become Lenders of record with a direct relationship with the Borrower. The LMA documentation follows this approach. The focus of the guidance below is therefore on the Lenders of record, who acquire interests through transfer or assignment. However, the potential influence of transactions “behind the scenes”, such as sub-participations, should not be overlooked. This is discussed further at the end of the comments on Clause 24 below.

Clause 24.1: Assignments and transfers by the Lenders

This clause provides that, subject to the specified conditions (see Clauses 24.2 (*Company consent*) and 24.3 (*Other conditions of assignment or transfer*) below), a Lender may assign its rights or transfer by novation its rights and obligations to a very wide class of permitted assignees and transferees. These include not just banks and financial institutions but also any type of entity which is “regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets”. The class of permitted transferees is thus very broad, and might include for example all sorts of credit funds, hedge funds and distressed debt specialists, as well as insurance companies and pension funds.

In practice

A 2006 decision of the UK Court of Appeal²⁰ made clear that to qualify as a financial institution in the context of a loan facility, an organisation need only be a “*legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and whose business concerns commercial finance*”. In particular, it is not necessary that an organisation’s business should include “bank-like activities”. Thus, even if the class of permitted Lenders is restricted to banks and financial institutions, it will remain very broad.

Strong Borrowers sometimes seek to restrict the class of permitted transferees by, for example:

- requiring transferees to be Qualifying Lenders. Please see comments on Clause 13 (*Tax Gross Up and Indemnities*) for more guidance on this topic; and/or
- requiring transferees to have a specified minimum credit rating. If a minimum credit rating is agreed, it is typically set around single A, although in some deals the required minimum rating may be slightly lower.
- Some Borrowers negotiate specific exclusions from the class of permitted transferees. For example, a list of institutions which are not acceptable may be settled, or industry competitors may be excluded, by name or by reference to a sector. This is discussed further below at Clause 24.3 (*Other conditions of assignment or transfer*).

²⁰ Essar Steel Limited v The Argo Fund Limited [2006] EWCA Civ 241.

In general, in this context, it is worth bearing in mind the relationship between the class of permitted Lender and the requirement for the Borrower's consent to transfers (see Clause 24.2 (*Company consent*)). A very broad class of permitted Lender will be more acceptable where the Borrower has a right to veto transfers which is not restricted. Where however the right to veto transfers is more limited, it may be appropriate to seek to narrow the class of permitted Lenders, for example to Qualifying Lenders.

Debt Purchase Transactions

Following a wave of instances of Borrowers and related parties buying into their own debt in the leveraged loan market during the financial crisis, the LMA added optional clauses to the Leveraged Agreement which either prohibit such "Debt Purchase Transactions", or provide a framework within which they are permitted. The potential for Debt Purchase Transactions will not be of relevance to all investment grade Borrowers. The economic benefits of such transactions are generally the result of purchasing the debt below par, so by definition such transactions are only likely to be of interest only to Borrowers at the bottom end of the investment grade spectrum and crossover credits.

In deals where Debt Purchase Transactions could be a possibility, Lenders may suggest the inclusion of provisions along the lines of the Leveraged Agreement which specify the manner in which such transactions can be undertaken, to ensure that all Lenders are given the ability to participate in the buyback if they wish (and are prompted to do so by a footnote to this clause in the Investment Grade Agreements).

Clauses 24.2 (Company consent) and 24.3 (Other conditions of assignment or transfer)

These clauses set out the conditions applicable to assignments and transfers. The most important feature is the requirement in Clause 24.2 for the Borrower's consent. The requirement for the Borrower's consent applies unless the assignment or transfer is to another Lender (or an Affiliate of a Lender) or, optionally, unless it is made at a time when an Event of Default is continuing. The Borrower's consent must not be unreasonably withheld or delayed, and will be deemed to be granted if not forthcoming within a specified period (optionally, 5 Business Days).

Clause 24.3(c) includes important protection for Borrowers from tax gross-up or indemnity obligations and increased costs claims following an assignment or transfer.

In practice

These provisions reflect market practice for investment grade Borrowers. However, it is not uncommon for Borrowers to seek to impose further, or clarificatory conditions on Lenders' ability to sell their participations.

Exceptions to consent requirement

It is conventional in the investment grade market for transfers and assignments of the Lenders' rights and obligations under the Agreement to be subject to the Borrower's consent save in very limited circumstances. The exception for transfer or assignment to another Lender or an Affiliate of a Lender is also normal practice. Lenders usually explain that they need to be able to transfer to Affiliates, for example in order to carry out their obligations to mitigate under Clause 16 (*Mitigation by the Lenders*). In addition, often, Lenders generally seek to disapply the consent right when an Event of Default has occurred and is continuing, although strong Borrowers may resist (which is why the provision is optional in the Investment Grade Agreements).

Sub-investment grade and leveraged Borrowers usually have to negotiate to achieve consent rights. The equivalent provision in the Leveraged Agreement contains two options here. Either the Lenders are required only to consult with the Borrower in relation to the identity of new Lenders, and the right to be consulted falls away after an Event of Default has occurred. Alternatively, the Borrower agrees with the Agent an approved "whitelist" of Lenders to whom transfers and assignments can occur without its consent, retaining a consent right in relation to entities which do not feature on the list.

If circumstances do arise where Arrangers seek to curtail an investment grade Borrower's consent right beyond the circumstances set forth in the Investment Grade Agreements, which can for example, occur in relation to larger acquisition facilities which will need to be sold beyond the primary syndicate, there are various techniques which provide some balance between the Arrangers' desire to secure liquidity and the Borrower's wish to maintain a level of control over the composition of its syndicate. The use of a "whitelist" of named institutions along the lines in the Leveraged Agreement might be one approach. This may be a list of two or three of the Borrower's relationship banks, or in deals involving bigger syndicates which are likely to be traded on an ongoing basis, a reasonably lengthy list of institutions, possibly accompanied by a requirement to refresh the list by agreement from year to year.

Where the Borrower's ability to veto transfers and assignments is restricted, other mechanisms for controlling syndicate composition become more important. For example, restricting the scope of the tax gross-up entitlement may deter some potential Lenders.

Consent not to be unreasonably withheld or delayed

A question that may arise in the context of the Investment Grade Agreements is in what circumstances will it be reasonable for the Borrower to withhold or delay its consent?

The leading English case on the meaning of reasonableness of consent in a financing transaction is *Barclays Bank plc v UniCredit Bank AG & Anor*²¹. The key points for Borrowers can be summarised as follows:

- It is likely to be for the Lenders to prove that the Borrower was acting unreasonably in withholding (or delaying) its consent, rather than for the Borrower to prove the reasonableness of its actions.
- The party withholding consent (the Borrower) may take account of its own commercial interests and not those of the other party (in this case, the Lender).
- The reasonableness or otherwise of the relevant party's actions will be considered objectively; in other words, the test is whether, given the circumstances, a reasonable person would have decided to withhold consent in that party's position.

The practical implication of these general principles is that what is reasonable will depend on the circumstances. For example, it might be argued in the context of a club facility comprising relationship banks, that it is reasonable for a Borrower to refuse to accept a Lender with whom it has no relationship into the syndicate. The same may not be true if the facilities are widely held and broadly syndicated. Accordingly, if the Borrower considers that its consent to a proposed transfer or assignment is to be withheld, it will need to consider carefully its reasons for doing so.

Very strong Borrowers may seek to delete the requirement to act reasonably to limit the circumstances in which its right to withhold consent might be challenged. If that is not achievable, it may be useful in the interests of certainty either to exclude certain categories of entity from the category of permitted transferees (see comments on Clause 24.1 (*Assignments and transfers by the Lenders*) above). The alternative approach is to define some of the circumstances where it would not be unreasonable to refuse consent. Examples include where the institution has previously been in a minority of Lenders refusing consent to an amendment or waiver request.

Deemed consent

The clause provides for consent to be deemed if not forthcoming within five Business Days. This timetable is designed to fit in with the settlement provisions in the LMA's secondary market documentation so Lenders can be reluctant to negotiate further. However, investment grade Borrowers whose loans are unlikely to be traded do manage to extend this period.

Tax and increased costs (Clause 24.3(c))

The Borrower is not obliged to gross up a transferee Lender, or make payments to a transferee Lender under the tax indemnity or Increased Costs clause, if, at the date of transfer, the transferor would

²¹ [2012] EWHC 3655 Comm; [2014] EWCA Civ 302.

not have had an entitlement to receive a payment under Clause 13 (*Tax Gross Up and Indemnities*) or Clause 14 (*Increased Costs*), had the transfer not occurred.

Historically, the protection for Borrowers provided here was based on market acceptance of the view that Borrowers should not suffer greater tax or capital adequacy costs as a result of transfers, no matter when they occurred, and some Borrowers continue to achieve this protection at all times (during and after primary syndication). This protection is generally most useful in relation to transfers to Treaty Lenders, who may have to be grossed up until a direction is made to the Borrower to pay free of withholding tax (see Clause 13 (*Tax Gross Up and Indemnities*)). This may be particularly valuable in circumstances where primary syndication may not close quickly, and there is a risk of transfers during that period to Treaty Lenders which may need to be grossed up.

