Speaking a common language: how different is the LSTA's new form of revolving credit facility from the LMA equivalent?

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The recent publication by the Loan Syndications and Trading Association ("LSTA") of a form of investment grade revolving credit facility (the "LSTA RCF") signals a change in approach for the LMA's US sibling. The LSTA "Model Credit Agreement Provisions", a library of largely boilerplate clauses, have existed for as long as the LMA's primary documents, but the LSTA RCF, the final version of which was made available to LSTA members on 19 October, is the LSTA's first full-form credit agreement.

The emergence of a New York law counterpart to the LMA's recommended forms facilitates a direct comparison of New York law and English law terms, highlighting some of the differences between the legal regimes, market practice and market dynamics in the US and in Europe. Although in substance, English law and New York law loan documentation has much in common, certain disparities remain.

This article highlights, by way of example, some of the areas where the terms of LSTA RCF and the LMA's equivalent investment grade templates (the "**IGAs**") diverge.

Assumed transaction

The first point to note is that the LSTA RCF is more comprehensive than the IGAs in some respects, but less so in others.

The LMA publishes 11 IGAs: there are revolving facilities, term facilities and term and revolving facilities combined. These are available in single currency and multi-currency versions and in versions with letter of credit or swingline options. Each includes an integral guarantee but they are all unsecured. Investment grade loans are quite often guaranteed for a variety of reasons. A common instance is where the borrower is the group's treasury company rather than the parent.

The LSTA has chosen to produce (or start with) only one template, an unsecured single currency revolving credit facility incorporating a swingline and a letter of credit option.

The LSTA RCF does not include a guarantee. This reflects normal practice in many investment grade transactions where the public reporting company is often the only borrower. As is the case in Europe, however, it is not unusual to see guarantees of investment grade loans if the borrower's capital markets debt is guaranteed.

The LMA IGAs were initially developed with a single A-rated corporate borrower in mind, so contain minimal representations, undertakings and events of default. These are often supplemented where the IGAs are used to document loans to borrowers at the lower end of investment grade. The LSTA RCF takes a more expansive view and contains

provisions more suitable for unsecured lending in the BBB- bracket as well as at the top end of the market. The representations and undertakings (including provisions relating to sanctions and anti-corruption laws) are more extensive and a number are presented in square brackets as optional provisions.

Benchmarks

Under the IGAs, the floating rate component of the interest rate is LIBOR, EURIBOR or an alternative benchmark, as agreed. The LSTA RCF provides for the use of an "Adjusted LIBO Rate". This is US$ LIBOR for the relevant period, adjusted automatically to take into account US statutory reserve requirements for eurocurrency liabilities (which have been zero since 1990). It also allows the borrower to opt for an alternative rate, the "ABR", which does not have a direct equivalent in the European market, and to convert between the Adjusted LIBO Rate and the ABR without requiring the loans to be "refinanced".

The ABR is a daily rate, defined as the highest of a) the agent's published prime or base lending rate, b) the Federal Funds Effective Rate plus 0.5% and c) the one month "Adjusted LIBO Rate" plus 1.00%. Thus ABR loans are not borrowed for specific interest periods in the same way as LIBOR loans. The interest rate on an ABR loan can fluctuate daily, if the ABR itself changes, and is payable quarterly in arrears.

Although the ABR option is almost always included in US agreements, it is rarely chosen by borrowers in practice, largely because interest on ABR loans is intended to be, and will generally be, higher than interest on LIBOR loans (even after taking into account that the spread on LIBOR loans is always 100 basis points higher than the spread on ABR loans). However, ABR can provide the borrower with additional flexibility. For example, LIBOR loans generally require three Business Days' notice of drawing, and prepayments made other than on the last day of the interest period may be subject to breakage. ABR loans are typically available on one Business Day's notice (or, depending on the agent or the lender group, on the same Business Day), and may be prepaid without breakage. If the borrower needs funds on short notice, it might request an ABR loan and concurrently provide notice to convert the ABR loan to a LIBOR loan three Business Days later.

