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A Borrower's Guide to the LMA's Investment Grade Agreements

6th Edition
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SLAUGHTER AND MAY/

Table of contents

INTRODUCTION /	1
1. THE ACT AND THE LMA	1
2. AIMS OF THIS GUIDE	1
3. CONTENTS OF THIS GUIDE	2
4. REFERENCES TO LMA PROVISIONS	3
PART I / USING THE LMA LIBRARY	7
1. THE INVESTMENT GRADE AGREEMENTS	7
2. HOW TO APPROACH THE INVESTMENT GRADE AGREEMENTS	8
3. WHAT'S NOT IN THE INVESTMENT GRADE AGREEMENTS?	13
4. THE INVESTMENT GRADE SUITE	15
5. THE LMA LIBRARY	15
6. ACCESS TO LMA DOCUMENTATION	17
PART II / RISK-FREE RATES IN THE LOAN MARKET	19
1. ESSENTIAL BACKGROUND	19
1.1 Transition timetable	19
1.2 A market-led process	20
1.3 The role of the LMA and the ACT	20
2. USING RFRS IN LOANS	21
2.1 The RFRs	21
2.2 Calculation of interest using RFRs	23
3. RISK-FREE RATES – THE OPTIONS	24
3.1 Overview	24

3.2	Choosing a rate (where a choice is available)	25
3.3	Sterling loans	27
3.4	USD loans	28
3.5	Euro loans	29
4.	CONVENTIONS FOR REFERENCING RFRs	31
4.1	Sterling loan conventions	31
4.2	Non-cumulative daily compounding	31
4.3	Lookback period	32
4.4	Observation shift	33
4.5	Interest rate floors	34
4.6	Conventions applicable to other ex-LIBOR currencies	36
4.7	RFR calculations and data sources	37
5.	TRANSITION ISSUES	39
5.1	Continuing relevance of transition tools	39
5.2	Transition trigger events	41
5.3	Three-part pricing	42
5.4	How is the CAS calculated?	44
5.5	Should the parties specify a methodology or a fixed CAS?	46
5.6	“Tough legacy” contracts	46
6.	DOCUMENTATION	50
6.1	LMA RFR documentation	50
6.2	The RFR Agreements	50
6.3	RFR terms – modular drafting	51
6.4	RFR terms – discussion points	52
6.5	Term SOFR facilities – discussion points	56

7.	HEDGING CONSIDERATIONS	62
7.1	Legacy LIBOR derivatives – the ISDA IBOR Fallbacks	62
7.2	2021 ISDA Definitions	64
7.3	RFR hedging	64
8.	BEYOND LIBOR	65
PART III / HOT TOPICS		68
1.	NAVIGATING CHALLENGING CONDITIONS	68
1.1	2022/23 outlook	68
1.2	Amend & extend or full refinancing?	69
1.3	Interest rates, inflation and rising energy costs	70
1.4	Exchange rate movements	72
1.5	Lessons from lockdown	74
1.6	Sanctions	78
2.	SUSTAINABILITY-LINKED LOANS	83
2.1	Introduction	83
2.2	A principled market	84
2.3	The LMA's approach to ESG	84
2.4	Selection of KPIs and SPTs	86
2.5	What is the role of a Sustainability Coordinator?	92
2.6	Reporting and verification	93
2.7	Financial consequences of achieving (or failing to achieve) SPTs	94
2.8	Other consequences – declassification	95
2.9	Documentation	97
2.10	A note on ESG due diligence (of relevance to all lending transactions)	98

2.11	Regulatory developments – the direction of travel	99
3.	UK LEGAL DEVELOPMENTS	102
3.1	Pensions Schemes Act 2021	102
3.2	National Security and Investments Act 2021	106
3.3	Economic Crime (Transparency and Enforcement) Act 2022	111

PART IV / COMMENTARY ON THE INVESTMENT GRADE AGREEMENTS 115

1.	INTRODUCTION	115
2.	PARTIES TO THE AGREEMENT - A NOTE ON TERMINOLOGY	115

SECTION 1: INTERPRETATION..... 117

Clause 1	Definitions and Interpretation	117
----------	--------------------------------	-----