Since the amendments made to the Investment Grade Agreements in April 2009, this protection for Borrowers has been disapplied in relation to transfers during the course of primary syndication. This point is often of no consequence in relation to working capital or other facilities which will be fully allocated at signing; but if that is not the case, this is a point Borrowers sometimes wish to negotiate.

Borrowers should be aware that Clause 24.3(c) disapplies the Borrower's protection against tax risk on transfers to Treaty Lenders if:

- the new Lender holds a passport under the DTTP Scheme and has provided, in the Transfer Certificate or Assignment Agreement, the requisite details to permit the Borrower to make the filings required to obtain a direction that the new Lender can be paid without any Tax Deduction; and
- the Borrower has failed to make the required filing within the applicable time limit (30 days of the relevant transfer date).

It is open to the Borrower to mitigate any potential tax risk relating to such Lenders by ensuring that the "Borrower DTTP Filing" is made on time. However, the Borrower's ability to make the Borrower DTTP Filing is dependent on the Borrower being aware of the transfer or assignment. This may not be a particular issue in circumstances where the Borrower's consent is required for the transaction to proceed, but where the Borrower's consent is not required, the Borrower is dependent on the Agent to deliver to it a copy of the relevant documentation. The Agent's obligation is to do so "as soon as reasonably practicable" following execution of the same by the Agent (see comments on Clause 24.8 (*Copy of Transfer Certificate, Assignment Agreement or Increase Confirmation to Company*)). Depending on the circumstances, this may or may not be in sufficient time to permit the Borrower to submit Form DTTP2. Accordingly, a Borrower may wish to consider amending the wording in Clause 24.3(c) to ensure that it is protected if it is not notified in time.

Minimum transfer/hold amounts

The Investment Grade Agreements do not impose any minimum amount on transfers and assignments or any requirement on the Original Lenders to maintain a minimum participation in the Facilities. Such devices are arguably of more importance in circumstances where the Borrower has no right to veto changes to the Lenders (which is not the case for most investment grade Borrowers), but warrant consideration where the Borrower is keen to ensure that its syndicate does not become too large or that its Original Lenders remain in the syndicate for the term of the loan.

Sub-participation and other "behind the scenes" transactions

As mentioned above, the Investment Grade Agreements do not restrict transfers of participations in the Facilities which do not involve changes to the Lender of record. From a Lender's point of view, an attractive feature of a sub-participation or similar is that it usually enables the Lender to transfer credit risk without regard to the transfer restrictions in the loan agreement, and without reference to the Borrower. Lenders are not usually under any legal obligation to provide Borrowers with any information about these transactions. As a matter of law, these transactions do not generally give the counterparties direct rights against the Borrower, so, the argument goes, they need not be a concern to them.

While there may be potential benefits for Borrowers from these transactions, for example in relation to pricing and liquidity, there may also be problems, in particular if the Borrower finds itself in need of a waiver or amendment (or faces financial difficulties or insolvency). There is a risk that a Lender's voting behaviour may be influenced, or even in some cases determined, by an unknown third party. In some cases, ultimately, the third party may also acquire the Lender's loan participation and become a Lender

of record. The difficulties of securing a corporate rescue without information about the “behind the scenes” transactions are well documented.

In the light of these concerns, some Borrowers seek limited information rights in relation to “single name” credit derivatives and sub-participations.

There may also sometimes be circumstances in which it might be justifiable for a Borrower to restrict the Lenders’ ability to enter into these transactions, so that its prior consent is required. This is a point which is extremely important to some Borrowers and such rights are agreed, sometimes in addition to a provision which requires Lenders to retain control of their voting rights in relation to the Facilities.

BREXIT NOTE: Lenders’ restructuring options

As noted in paragraph 10 of Part II, many EU-based financial institutions carry on business, including lending activities, in other EU member states in reliance on “passporting” rights enshrined in EU legislation. These essentially enable an institution authorised in one EU jurisdiction, to carry out the relevant activity across the EU.

This gives rise, of course, to broad questions with regard to the volume of lending and other types of financial sector activity that will be based in the UK post-Brexit. The financial sector has been vocal about the need to secure continued access to the EU for UK-based institutions and it is hoped that the preservation of London’s position as a global financial centre will be a key priority in the exit negotiations.

In the context of loan documentation, it prompts focus on a narrower point: what options does a lender have under existing LMA terms to relocate its participation to an office or subsidiary in another jurisdiction or, should it turn out post-Brexit they are unable legally to continue or should they conclude that it is not desirable to do so, to exit the transaction.

In summary, Lenders have a significant amount of flexibility to restructure how their participations are held and/or to exit a facility under LMA terms:

- Lenders are permitted to transfer their participations to Affiliates (for example, a subsidiary in a remaining EU member state) without the need for the consent of, or to consult with, the Borrower (Clause 24.2 (*Company consent*)).
- Lenders are permitted to transfer their participations to another Facility Office (e.g. a branch in a remaining EU member state operating under the third country rules). This can normally be achieved simply by giving notice to the Agent the requisite number of days in advance (see the definition of “*Facility Office*” in Clause 1.1 (*Definitions*)).
- The illegality clause (Clause 8.1 (*Illegality*)) permits individual Lenders to exit the facility if it becomes unlawful in any applicable jurisdiction for a Lender to perform any of its obligations or to fund, issue or maintain its participation. The Lenders’ rights under this provision are, however, subject to Clause 16 (*Mitigation by the Lenders*), which requires lenders to take all reasonable steps to mitigate the consequences of an illegality event, including by transferring its rights and obligations to an Affiliate or another Facility Office.
- Lenders will generally have the option to exit the deal by selling their participation to a third party. In the investment grade market, this is likely to require consent of the Borrower depending on the structure of the disposal (disposals which do not involve a change to the Lender of record, for example, by way of sub-participation, rarely require the Borrower’s consent).

The key concern for Borrowers is likely to be whether their existing UK-based lending relationships will continue post-Brexit. The Borrower should not be financially prejudiced as a result of the operation of these terms. The Investment Grade Agreements provide that the Borrower’s liability under the increased costs indemnity, the tax gross-up provision and the tax indemnity should not increase as a result of the restructuring or sale of a lender’s participation (see comments above on paragraph (c) of Clause 24.3 (*Other conditions of assignment or transfer*)).

In some multi-jurisdictional transactions an additional mechanic has been in use for some time, which permits a Lender to nominate an appropriately licensed Affiliate to be the Lender in respect of a particular Utilisation. The Affiliate does not assume the Lender's commitments under the Facility, nor does it have any voting rights as a Lender. Its role is to be available to participate in specific Utilisations as Lender should the original Lender find itself unable, normally for regulatory reasons, to do so. Such provisions are often referred to as “**Designated Entity clauses**”. A Designated Entity clause essentially provides a Lender with a more efficient alternative to transferring or assigning its commitments to an Affiliate at short notice. Designated Entities, if they are to act as such, must be pre-approved for KYC purposes by the Agent; the time required to complete KYC checks is an important factor affecting the timetable for a transfer by novation or an assignment.

Designated Entity clauses are not currently widely used (certainly not outside the leveraged loan market) because in most circumstances, participating banks will allocate lending commitments within their group at the outset of a transaction to ensure they are held by entities which are licensed to advance funds to any Borrower which requests them. However, if the Obligors are situated in a particularly broad array of jurisdictions, where there is uncertainty as to which Borrowers will utilise the Facility, or where there is concern about a forthcoming change in applicable regulatory requirements, a Designated Entity clause can be useful.

Designated Entity clauses have been highlighted more recently as a potentially useful device, should Lenders find themselves unable to participate in Utilisations to Borrowers in certain countries as a result of the loss of passporting rights when the UK leaves the EU. While it is by no means certain that such a clause would solve all issues that could arise, the LMA published in April 2017 a form of Designated Entity clause, intended as slot-in drafting, for use in appropriate circumstances. If a Designated Entity clause (whether based on the LMA's drafting or otherwise) is suggested by Lenders, treasurers should discuss its implications with their legal advisers.

Clauses 24.6 and 24.7: Procedure for transfers and assignments

These clauses set out the procedure which Lenders are required to follow on a transfer or assignment of their participation.

Clause 24.8: Copy of Transfer Certificate, Assignment Agreement or Increase Confirmation to Company

The Borrower is entitled to a copy of any transfer and assignment documentation or Increase Confirmation from the Agent, which will be provided “as soon as practicable” following execution. The Agent's obligation to execute the documentation arises only once the Agent is satisfied that all necessary KYC or similar checks have been carried out.

In practice

If the incoming Lender is a Treaty Lender that intends to use the DTTP Scheme, the Borrower will need to receive this information in good time to comply with its obligation to make a Borrower DTTP Filing. Borrowers may therefore request that the Agent uses its best endeavours to pass on the relevant documentation within a specified number of days of receipt.