Rate fallbacks

The standard rate fallbacks under the IGAs provide for the use of interpolated benchmark rates, or if not, provide the option of using Reference Bank Rates. If Reference Bank Rates are not available or not used, each lender is entitled to charge its cost of funds from whatever source it may reasonably select (its "**Funding Rate**") in place of the chosen benchmark, or a weighted average of the syndicate's Funding Rates if that option is chosen. The IGAs also offer an alternative fallback regime which incorporates historic rates and rates for shortened interest periods if LIBOR is unavailable, before resorting to Reference Bank Rates and Funding Rates.

These fallback provisions apply if the chosen benchmark is unavailable on screen, or if an agreed percentage of lenders notify the agent that they cannot fund themselves at the chosen rate.

The rate fallback provisions in the LSTA RCF operate a bit differently. If LIBOR is unavailable on screen, the fallback is interpolated rates. If interpolation is not possible, the rate will be the rate at which the agent offers US$ deposits to first class banks in the London interbank market. Some agent banks in the US, however, are unwilling to accept this responsibility, and do not include this fallback in their forms.

If that fallback regime fails, the general rate fallback provisions may apply. If the agent determines that LIBOR, due to "circumstances affecting the London interbank eurodollar market…cannot be determined pursuant to the definition thereof" or if a certain percentage of lenders notify the agent that either relevant US$ deposits are not available in the London interbank eurodollar market or that LIBOR does not "adequately and fairly" represent their cost of funds, Lenders are not obliged to "make or maintain" LIBOR loans until such time as alternative arrangements are made. The template does not cater for funding to continue automatically using Reference Bank Rates or Funding Rates. However, the borrower would be able in these circumstances to revoke its drawdown request and draw an ABR loan instead (or to convert outstanding LIBOR loans to ABR loans).

The approach in the LSTA RCF reflects New York market practice, which has largely dispensed with Reference Bank Rates. Unwillingness among lenders to take on the Reference Bank role is also prevalent in Europe. However, for the time being at least, although Reference Banks are not being appointed by name in documentation, the Reference Bank concept features in most English law deals.

Increased costs

Both templates require the borrower to indemnify the lender-side parties in respect of any increased costs that arise during the course of the facility. The templates define increased costs in different ways, but the essence under both is that any costs attributable to the lenders having entered into the facility or funding or performing their obligations under it are for the account of the borrower, to the extent those costs are the result of a change in law after the date of the agreement.

The LSTA RCF provides that any costs arising out of the Dodd-Frank Act or relating to Basel III shall fall within the scope of the indemnity regardless of whether they constitute a change in law. The LMA clause alludes to that possibility in a footnote, but does not "carve-in" such costs expressly. This point is often raised by lenders in practice, although in investment grade deals, perhaps not as frequently as was the case 12-18 months ago.

The LSTA increased costs clause is subject to a temporal limitation; the borrower is not obliged to meet claims for increased costs that arise more than 9 months prior to the lender notifying the agent of its claim. A time limit is often negotiated into the LMA clause in practice, but is not a feature of the IGAs.

Incremental facilities and extension options

Extension options are common in English law investment grade loans. Options to increase the amount of a facility ("incremental capacity" or "accordion" features) are not

unusual, although in the context of unsecured lending, they are more commonly seen in mid-market deals. These features are negotiated on a case by case basis as neither is included in the IGAs.

The LSTA RCF enables the borrower to request a 364 day extension to the term of the facility. This is fairly customary in New York law documents, the mechanic having been developed to permit extensions of 364-day facilities in a manner that would allow them to continue to qualify for preferential capital treatment under Federal Reserve guidelines. The borrower must request the extension within a specific window and the lenders are free to participate or not. To the extent the lenders decline the borrower's request, the borrower may seek replacement lenders. If the borrower is able to garner commitments from a sufficient number of existing and third party lenders, the commitments of those lenders will be extended. This mechanism is quite similar to the extension options that are commonly used in Europe.

The LSTA RCF also includes an accordion. The borrower may request that the commitments are increased up to a financial cap. The mechanism operates along similar lines to the extension option. The borrower may approach existing lenders or eligible third party lenders, who choose to participate at their discretion.

It is useful that the LSTA has included this feature in the RCF, although in the US, as in Europe, in general incremental capacity is seen most frequently in secured deals, where a key motivation is the potential expense of re-opening the finance documents as and when further debt is required.