SECTION 2: THE FACILITIES..... 157

Clause 2	The Facilities	157
	Possible Supplementary Provisions - Accordion Facilities	159
Clause 3	Purpose	161
Clause 4	Conditions of Utilisation	161

SECTION 3: UTILISATION..... 165

Clause 5	Utilisation	165
Clause 6	Optional Currencies	166

SECTION 4: REPAYMENT, PREPAYMENT AND CANCELLATION 170

Clause 7	Repayment	170
	Possible Supplementary Provisions – Extension Option	171

Clause 8 Prepayment and Cancellation	172
SECTION 5: COSTS OF UTILISATION.....	178
Interest rate provisions - overview	178
Clause 9A Rate Switch	179
Clause 9 Interest	182
Clause 10 Interest Periods	184
Clause 11 Changes to the Calculation of Interest	187
Clause 12 Fees	197
SECTION 6: ADDITIONAL PAYMENT OBLIGATIONS	199
Clause 13 Tax Gross-up and Indemnities	199
Clause 14 Increased Costs	216
Clause 15 Other Indemnities	222
Clause 16 Mitigation by the Lenders	225
Clause 17 Costs and Expenses	226
SECTION 7: GUARANTEE.....	228
Clause 18 Guarantee and Indemnity	228
SECTION 8: REPRESENTATIONS, UNDERTAKINGS AND EVENTS OF DEFAULT	230
Overview – approach to commercial terms	230
Techniques for limiting the commercial terms	232
Possible Supplementary Provisions - Sanctions	235
Possible Supplementary Provisions – Anti-Corruption Laws	238
Clause 19 Representations	240
Clause 20 Information Undertakings	250
Clause 21 Financial Covenants	259

Clause 22 : General Undertakings	271
Clause 23 Events of Default	281
SECTION 9: CHANGES TO THE PARTIES.....	295
Clause 24 Changes to the Lenders	295
Possible Supplementary Provisions: Designated Entity Clause	303
Clause 25 Changes to the Obligors	308
SECTION 10: THE FINANCE PARTIES.....	309
Clause 26 The Role of the Agent and the Arranger	309
Possible Supplementary Provisions: Clause 26.18 (amounts paid in error)	314
Clause 27 Conduct of Business by the Finance Parties	318
Clause 28 Sharing Among the Finance Parties	319
SECTION 11: ADMINISTRATION	320
Clause 29 Payment Mechanics	320
Clause 30 Set-Off	323
Clause 31 Notices	323
Clause 32.3 Day Count Convention and Interest Calculation	324
Clause 33 Partial Invalidity	326
Clause 34 Remedies and Waivers	326
Clause 35 Amendments and Waivers	327
Possible supplementary provisions: “yank the bank” and “you snooze you lose”	330
Clause 36 Confidentiality	333
Clause 37 Confidentiality of Funding Rates	338
Clause 38 Bail-in	338
Clause 39 Counterparts	342

SECTION 12: GOVERNING LAW AND ENFORCEMENT 343

Clause 40 Governing Law	343
Clause 41 Enforcement	344

SCHEDULES 348

Schedule 1 The Original Parties	348
Schedule 2 Conditions Precedent	348
Schedule 3 Requests	349
Schedule 4 Form of Transfer Certificate	349
Schedule 5 Form of Assignment Agreement	349
Schedule 6 Form of Accession Letter	349
Schedule 7 Form of Resignation Letter	350
Schedule 8 Form of Compliance Certificate	350
Schedule 9 Existing Security	350
Schedule 10 LMA Form of Confidentiality Undertaking	350
Schedule 11 Timetables	350
Schedule 12 Form of Increase Confirmation	351
Schedule 13 Reference Rate Terms	351
Schedule 13 Parts I, II, III and IVB – Reference Rate Terms for Compounded Rate Currencies	352
Schedule 13 Part IVA – Reference Rate Terms for Term Rate Currencies	365
Possible supplementary provisions: Reference Rate Terms for additional currencies	372
Schedule 14 Daily Non-Cumulative Compounded RFR Rate	373
Schedule 15 Cumulative Compounded RFR Rate	375
Note: Compounded/Term MTR with/without observation shift	375