See comments at Clause 10.1 (*Selection of Interest Periods*) and Clause 13 (*Tax Gross Up and Indemnities*).

Clause 24.9: Security over Lenders' rights

This optional provision was introduced by the LMA in April 2009. In outline, it provides that a Lender may use its rights under the Finance Documents as security for its own indebtedness. Examples could be security granted to a central bank or to investors in a securitisation.

In practice

The Borrower is protected by provisions which prohibit the security from being granted on terms which involve a change in the Lender of record or a release of the Lender from its obligations to the Borrower. In addition, the Borrower cannot be required to make payments to any person other than the Lender, nor to make any greater payment than would otherwise be required to the Lender. On the basis of this protection, the Borrower does not have any consent or consultation rights where security is granted by the Lender. The chief risk to the Borrower arising from security being granted by a Lender is in broad terms the same as that arising where the Lender uses a sub-participation or similar arrangement to offset its credit risk: the possibility of an unknown third party influencing the Lender's voting behaviour (see comments on Clauses 24.2 (*Company consent*) and 24.3 (*Other conditions of assignment or transfer*)).

Borrowers should be aware that provisions such as Clause 24.9 have become increasingly important to Lenders for the purposes of accessing central bank funding, on which banks have become more reliant in recent years. This clause is therefore commonly included in syndicated loan agreements. A few investment grade Borrowers seek to limit the Lenders' permission to use its participation in the Facilities as security by reference to security for obligations owed to a federal reserve or central bank, excluding the permission to securitise the loan which appears in the LMA clause.

Clause 24.10: Pro rata interest settlement

This optional provision was introduced to facilitate transfers of loan participations mid-Interest Period. Where the Agent is willing, the payment of interest and fees at the end of the Interest Period will be split between transferor and transferee *pro rata* to the time they have been a Lender during that period. Without this arrangement, the Borrower's obligation is only to pay the Lender of record at the end of the Interest Period, so that either the transferee has to pay a proportion of the amount received at the end of the Interest Period on to the transferor, or it has to pay an amount in respect of the prospective payment of interest and fees when the trade settles.

In practice

Borrowers may want to ensure that the Agent is required to notify it as well as the Lenders if it is able to distribute interest payments on a *pro rata* basis.

Clause 25: Changes to the Obligors

Clause 25 sets out provisions for changes to the Obligors.

Clause 25.2 contains a general prohibition on the assignment or transfer by any Obligor of any of its rights or obligations.

Clauses 25.2 and 25.3 provide a mechanism for the accession and resignation of Borrowers.

Clauses 25.4-6 provide a mechanism for the accession and resignation of Guarantors.

In practice

Depending on which of the options is selected by the Agent, the Borrower will need to obtain the approval either of all Lenders or of the Majority Lenders for a Subsidiary to become an Additional Borrower, and the Subsidiary may need to be wholly-owned. What is appropriate will depend very much on the circumstances of the Borrower and the transaction. Borrowers may need to bear in mind that Lenders may be subject to country and sector limits that affect their decision-making process.

A Subsidiary may have to be wholly-owned to become an Additional Guarantor.

Section 10: The Finance Parties

Clause 26: The Role of the Agent and the Arranger [and the Reference Banks]

Clause 26 sets out the role of the administrative parties, the Agent and the Arrangers. Most of the provisions are designed to protect them from liability in their capacity as such. This clause also includes optional provisions to provide similar protection to Reference Banks, if appointed.

Borrowers should be aware of the background to the current approach to the role of the Agent and other administrative parties in the LMA's templates.

In ordinary circumstances, the agency function should not be onerous. It is largely limited to acting as a conduit for payments and notices. More demands are likely to be made of the Agent if financial difficulties arise either within the Borrower's or indeed within a Lender's group.

During and in the aftermath of the financial crisis, Agents, in particular those involved in leveraged loans, found themselves increasingly occupied with consent requests and restructurings, often involving difficult issues of interpretation with regard to appropriate majorities. This led to increased focus on the scope of their contractual protection, which in a couple of cases ended in litigation²².

In response, the LMA conducted a comprehensive review of the agency provisions in its recommended forms, the results of which were added to the Investment Grade Agreements (following discussions with the ACT) in 2014.

At first sight, the LMA's revised agency language appears significantly different. It is certainly longer and more detailed than the pre-existing provisions. However, much of the current language simply spells out more clearly matters which were probably within the scope of the previous provisions.

For example, the new language specifies in a number of places in the Agreement that the Agent expects to incur no liability in relation to services provided with the authority of the Lenders or in reliance on the work of advisers. To the extent the new provisions provide more specific examples of circumstances in which the Agent will not be liable for judgments it is tasked with fronting on the Lenders' behalf (for example, a decision as to whether a particular amendment requires Majority Lender or unanimous consent on which it takes legal advice), they do not constitute a material departure from the general principles reflected in the terms they replace.

However, in some areas, the new LMA language constitutes a substantive narrowing of the scope of the Agent's liability in relation to specific risks which (in the view of the agency community) are not proportionate to the rewards of the Agent's role.

For example, the Agent's liability is excluded in its entirety for certain actions which involve the exercise of discretion, most notably for confirming the satisfaction of the conditions precedent. In addition, the Agent's liability for loss of profit damages and other indirect or consequential losses is excluded (see Clause 26.10 (*Exclusion of liability*)).

Nonetheless, the revised provisions relating to the role and liability of the Agent have not generally speaking been objectionable to Borrowers or Lenders, and were adopted by the market relatively smoothly. Liability for the performance of the Lenders' obligations under the agreement should fall on the Lenders and not on the Agent whose role is purely administrative and many of the revised provisions have been viewed as an extrapolation of the commercial position that previously applied.

The key features of this clause are outlined below, together with aspects on which Borrowers most commonly comment.

Clause 26.1: Appointment of the Agent

This clause appoints the Agent to act as agent for each Arranger and each Lender for the purposes of the Finance Documents.

²² See, for example, *Torre Asset Funding Ltd & Anor v The Royal Bank of Scotland plc* [2013] EWHC 2670 (Ch).

Clause 26.2: Instructions

The Agent is obliged to act in accordance with the instructions of the Majority Lenders (or all Lenders, where the issue is stipulated to be an all-Lender decision: see Clause 35 (*Amendments and Waivers*)). The Agent may ask Lenders for specific indemnification and/or security for any cost, loss or liability it may incur in complying with those instructions, and may refuse to act until that has been provided.

Clause 26.3: Duties of the Agent

The key provision here is the first sentence that states that the Agent's duties under the Finance Documents are "solely mechanical and administrative in nature".

This, and many other of the agency clauses underline that the role of an Agent in relation to a syndicated loan is essentially administrative. Accordingly, as a general proposition it is appropriate for the Agent to expect to be protected from liability in respect of substantive obligations which are the responsibility of the Lenders (or indeed the Borrower).

The LMA provisions which limit the Agent's liability are supplemented with indemnity protection. The Lenders undertake to indemnify the Agent in respect of any of its functions, absent gross negligence or wilful default, or in all cases absent fraud if the liability relates to a Disruption Event.

Clause 26.8: Responsibility for documentation

Neither the Agent nor an Arranger is responsible for the adequacy, accuracy or completeness of any information supplied in relation to or under the Finance Documents, nor for the Finance Documents themselves.

The final paragraph of this clause provides that neither the Agent nor any Arranger has responsibility for any determination as to whether any information is non-public information.

Clause 26.10: Exclusion of liability

This clause contains a very comprehensive limitation on the Agent's liability. Essentially, all liability of any kind is excluded, absent gross negligence or wilful default. The Agent's liability is excluded, to apply only in the case of its own fraud, if the Agent's performance is inhibited by a "Disruption Event", in summary, a "force majeure" disruption to payment or communications systems beyond its control.

In practice

Borrowers (and Lenders) might question why the Agent should not be responsible for breach of its administrative obligations. However, that Agents should take no responsibility for their actions absent gross negligence or wilful default represents long-established market practice and is the position taken in all of the LMA's recommended forms.

Agency fees are typically set at a level that acknowledges the Agent's limited administrative function.

Clause 26.11: Lenders' indemnity to the Agent

In summary, this clause provides that each Lender shall indemnify the Agent in respect of any losses or liabilities incurred in connection with its role, unless the Agent has been reimbursed for the same by an Obligor pursuant to a Finance Document.

In practice

In the Investment Grade Agreements, the indemnity protection offered to the Agent is different from that which appears in a number of the LMA's other templates. As noted in the commentary on Clause 15.3 (*Indemnity to the Agent*) the Leveraged Agreement and some of the LMA's other English law agreements extend the Borrower's indemnity obligations to the Agent so that their scope is identical to the Lenders' indemnity to the Agent. The Borrower is obliged to indemnify the Agent for all costs, liabilities and expenses it incurs in its capacity as such, save to the extent the Agent is grossly negligent or wilfully defaults. Further, if a Lender makes a payment to the Agent pursuant to the equivalent of this Clause 26.11, it is generally entitled to claim reimbursement of that amount from the Borrower.