Financial covenants

The IGAs do not include financial covenants. However, they do contain a marker, acknowledging that they may be required. Financial covenant tests can be quite sector-specific, and may not be required at all from more highly rated borrowers. However, interest cover ratios ("**ICRs**"), leverage ratios and minimum tangible net worth ("**MTNW**") requirements are all commonly used in investment grade lending, and it is not unusual for those covenants to be crafted using elements of the financial covenant provisions published separately by the LMA. The LMA's financial covenant provisions (which derive from its leveraged agreement) include net leverage and an ICR, in a form which can easily be adapted for corporate lending. The LMA's pre-export finance facility contains a MTNW covenant, which is also easily adapted.

The LSTA RCF includes three optional financial covenants in the template itself: an ICR, a leverage ratio and a MTNW requirement, which are also the commonly seen financial covenants in the US. Their formulation is slightly different to the financial covenant provisions put forward by the LMA, reflecting US norms. For the purposes of the ICR and the leverage ratio, EBITDA is built from consolidated net income, a US GAAP income statement item. In Europe, the basis of EBITDA is normally operating profit. The LSTA RCF provides for leverage to be calculated on a gross basis, rather than the net basis used in Europe, although in practice, many US borrowers negotiate for some ability to net unrestricted cash.

The LSTA RCF provides for quarterly financial reporting and covenant testing. In most of Europe, investment grade borrowers are required to report and test their covenants semi-annually.

Voting

Loan market practice is quite established in both the US and in Europe with regard to required voting majorities. The US norm (suggested in the LSTA RCF) is that most lender voting will proceed on the basis of a simple majority in interest, with the consent of lenders representing more than 50% of the facility including both drawn and undrawn commitments ("Required Lenders" in LSTA terminology) being required to effect most amendments, to declare defaults and accelerate the loans and to instruct the agent. The IGAs, reflecting European norms, suggest defining "Majority Lenders" as lenders holding 662/3% of drawn and undrawn commitments.

The list of matters requiring unanimous lender consent is shorter in the LSTA RCF than in the IGAs, reflecting the US's slightly more relaxed approach to amendments. For example, alterations to the illegality and the governing law and jurisdiction clauses are not all-lender decisions as in the IGAs, which may reflect differing levels of sensitivity among lenders to these issues. A notable point of detail is that the LSTA RCF provides that unanimous lender consent is not required for amendments to financial covenant terms that have the effect of reducing the interest rate. A clarification along these lines is useful from the borrower's point of view.

Assignments and transfers

The IGAs provide, in summary, that a change to the lenders of record requires the borrower's consent, unless the new lender is an existing lender or an affiliate of a lender, or is made at a time when an event of default is continuing. The borrower's consent must not be unreasonably withheld or delayed, and is deemed if not forthcoming within 5 Business Days. No minimum transfer or minimum hold amount is specified, although these are quite often negotiated in practice.

The equivalent terms of the LSTA RCF require the consent of the borrower in similar circumstances, but are more detailed and include a more comprehensive set of conditions. Third party sales are subject to the agent's consent and minimum amount requirements. Optional provision is made for the use of a blacklist of "Disqualified Institutions", who cannot participate in the facility. This blacklist mechanism is more common in the leveraged market, although seen occasionally in investment grade deals.

Comment

US market participants are in the process of assessing the value of the LSTA RCF as a standardised starting point for investment grade lending. The fact that it has been produced suggests a level of demand within the investor community, but whether the major arranging banks will adopt the new template to the same extent as its LMA counterparts, as well as whether any adjustments are required to facilitate widespread adoption, remains to be seen.

The LSTA RCF has generated significant interest among London lawyers who are accustomed to operating from the common reference point provided by the LMA templates. A New York law comparator is a welcome development and a useful resource given the increasing need for banking lawyers to be aware of and marry US and UK loan market practices in cross-border deals.

This article was written by Kathrine Meloni, special adviser at Slaughter and May and Michael S. Goldman, partner at Cravath, Swaine & Moore LLP. It first appeared in the Loan Market Association's 2017 end of year newsletter.

Kathrine Meloni,
Special Adviser, Slaughter and May, London
T +44 (0) 20 7090 3491
E kathrine.meloni@slaughterandmay.com

Michael S. Goldman,
Partner, Cravath, Swaine & Moore LLP, New York
T +1 (212) 474-1929
E mgoldman@cravath.com