For the reasons noted in the commentary on Clause 15.3, investment grade Borrowers should resist any suggestion that the indemnity obligations in this clause should be broadened along similar lines.

Clause 26.12: Resignation of the Agent

If the Agent wishes to resign, the Lenders, in consultation with the Borrower, have 20 days to appoint a successor Agent. If they fail to do so within that period, the resigning Agent may appoint a successor itself.

Where the Agent becomes entitled to appoint a successor, it is permitted, to the extent it considers necessary, to agree with the incoming Agent changes to the rights and obligations of the Agent under the agreement “consistent with then current market practice” together with “any reasonable amendments to the agency fee payable under this Agreement which are consistent with the successor Agent’s normal fee rates...”.

In practice

The thrust of this provision is unattractive to Borrowers, essentially permitting the outgoing Agent unilaterally to change the terms of the Agreement, most likely not in the Borrower’s favour. However, some Agent banks who have found themselves in difficult positions, for example, faced with a conflict of interests, and who need to make a swift exit feel this to be important protection. Borrowers might take some comfort from the requirement on the outgoing Agent to act reasonably and in accordance with market practice.

The provisions are, in any event, optional in the Investment Grade Agreements reflecting that provisions along these lines may be unnecessary in the investment grade market.

Clause 26.16: Agent’s Management Time

Under this optional provision, claims by the Agent under Clause 15.3 (*Indemnity to the Agent*) and Clause 17 (*Costs and Expenses*) will be increased to cover the costs of the Agent’s management time.

In practice

Borrowers are likely to view these costs as overheads, which should be treated as such, and point out that the Agent is paid a fee for its role. Many Borrowers object to the inclusion of this provision in investment grade facilities.

Clause 26.18: Role of Reference Banks and Clause 26.19: Third party Reference Banks

These clauses are part of the package of provisions aimed at addressing the potential reluctance of many institutions to act as Reference Banks (see paragraph 4 of Part II, the definitions of “**Reference Bank**” and “**Reference Bank Rate**” in Clause 1.1 (*Definitions*) and Clause 11 (*Changes to the Calculation of Interest*)).

Clause 26.18 makes clear that they are under no obligation to quote and protects the Reference Banks from liability. Essentially, they are held to the same standard as other administrative parties, and will not have any liability save due to gross negligence or wilful default. Clause 26.19 enables any Reference Banks who are not parties to the Agreement to rely on the protections in the Agreement (see Clause 1.4 (*Third Party Rights*)).

Clause 27: Conduct of Business by the Finance Parties

This Clause is most often discussed in the context of Clauses 13.4 (*Tax Credit*) and 16 (*Mitigation by the Lenders*). It provides, in outline, that nothing in the Agreement will interfere with a Lender’s right to arrange its affairs as it sees fit, or oblige a Lender to make a claim for tax relief or a tax credit.

In practice

This clause is very Lender-friendly, and means in effect that the Borrower will obtain the benefit of a Tax Credit enjoyed by a Lender after the Borrower has grossed-up a payment only if the Lender is able and willing to co-operate. Likewise, the obligation of a Lender in Clause 16 (*Mitigation by the Lenders*) to take all reasonable steps to mitigate has to be read in the context of Clause 27. It is likely to be difficult for a Borrower to persuade the Lenders to make concessions in this area, though as noted at Clause 13.4 (*Tax Credit*), an exception could be made for what is in fact the most common form of Tax Credit in this context.

Clause 28: Sharing among the Finance Parties

It is a key principle of syndicated lending that each Lender will be treated equally. Absent the handful of circumstances where the Borrower is entitled to prepay single Lenders for cause (see Clause 8 (*Prepayment and Cancellation*)), any payment to the Lenders must be shared *pro rata*. This clause makes provision for the sharing of any payment received by a single Lender among the syndicate.

Section 11: Administration

Clause 29: Payment Mechanics

Clause 29 makes provision for payment mechanics.

Clause 29.1: Payments to the Agent and Clause 29.2: Distributions by the Agent

The Agent will notify the Borrower of the details of the account to which payment must be made.

The Borrower must give the Agent not less than five Business Days' notice of the details of the account to which it wants payment to be made.

Clause 29.3: Distributions to an Obligor

This clause provides that the Agent can set off funds received by it from the Lenders for the Borrower against an amount due from the Borrower; where the amounts are in different currencies it can use the funds received from the Lenders to make the necessary foreign currency purchase to set off against the amount due from the Borrower. The Agent is entitled to do this if it obtains the Borrower's consent, or under Clause 30 (*Set-Off*), discussed below.

Clause 29.4: Clawback and pre-funding

It is not uncommon in the syndicated loan market for the Agent to advance funds to the Borrower prior to being put in funds by the Lenders.

Perhaps surprisingly, the LMA recommended forms did not until relatively recently contain any specific protections for the Agent in the event that it found itself out of pocket as a result of pre-funding.

Paragraph (c), which was added to this clause in 2014, provides that if the Agent has agreed to advance funds to the Borrower prior to being put in funds by the Lender, the risk and cost of a Lender defaulting on its obligation to reimburse the Agent fall on the Borrower. The Borrower is obliged to pay back to the Agent the sum advanced, and, to the extent the defaulting Lender fails to do so, reimburse the Agent any resulting costs.

In practice

Pre-funding potentially confers a benefit on the Borrower; for example, a reduction in the amount of notice required to draw the Facilities or even just assurance that it will get its funds in time if one Lender is delayed for some reason. Further, an agreement by the Agent to "pre-fund" is a departure from the administrative role, to a commercial "fronting" role.

It might seem reasonable that the Agent would wish to be protected from liability in this instance. The defaulting Lender is also probably in breach of contract in that instance meaning that the Borrower may have a claim against it for its resulting losses.

However, a Borrower may not want to incorporate a clause that contemplates Lender default without the rights to manage "**Defaulting Lenders**" set out in the Lehman provisions discussed in Part IV). It is suggested that this paragraph, if incorporated, should be used in conjunction with those provisions.

Clause 29.6: No set-off by Obligor

The Borrower must make all its payments free of set-off.

Clause 29.7: Business Days

The modified following Business Day convention applies to LMA loan documentation, so that if a payment is due on a day which is not a Business Day, it will instead be due on the next Business Day in the same calendar month (if there is one) or the preceding Business Day (if not).

See also Clause 10.3 (*Non-Business Days*).

Clause 29.8: Currency of Account

Paragraph (a) of this clause purports to designate the currency of the Loan as the currency of account and the currency of payment of any sum due from an Obligor under any Finance Document. Paragraphs (b) and (c) go on to require that each payment of principal and interest respectively shall be made in the currency in which the relevant amount is denominated on its due date.

In practice

This is one of the boilerplate clauses that became the subject of increased focus as participants in the loan market started to become concerned about the break-up of the euro at the height of the first Greek debt crisis.

The clause was amended in June 2014 to make clear that payments are required in the currency in which the relevant amount is denominated “pursuant to the Agreement”, a potentially useful clarification that is designed (it is assumed) to exclude any deferral to the law of any particular Eurozone country to determine the currency of payments in a euro exit scenario. This change was part of a package of changes made to address this issue.

Clause 29.9: Change of currency

If there is a change in the currency unit used by a particular country, this clause facilitates any necessary amendments to the Agreement. It was introduced primarily to deal with new countries adopting the euro in place of their domestic currency.

Clause 29.10: Disruption to payment systems

This clause was added in 2005, as a consequence of 9/11; for background information, see the comments on Clause 23.1 (*Non-payment*).

This clause provides that if a Disruption Event occurs, the Agent and the Borrower may confer, with a view to agreeing any changes to the operation or administration of the Facilities as the Agent may deem necessary. Any changes actually agreed by the Agent and the Borrower are binding on the parties.

In practice

The Agent is not obliged to consult with the Borrower or the Lenders if, in its opinion, it is not practicable to do so in the circumstances. In this case, no changes can be made. Borrowers might seek to specify that the Agent’s view as to whether consultation is practicable should be a reasonable one, although this is not a point that is commonly taken.

Clause 30: Set-Off

This permits a Finance Party to set off a matured obligation due to it by an Obligor under the Agreement against a matured obligation due by it to that Obligor, whether or not under that agreement. The Lender is entitled to set off even if the obligations are owing in different currencies, using a market rate of exchange.

In practice

The Borrower needs to check that it is not prohibited from giving the Lenders this right because of the terms of the negative pledges it has given to other lenders. If it has to accept set-off to some extent, as is often the case, it may seek to ensure that it is permitted only if there is an Event of Default continuing (which should normally be the case if a matured obligation is due from an Obligor under the Finance Documents and it has not been satisfied by payment). The Lender should be required to notify the Borrower promptly after any set-off.

Clause 31: Notices

All communications are to be made by fax or letter. Communications to the Agent must be actually received by it and addressed to the correct officer or department. The onus is on the sender of a fax to ensure that it is received in legible form.

Clause 31.5 (*Electronic communication*) provides that any two parties to the Agreement may communicate by email or other electronic means if they agree to do so and provide each other with their email addresses and any other necessary information. Borrowers should note that any electronic communication that becomes effective after 5 p.m. in the place in which the recipient has its address for the purposes of the Agreement is deemed only to become effective on the following day.

Clause 32: Calculations and Certificates

Interest, commission and fees accrue from day to day, and are calculated on the basis of the actual number of days elapsed and a 360-day year, or market practice, if that is different. For example, the day-count fraction for sterling and Hong Kong dollars is 365.

Clause 33: Partial Invalidity

This is a standard boilerplate provision to the effect that the invalidity of any provision of the Finance Documents shall not invalidate the remainder.

Clause 34: Remedies and Waivers

This clause provides that no failure to exercise or delay by any Finance Party in exercising its rights under any Finance Document shall operate as a waiver of that right. Its purpose is to preserve the rights of the Finance Parties unless they cease according to the terms of the document or are waived pursuant to Clause 35 (*Amendments and Waivers*).

In a 2009 Court of Appeal case²³, which concerned a commercial contract, it was held that a contracting party had lost its right to terminate the contract for breach by virtue of it having continued to perform the contract following the breach, notwithstanding the contractual remedies and waivers provision. The party in question had, by its conduct, affirmed the contract.

As a result, Lenders became concerned that they could be at risk of being taken to have waived their rights arising out of an Event of Default in circumstances where they continued to advance funds following an Event of Default. In an attempt to address this, Clause 34 was amended in December 2011 to provide specifically that no election to affirm any of the Finance Documents on the part of any Finance Party will be effective unless in writing.

Clause 35: Amendments and Waivers

Clause 35.1: Required consents and 35.2: All Lender matters

All parties will be bound by amendments or waivers to which Majority Lenders and the Obligors consent. The majority required is usually fixed at 66.6% of Total Commitments. Changes to certain key provisions, such as the Margin, however require the consent of all Lenders. These key provisions are listed in Clause 35.2.

35.2 All Lender matters (Investment Grade Agreements)

“[Subject to Clause 35.4 ([Replacement of Screen Rate) an]/An] amendment or waiver of any term of any Finance Document that has the effect of changing or which relates to:

- (a) the definition of “Majority Lenders” in Clause 1.1 (Definitions);*
- (b) an extension to the date of payment of any amount under the Finance Documents;*

²³ Tele2 International Card Company SA v Post Office Limited [2009] EWCA Civ 9.

- (c) a reduction in the Margin or a reduction in the amount of any payment of principal, interest, fees or commission payable;
 - (d) [a change in currency of payment of any amount under the Finance Documents;]
 - (e) an increase in any Commitment, an extension of any Availability Period or any requirement that a cancellation of Commitments reduces the Commitments of the Lenders rateably under the relevant Facility;
 - (f) a change to the Borrowers or Guarantors other than in accordance with Clause 25 (Changes to the Obligors);
 - (g) any provision which expressly requires the consent of all the Lenders;
 - (h) Clause 2.3 (Finance Parties' rights and obligations), [Clause 5.1 (Delivery of a Utilisation Request),] Clause 8.1 (Illegality), [Clause 8.2 (Change of control),] [Clause 8.8 (Application of prepayments),] Clause 24 (Changes to the Lenders), Clause 25 (Changes to the Obligors), [Clause 28 (Sharing among the Finance Parties),] this Clause 35, Clause 39 (Governing law) or Clause 40.1 (Jurisdiction);
 - (i) the nature or scope of the guarantee and indemnity granted under Clause 18 (Guarantee and indemnity); or
 - (j) [],
- shall not be made without the prior consent of all the Lenders."

In practice

Borrowers should be aware that in the event that amendments and waivers are required, although the list of matters requiring unanimous consent is specific, the introductory wording "*An amendment that has the effect of changing, or which relates to.*" can sometimes lead to difficult questions as to whether Majority Lender or unanimous Lender consent is required, in particular where (for example), the Margin or payment provisions have the potential to be affected by changes to covenant terms (which may of course not be a relevant consideration for many investment grade Borrowers). It can be difficult to negotiate or limit this introductory wording. In the context of covenant exceptions, it can therefore be helpful to provide specifically that further exceptions (for example, to the "No disposals" covenant or the negative pledge), can be agreed with Majority Lender consent.

In broad terms, the list of matters requiring unanimous consent in the Investment Grade Agreements reflects what is normally agreed. The exceptions are some of the matters added to this list more recently, which mostly stem from the Leveraged Agreement and in a number of cases, address concerns that are most relevant in the leveraged market. These include:

- The reference in paragraph (e) to any amendment or waiver that has the effect of changing or which relates to "*any requirement that a cancellation of Commitments reduces the Commitments of the Lenders rateably under the relevant Facility*". The change was most likely prompted by Lenders' concerns about certain restructuring techniques that have been employed in the leveraged and sub-investment grade market and which have the effect of extending the maturity date of certain Facilities without the need to obtain unanimous Lender consent. This is arguably an unnecessary addition to the Investment Grade Agreements, given investment grade loans, as already mentioned, are not amended and restructured in the same manner or with the same frequency as leveraged loans.
- Changes to Clauses 39 (Governing Law) and 40 (Enforcement). These were added in the wake of the round of loan restructurings that followed the financial crisis. English law and jurisdiction can be a factor which determines the availability of an English law scheme of arrangement to a foreign company. Accordingly, these are important provisions from the point of view of the availability of Lenders' preferred restructuring processes where the Borrower is not a UK company.
- Changes to the change of control prepayment event. This is optional because it is relevant only where the change of control clause confers an individual right on Lenders to require prepayment. Where the change of control clause confers an individual right on Lenders to require prepayment, Lenders may

feel that individual decision should not be capable of removal or amendment by Majority Lenders. (See further comments on Clause 8.2 (*Change of control*).)

It is also worth noting that if the Agreement contains representations and/or undertakings relating to sanctions compliance (see section 5 of Part II), some Lenders insist that any amendments or waivers of such provisions should require all-Lender consent, a point highlighted in footnotes to the Investment Grade Agreements.

Clause 35.3: Other exceptions

An amendment or waiver which relates to the rights or obligations of one of the administrative parties in their capacity as such cannot be effected without the consent of the affected party (the Agent, the Arranger or Reference Bank as the case may be).

Clause 35.4: Replacement of Screen Rate

This optional clause, introduced in November 2014, provides for decisions regarding replacement benchmarks. In the event that any Screen Rate is unavailable (see Clause 11.1 (*Unavailability of Screen Rate*), the Majority Lenders and the Obligor can agree an alternative.

This clause is subject to an optional “you snooze you lose” provision (see further below). If any Lender fails to respond to a request for an amendment or waiver relating to a replacement benchmark within a specified number of Business Days, its participation shall be disregarded for the purposes of determining whether Majority Lender consent has been obtained.

“Yank the bank” and “you snooze you lose”

“Yank the bank” is the colloquial term for a clause that permits the Borrower to replace a Lender where the Lender does not consent to a request for a waiver or amendment, but the requisite majority of other Lenders have done so. A “you snooze you lose” provision specifies that if a Lender does not respond to a request for an amendment or waiver within a particular time frame, its participation shall be disregarded for the purposes of determining whether the agreement of the required group of Lenders has been obtained.

Such provisions are aimed at facilitating waiver and consent processes in relation to loans which are widely held, and may involve a number of non-bank Lenders who may not be as well-equipped as banks to participate in such processes, or who may elect not to receive notice of such processes, because they do not wish to be party to price-sensitive information. Provisions along these lines are included in the Leveraged Agreement but not the Investment Grade Agreements.

They are not often necessary in the context of investment grade loans which typically do not involve non-bank Lenders of the type such provisions are aimed at managing. However, they can be relevant in some instances and are potentially helpful to Borrowers with larger syndicates.

In practice

As discussed in Part II, the process of reforming and looking for risk-free alternatives to major benchmarks, including LIBOR, continues to gather pace. This optional clause is therefore potentially useful to both Lenders and Borrowers should any transition to a new rate be required during the course of the Facilities.

Clause 36: Confidential Information

Clause 36.1: Confidentiality and Clause 36.2: Disclosure of Confidential Information

Clause 36.1 contains undertakings given by each Finance Party to keep Confidential Information confidential, and not to disclose it save as specified in Clause 36.2. Each Finance Party also agrees to protect all

Confidential Information with security measures and a degree of care that would apply to its own confidential information.

The definition of “**Confidential Information**” is in a form familiar to the market, which is based on the definition used in the LMA stand-alone forms of Confidentiality Undertaking for use in primary syndication and in the secondary market. It covers all information relating to the Company, any Obligor, the Group, the Finance Documents or a Facility which a Finance Party becomes aware of in that capacity or which is received by it in relation to the Finance Documents or a Facility from any member of the Group or any of its advisers, including via another Finance Party.

It excludes information that:

- is or becomes public (other than as a result of a breach of Clause 36),
- is identified at the time of delivery as non-confidential by any member of the Group or its advisers, or
- is information either already known by the relevant Finance Party or obtained by it later from a source which is (as far as the Finance Party is aware) unconnected with the Group, and which has not (as far as the Finance Party is aware) been obtained in breach of any obligation of confidentiality.

This clause was added to the Investment Grade Agreements in 2009 in light of the increasing numbers of non-bank lenders being included in lending syndicates. It is not clear that the common law duty of confidentiality owed by a bank to its customer extends to non-banks, and the scope of any implied duty is uncertain. Accordingly, the LMA agreed to insert an express confidentiality undertaking in their loan documentation, which was in general a welcome development for the protection of the information provided to syndicates.

The confidentiality undertaking in this clause, however is subject to a number of limitations. Firstly, the undertaking ceases to apply to a Finance Party on the date falling 12 months after the earlier of the date when it ceases to be a Finance Party and the date of final repayment of the Facilities. Secondly, the obligation is subject to a number of exceptions, categories of recipient to whom disclosure is permitted without the consent of the Company. These include:

- *Finance Parties’ Affiliates.* This category includes Related Funds and officers, directors, employees, professional advisers, auditors, partners and Representatives (broadly defined and discussed below) as well as Affiliates. It permits disclosure on condition simply that the recipient is informed that the information is confidential and may be price sensitive. However there is no requirement to inform where the recipient is subject to professional or other confidentiality obligations.
- *Actual and potential secondary market purchasers,* including sub-participants and their Affiliates, Related Funds, Representatives and professional advisers. A Confidentiality Undertaking must be provided by the recipient of the information unless the recipient is a professional adviser who is subject to confidentiality obligations.
- *Lenders’ Representatives.* The Investment Grade Agreements (see Clause 26.14 (*Relationship with the Lenders*)) permit a Lender to appoint a Representative to receive all communications in relation to the Finance Documents. A Representative is permitted to receive Confidential Information if it signs a Confidentiality Undertaking, although this requirement does not apply where it is a professional adviser subject to confidentiality obligations.
- *Investors and financiers of secondary market purchases.* A Confidentiality Undertaking must be provided, unless the recipient is otherwise bound by confidentiality requirements and is informed that the information may be price sensitive.
- *As required by law/regulators or required in connection with litigation.* This category permits any disclosure “required” by law or in connection with and for the purposes of any litigation or similar proceedings. The Finance Party must notify the recipient that the information is confidential and may be price sensitive, unless this is impracticable in the opinion of the Finance Party.
- *Lenders’ chargees.* The Investment Grade Agreements include an optional provision, Clause 24.8 (*Security over Lenders’ rights*), setting out terms protecting the Borrower where a Lender creates security over its rights under any Finance Document. In these circumstances, Confidential Information can be

disclosed to the chargee. The chargee must be informed that the information is confidential and possibly price-sensitive, unless it is impracticable to inform the chargee, in the opinion of the Lender.

The categories above permit disclosure of such Confidential Information as the Finance Party considers appropriate.

In addition, disclosure is permitted to two further categories of recipient:

- *Rating agencies*: This is optional, permitting Lenders to disclose Confidential Information to a rating agency to enable it to carry out its normal rating activities in relation to the Finance Documents and/or the Obligors.
- *Providers of administration or settlement services*: Persons appointed by a Finance Party to perform such services, for example, for the purposes of secondary market trading. Such providers are entitled to receive such Confidential Information as may be required to be disclosed to enable them to provide the relevant service, subject to completion of an appropriate confidentiality undertaking (the LMA produces a specific form for this purpose).

In practice

The main topic Borrowers generally focus on here is the duration of the confidentiality undertaking and the carve-outs.

Although the market is familiar with a 12 month period, as it has featured in the LMA stand-alone forms of Confidentiality Undertaking for some time, Borrowers may be concerned that it may not be long enough to protect all types of Confidential Information. The LMA acknowledges by the use of square brackets that the reference to 12 months is subject to negotiation. Borrowers should remember that neither the banks' common law duty of confidentiality nor the implied duty of confidentiality which Borrowers had to rely on prior to the introduction of this express confidentiality undertaking had an end date.

The carve-outs are not often negotiated extensively, although some Borrowers may prefer that Confidential Information is disclosed to the various categories of recipient (in particular, perhaps, Lender Affiliates) on a "need-to-know" basis, rather than "as appropriate". Borrowers should also consider whether there are any classes of recipient to whom disclosure should be expressly prohibited - for example, competitors.

As noted under "**Confidentiality Undertaking**" in Clause 1.1 (*Definitions*), Borrowers should ensure that the form of Confidentiality Undertaking (to be set out in Schedule 11) for use under the terms of Clause 36 is in a form acceptable to them.

Clause 36.3: Disclosure to numbering service providers

The LMA is keen to promote settlement efficiency in the loan market and has strongly encouraged banks to include this optional language in loan agreements. A numbering service provider ("**NSP**") allocates an ID number to the facility, which will be distributed to syndicate members to facilitate trading. To do so, it will need a certain number of details about the facility, which are listed in this clause. These details may not remain confidential, hence the Borrower is required to represent that the information disclosed to any NSP is not price sensitive nor at any time will it be.

The details to be disclosed pursuant to this clause are as follows:

- the names of the Obligors, their country of domicile and place of incorporation of Obligors;
- the date of the Agreement and its governing law;
- the names of the Agent and the Arranger;
- the date of each amendment and restatement of the Agreement;
- the amounts of, and names of, the Facilities (and any tranches) and the amount of the Total Commitments;

- the currencies of the Facilities;
- the type of Facilities (term, revolver etc.) and their ranking;
- the Termination Date for Facilities; and
- such other information agreed between such Finance Party and the Company,

plus details of any changes to the above from time to time.

In practice

Although investment grade loans, in many cases, are not traded, this provision is generally treated as boilerplate. The only objection most Borrowers have to the drafting is to the forward-looking nature of the representation regarding the absence of price-sensitive information. The main objection to the representation is that it is impossible to determine at the date of the Agreement whether future information is or is not price sensitive. On that basis, some Borrowers seek to delete this provision.

It is worth noting, however, that information of the type listed would not normally be price sensitive, with the possible exception of the date of any amendment or restatement and changes to the information previously supplied. In addition (and as highlighted by the LMA), in most cases where the relevant Obligor has publicly traded securities, the information listed in this clause would, in any event, need to be disclosed by that Obligor in accordance with the UK disclosure requirements on issuers of listed securities (although the timing may be different).

Borrowers should also be aware of the background here, which is explained by the LMA in a footnote to the clause. In summary, if unpublished price-sensitive or inside information were disclosed to a NSP (with or without the consent of the Borrower) by a Lender in circumstances where that information will be disclosed only to subscribers of the NSP (and not to the public), that Lender and the individuals concerned could be guilty of an offence under the insider dealing/market abuse regime in the UK. Restricting the information that can be disclosed by Lenders to NSPs to relatively anodyne and descriptive information helps to minimise the risk that the information will be unpublished price-sensitive or inside information. However, given the seriousness of the consequences for Lenders, and on the basis that only the Obligors can know with certainty whether any of that information is unpublished price-sensitive or inside information, the representation is intended as a means of ensuring reasonable steps have been taken to avoid inside or price-sensitive information being selectively disclosed with no confidentiality restrictions.

Clause 37: Confidentiality of Funding Rates and Reference Bank Quotations

These clauses require the Agent to keep Reference Bank Rates and “**Funding Rates**” (individual lenders’ cost of funds, if cost of funds is applicable), confidential. The obligation to keep Funding Rates confidential extends also the Obligors (who will obviously need to receive details of such rates to make interest payments under the Agreement). The clause goes on to specify the limited circumstances in which disclosure is permitted.

As explained in paragraph 4 of Part II, the need for confidentiality obligations stems from LIBOR contributors’ obligations under the LIBOR Code of Conduct for Contributing Banks to keep their funding rates confidential, which is in turn designed to implement the IBA’s obligations under the FCA regulatory regime applicable to benchmark administrators. The Code permits the disclosure by contributing banks of submitted rates to individuals who have a commercially reasonable business need to know and/or to certain customers, so long as “appropriate arrangements for preserving confidentiality” are in place. As Reference Bank Rates are intended to be calculated on broadly the same basis as LIBOR (or the benchmark they are intended to replace), contributing banks felt it appropriate that such rates should similarly be kept confidential. This has been applied by extension, to Funding Rates.

Borrowers should be aware that this clause was discussed with the IBA before being introduced.

Clause 38: Counterparts

This is a boilerplate provision that permits each Finance Document to be executed in any number of counterparts, as is customary for convenience.

Section 12: Governing Law and Enforcement

Clause 39: Governing Law

The Investment Grade Agreements are expressed to be governed by English law. Clause 39 (*Governing Law*) also contains optional wording which provides that any non-contractual obligations arising out of or in connection with the Agreement are governed by English law. A footnote explains that this wording is optional as where the Agreement forms part of a suite of documents, some of which are governed by the laws of another country (for example, security documents), it may be inappropriate to designate English law as the law of any non-contractual obligations arising out of or in connection with those documents.



BREXIT NOTE: English law

In general, there is no suggestion that Brexit should cause parties to reconsider their choice of English law. Under Rome I²⁴, the current EU regulation on choice of law, the courts of each member state are required to give effect to the parties' choice of law, regardless of whether that law is the law of an EU member state. Accordingly, where those parties have chosen English law to govern their contracts, absent a change in the EU regime, the courts of the EU member states should continue to respect that choice notwithstanding Brexit.

The law governing non-contractual obligations is determined in accordance with Rome II²⁵, which functions in much the same way as Rome I, in that the courts of EU member states must apply whichever law the application of Rome II specifies, whether or not that law is the law of another member state. English law, if selected by the parties, should therefore continue to be upheld following Brexit²⁶.

Accordingly, in general, Brexit provides no reason to choose a governing law other than English law where English law would otherwise be the preferred choice, and the LMA has indicated that it has no current plans to adjust this clause in light of Brexit.

Clause 40: Enforcement

Clause 40.1: Jurisdiction

Clause 40.1 designates the parties' choice of jurisdiction. This clause confers exclusive jurisdiction on the courts of England but does not prevent the Finance Parties from taking proceedings in the court of any other jurisdiction. The intention of the clause is to restrict as far as possible the Obligors' ability to bring proceedings in relation to the Agreement other than in the courts of England, while preserving the Finance Parties' rights to bring proceedings where they choose.

In practice

An "asymmetric" jurisdiction clause of this type is customary in loan documentation and is not often altered. Should Lenders seek to alter this provision, Borrowers should discuss the implications of the proposed changes with their legal advisers.

A handful of decisions of the courts of other EU countries (notably, France) have cast doubt on the legal validity of such clauses under the Brussels Recast Regulation and its predecessor in recent years. These caused some concern in the English law market, as these EU rules (pending Brexit at least) are directly effective across the EU. However, no English decision has held such a clause to be invalid and in 2017, an English court upheld the validity of an asymmetric jurisdiction clause and did not follow the French approach²⁷.

²⁴ Regulation (EC) No. 593/2008.

²⁵ Regulation (EC) No. 864/2007.

²⁶ This gives comfort to parties concerned about the continuing recognition of a choice of English law before the EU courts. It does not however ensure a reciprocal regime, which may be beneficial and reasonably straightforward for the UK to offer as part of any exit negotiations. Rome I is similar in philosophy to the pre-existing English law regime, which would automatically apply upon the UK ceasing to be bound by Rome I. It is not, however, identical in all respects. Rome II, however, is quite different to the pre-existing UK regime, which would require substantial updating to replicate the current regime.

²⁷ *Commerzbank AG v Liquimar Tankers Management Inc* [2017] EWHC 161 (Comm).

Clause 40.2: Service of process

This clause provides for the appointment of a process agent for the Obligors. It is only required if any Obligor is not incorporated in England and Wales.



BREXIT NOTE: Dispute resolution options

The Brussels Recast Regulation²⁸, the principal EU instrument relating to jurisdiction and the enforcement of judgments rests on the principle that a defendant should be sued in the European state in which he is domiciled, subject to exceptions. The most relevant exception is the provision unique to the Brussels Recast Regulation, whereby exclusive jurisdiction clauses will be respected by EU member state courts. This means that subject to certain fairly narrow exclusions, where parties have entered into exclusive jurisdiction agreements, only the court of the chosen member state(s) can hear their disputes and any other court before which proceedings are brought must stay those proceedings in deference to the chosen court.

The Brussels Recast Regulation also provides for the judgments of EU member state courts to be exported relatively quickly and easily to other member states. Assuming certain basic conditions are met, member state courts will recognise and enforce each other's judgments as if they had been made domestically.

Most of the LMA's recommended forms of English law facility agreement (including the Investment Grade Agreements) contain asymmetric or one-sided jurisdiction clauses, which confer exclusive jurisdiction on the English courts for the benefit of the Finance Parties only. The Finance Parties remain able to pursue the borrower in whichever courts they please.

The obligation of an EU court to respect an exclusive jurisdiction agreement applies only to the extent that jurisdiction agreement confers jurisdiction on the court of an EU member state. Accordingly, following Brexit, in the absence of a negotiated agreement to continue the Brussels Recast regime, there is some risk that English jurisdiction clauses may not be respected by the remaining EU member states as the chosen forum to hear disputes in all of the same circumstances as currently. In addition, the enforceability of an English judgment before the courts of the EU member states will no longer be governed by the Brussels Recast machinery.

The question therefore, is whether this risk is sufficient to prompt contracting parties to change their jurisdiction clauses in new contracts in anticipation (for example, by selecting the courts of another EU member state or by referring disputes to arbitration).

In general, no changes are being made. The benefits of the English court system remain and to divert away from that at a point where it is not at all certain if the status quo will be disturbed would seem premature. It is widely anticipated that in the area of jurisdiction and judgments, the Government will prioritise filling any gaps in the post-Brexit legislative regime and there are a number of legal options for doing so.

²⁸ Regulation (EU) No. 1215/2012. Note that the Brussels Recast Regulation applies to proceedings started on or after 10 January 2015. Proceedings begun before this date are subject to Brussels I (Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters).

Schedules

Schedule 1: The Original Parties

This is blank for the insertion of the names of the Original Obligors and the Original Lenders.

Schedule 2: Conditions Precedent

This specifies the Conditions Precedent to initial Utilisation, see Clause 4.1 (*Initial Conditions precedent*).

It also specifies a similar set of Conditions Precedent to be delivered if a new Borrower or Guarantor accedes to the Agreement pursuant to Clause 25 (*Changes to the Obligors*).

As highlighted in the LMA User Guide, amendments to this Schedule are likely to be required if any of the Obligors are not incorporated in England and Wales.

Schedule 3: Requests

Part I contains a form of Utilisation Request (see Clause 5 (*Utilisation*)) and Part II, a form of Selection Notice for the purpose of, among other things, selecting Interest Periods for drawings under the Term Facility (see Clause 10.1 (*Selection of Interest Periods*)).

Schedule 4: Mandatory Cost formulae

An optional schedule, required only if Mandatory Costs are payable on the Facilities, which is generally not the case. See definition of “**Mandatory Costs**” at Clause 1.1 (*Definitions*) and Clause 9.1 (*Calculation of interest*).

Schedule 5: Form of Transfer Certificate

This contains the LMA’s form of Transfer Certificate, to be used to transfer a Lender’s participation by novation pursuant to Clause 24 (*Changes to the Lenders*).

Schedule 6: Form of Assignment Agreement

This contains the LMA’s form of Assignment Agreement, to be used to assign a Lender’s participation pursuant to Clause 24 (*Changes to the Lenders*).

Schedule 7: Form of Accession Letter

A form of letter to be used by acceding Borrowers or Guarantors. See Clause 25 (*Changes to the Obligors*).

Schedule 8: Form of Resignation Letter

A form of letter to be used by resigning Borrowers or Guarantors. See Clause 25 (*Changes to the Obligors*).

Schedule 9: Form of Compliance Certificate

This certificate confirms compliance with any financial covenants. See Clause 20.2 (*Compliance Certificate*).

Schedule 10: Existing Security

There is an exception to Clause 22.3 (*Negative pledge*) for security interests existing at the date of the Agreement. This Schedule is blank for those security interests and the principal amount secured by them to be listed.

Schedule 11: LMA Form of Confidentiality Undertaking

This is the form of Confidentiality Undertaking to be entered into as required for the purposes of Clause 36 (*Confidential Information*). See also comments on definition of “**Confidentiality Undertaking**” at Clause 1.1 (*Definitions*).

Schedule 12: Timetables

For ease of reference, the times by which certain actions under the Agreement are to be taken or measured are specified here, for example, the time for delivery of a Utilisation Request for the purposes of Clause 5.1 (*Delivery of a Utilisation Request*) and the time at which LIBOR or EURIBOR is to be fixed for each relevant currency.

Schedule 13: Form of Increase Confirmation

This is the form of Increase Confirmation to be used to effect the assumption of previously cancelled Commitments by an Increase Lender pursuant to Clause 2.2 (*Increase*).

Schedule 14: Other Benchmarks

If a Benchmark Rate for a Non-LIBOR Currency is used, this Schedule must be completed to specify any adjustments to the Agreement that are required in relation to any Benchmark Rate (for example, to the definition of “Business Day”, the payment, rate-fixing and calculation conventions, the Interest Periods that may be selected and the fallback rates to be used if the Benchmark Rate is unavailable).

See paragraph 4 of Part II and definition of “**Benchmark Rate**” at Clause 1.1 (*Definitions*).

Part IV: Commentary on the Lehman provisions

1. Introduction

The risk of Finance Party default under a loan agreement is a risk factor that the loan market moved swiftly to address following the collapse of Lehman Brothers. The LMA's response was to create a set of optional "Finance Party Default" clauses, which were first published in 2009. These are often colloquially referred to as the "Lehman provisions".

The LMA did not consult the ACT on the Lehman provisions before their first publication in 2009, in contrast to previous practice in relation to investment grade documentation. Subsequently, discussions did take place and changes to the Lehman provisions have been made with the approval of the ACT since then.

Most of the Lehman provisions are a welcome addition to facility documentation for Borrowers. They are widely used and, generally speaking, the main concepts addressed by the LMA drafting will be familiar to those who have negotiated loan documentation since 2009. This might suggest that the most commonly used aspects should be incorporated into the Investment Grade Agreements (they were incorporated in full into the Leveraged Agreement shortly after publication). Despite representations from the ACT, only certain aspects, including the "cashless rollover" provisions, which provide for cashless repayment and drawing on the rollover of a revolving facility loan have been incorporated into the Investment Grade Agreements (discussed at Clause 7.2 (*Repayment of Facility B Loans*) in Part III). The remainder are still presented as optional clauses. Accordingly, they are addressed separately in this Part IV.

2. Defaulting Lenders

Most of the Lehman provisions address the consequences of a Lender becoming a "Defaulting Lender". In summary, a Defaulting Lender is a lender:

- that fails to fund, or gives notice that it will do so;
- that rescinds or repudiates a Finance Document; or
- in respect of which an "Insolvency Event" occurs.

For Facilities incorporating fronted letter of credit facilities, the definition of a Defaulting Lender is extended to include a fronting bank (an "*Issuing Bank*" in LMA terminology) whose credit rating has deteriorated below an agreed minimum.

Once a Lender becomes a Defaulting Lender, the following provisions are triggered:

- The Borrower can cancel the undrawn Commitments of the Defaulting Lender, which can be immediately or later assumed by a new or existing Lender selected by the Borrower.
- The participation of the Defaulting Lender in the revolving facility is automatically termed out and can be prepaid (an optional provision).
- The Defaulting Lender can be forced to transfer its participation in the Facilities to a new Lender at par.
- No Commitment Fee is payable to the Defaulting Lender (an optional provision).
- The Defaulting Lender is disenfranchised to the extent of its undrawn Commitments and on its drawn Commitments if it fails to respond in the specified time frame ("you snooze you lose", a concept explained at Clause 35 (*Amendments and Waivers*) in Part III).
- The identity of a Defaulting Lender may be disclosed by the Agent to the Borrower.

These provisions are widely used, including the optional aspects. They are also available in a version suitable for use in swingline facilities.

Borrowers will note that there is no general right to prepay a Defaulting Lender. Under the Lehman provisions, the Borrower is only permitted to prepay the Defaulting Lender in relation to Revolving Facility drawings which are termed out. The Borrower may not be disadvantaged to a significant extent by this, as Defaulting

Lenders are unable to vote to the extent of their undrawn Commitments, and are subject to a “you snooze you lose” provision to the extent of their drawn Commitments. However, some Borrowers may want the flexibility to prepay rather than have the Defaulting Lender remain in the syndicate with voting rights which it may or may not exercise. This is a point for Borrowers to discuss with their Arrangers. A few syndicates have approved a general prepayment right along these lines to date (including in relation to Term Facilities).

3. Impaired Agent

The Lehman provisions include clauses designed to protect the Borrower and the Lenders against the risk that an Agent may get into financial difficulty.

The definition of an “**Impaired Agent**” is similar to the concept of a Defaulting Lender, discussed above. An Impaired Agent is, in outline, an Agent:

- which fails to make a payment required under the Finance Documents;
- which rescinds or repudiates a Finance Document;
- which is a Defaulting Lender; or
- in respect of which an Insolvency Event occurs.

If an Agent becomes an Impaired Agent:

- Majority Lenders can remove it, after consultation with the Borrower, by appointing a replacement Agent.
- The Lenders and the Borrower can make payments to each other directly, instead of through the Agent. Alternatively, payment can be made to a trust account in the name of the person making the payment, for the benefit of the payee.
- Notices and communications can be made directly between the parties.

These provisions are also widely used and available in a version suitable for swingline facilities.

4. Issuing Banks

The Lehman provisions contain a number of clauses aimed at protecting Issuing Banks if a Lender’s credit rating drops below an acceptable level or if it becomes a Defaulting Lender. This will trigger, among other things, a requirement for the cash collateralisation of that Lender’s share of any letters of credit issued under the Revolving Facility.

5. Alternative Market Disruption provisions

The Lehman provisions until quite recently, also included a set of “Alternative Market Disruption” provisions. These comprised an alternative benchmark fallback rate regime, to be used in place of the mechanism in Clause 11 (*Changes to the Calculation of Interest*).

These Alternative Market Disruption clauses provided an alternative fallback reference bank rate, to be used in two circumstances:

- if the ordinary Reference Bank Rate fallback is unavailable; or
- if the market disruption provisions in the Agreement were triggered; in other words, the requisite percentage of Lenders notify the Agent that they are unable to fund themselves at the agreed benchmark.

In these circumstances interest will be charged at an “Alternative Reference Bank Rate”, rather than moving at Lenders’ individual cost of funds.

The quotations from the Alternative Reference Banks are obtained on the same basis as from the Reference Banks. These are used to calculate the “**Alternative Reference Bank Rate**”. The intention is that the “**Alternative Reference Banks**” are an additional and larger group than the Reference Banks.

If the Alternative Reference Bank Rate is unavailable, or the requisite percentage of Lenders notify the Agent that they are unable to fund themselves at the Alternative Reference Bank Rate, interest will be payable based on individual Lenders' cost of funds. In relation to the latter trigger, the threshold percentage of Lenders notifying the Agent that their cost of funds exceeds the Alternative Reference Bank Rate should be higher than that required to trigger the initial market disruption event.

These Alternative Market Disruption provisions were thus intended to reduce the likelihood of the Borrower being required to pay interest based on individual Lenders' cost of funds, by providing for the use of Alternative Reference Bank Rates as an interim measure. Effectively, the Alternative Reference Banks are a safety net before the Borrower is required to pay the Lenders their cost of funds.

The Alternative Market Disruption provisions were not, however, widely adopted in the investment grade market (or more generally). Initially, this was possibly because of their length and complexity. More recently, they became even less appealing due to the difficulties (documented in Part III) of locating lenders willing and able to act as Reference Banks (let alone Alternative Reference Banks).

Accordingly, the LMA, having consulted the ACT, chose to delete this aspect of the Lehman provisions in July 2017.

Glossary

Terms defined in the MTR have the same meanings in this guide.

The terms specified below have the following meanings in this guide.

ACT	The Association of Corporate Treasurers.
BBA	The British Bankers' Association.
EMMI	The European Money Markets Institute, the current administrator of EURIBOR.
FCA	The UK Financial Conduct Authority.
IBA	ICE Benchmark Administration, the current administrators of LIBOR.
Investment Grade Agreements	The LMA's recommended forms of facility agreement for investment grade borrowers (July 2017 versions).
Lehman provisions	The LMA's Users' Guide to LMA Finance Party Default Clauses in conjunction with the recommended form of primary documents (July 2017 version).
Leveraged Agreement	The LMA's senior multi-currency term and revolving facilities agreement for leveraged acquisition finance transactions (August 2017 version).
LMA	The Loan Market Association.
LMA User Guide	The LMA's Users' Guide to the Investment Grade Primary Documentation (July 2017 version).
MTR	The LMA's recommended form of multi-currency term and revolving facilities agreement for multiple borrowers and guarantors (July 2017 version).
PRA	The Bank of England in its capacity as the UK Prudential Regulation Authority.

About the Association of Corporate Treasurers

The ACT is the chartered professional body for treasury. We work in the public and the profession's interest to influence policy and ensure decision makers understand the impact of proposed changes to regulation and market practice on non-financial corporates.

Influencing decision makers

We represent the position of the treasury profession to government, regulators, policy makers and other industry bodies (including the LMA) to provide the real economy perspective.

Informing treasurers

We monitor developments in regulation, market evolution, technology and the economy which impact on treasury activity and provide informed and unbiased technical advice.

Guidelines about our approach to policy and technical matters are available at www.treasurers.org/technical/manifesto.

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About Slaughter and May

Slaughter and May is a leading international law firm that advises on a wide range of often groundbreaking transactions and has a varied client list that includes major corporations, financial institutions and governments.

Our loan finance practice advises both investment grade and sub-investment grade borrowers in all industry sectors, which gives us a depth of understanding of borrowers' needs. We also act for leading financial, commercial and industry players and banks, providing us with a wide perspective on the market.

Slaughter and May provides ongoing advice to the ACT in relation to the LMA's investment grade loan documentation and related issues.

Further information about Slaughter and May is available at www.slaughterandmay.com.

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