PART V / COMMENTARY ON THE LEHMAN PROVISIONS	377
1. INTRODUCTION	377
2. DEFAULTING LENDERS	378
3. IMPAIRED AGENT	379
4. ISSUING BANKS	380
GLOSSARY	382
ABOUT THE ASSOCIATION OF CORPORATE TREASURERS	389
ACT KEY CONTACTS.....	390
ABOUT SLAUGHTER AND MAY	391
SLAUGHTER AND MAY KEY CONTACTS.....	392
CONTACT DETAILS.....	393

INTRODUCTION



INTRODUCTION /

1. THE ACT AND THE LMA

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 text of the first recommended form of facility agreement for investment grade borrowers (the **Investment Grade Agreement**). The ACT has continued to assist the LMA with the Investment Grade Agreement, of which there are now multiple variations (together, the **Investment Grade Agreements**), ever since.

2. AIMS OF THIS GUIDE

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 Agreement in 1999, aims to assist treasurers reviewing draft loan documentation, using an Investment Grade Agreement as its reference point. It explains the operation of its main clauses and highlights the key areas for negotiation. This guide also aims to provide guidance to treasurers on current hot topics of relevance to current and forthcoming lending transactions.

Each new edition of this guide is updated to reflect the most recent adjustments made by the LMA to its collection of Investment Grade Agreements, as well as certain key legal, regulatory and market

¹ <https://www.lma.eu.com/>

developments that have had an impact on lending activity and terms in practice.

The development and documentation of appropriate conventions for the use of risk-free rates (**RFRs**) in loans has been a monumental project, in which both the LMA and the ACT have played leading roles. Extensive amendments have been made to the Investment Grade Agreements to cater for the transition from LIBOR to RFRs since the last edition of this guide was published in 2017. This guide covers the essential background for treasurers, alongside a clause-by-clause discussion of the RFR-related provisions of the newest versions of the Investment Grade Agreements.

Another major development has been the growing popularity of ESG loan products, which when the last edition was prepared, did not really exist. These products and the underlying regulatory environment are still evolving in many respects and this is a fast-moving area. This 6th edition contains an introduction to sustainability-linked lending, the nature of the products currently available and how “ESG” features are being reflected in documentation at the time of writing.

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.

3. CONTENTS OF THIS GUIDE

The guide is divided into five Parts:

Part I (Using the LMA Library): describes the various Investment Grade Agreements, their place in the broader LMA documentation collection and how they should be approached by borrowers. It also outlines the main aspects of the Investment Grade Agreement that are typically negotiated.

Part II (Risk-Free Rates in the Loan Market): provides essential background to the use of RFRs in loan transactions, an overview of the key concepts, the current status of the transition project, how RFRs are

addressed in the Investment Grade Agreements and the key issues to be settled between the parties.

Part III (Hot Topics): contains commentary on the hot topics and recent legal regulatory developments affecting lending transactions including:

- **Section 1: Navigating challenging conditions:** in light of recent events, including the COVID-19 pandemic and the Russia/Ukraine war, this section looks at how macro-economic and geopolitical events might affect treasurers' fundraising strategies and impact lending terms.
- **Section 2: Sustainability-linked loans:** contains an introduction to ESG loan products, the difference between green, social and sustainability-linked lending, the key topics for treasurers to consider and how the classification of a loan as "sustainable" affects the documentation terms.
- **Section 3: UK legal developments:** outlines some recent UK legislation which will affect certain loan transactions: the Pension Schemes Act 2021, the National Security and Investments Act 2021 and the Economic Crime (Transparency and Enforcement) Act 2022.

Part IV (Commentary on the Investment Grade Agreements): this Part, the centre of the guide, is a clause by clause commentary on the Investment Grade Agreements. It outlines in detail the meaning and intent of the key clauses, and comments on how they might be viewed from the borrower's perspective.

Part V (Commentary on the Lehman Provisions): an overview of the LMA's Finance Party Default clauses and some of the key points from the borrower's point of view.

The guide also includes a Glossary listing abbreviations and defined terms. Capitalised terms used in this guide and not listed in the Glossary have the meanings given in the Investment Grade Agreements.

4. REFERENCES TO LMA PROVISIONS

This guide refers to sections and clause numbers of an Investment Grade Agreement. These references are to sections and clauses of the

LMA's multi-currency term and revolving facilities agreement referencing compounded/term rates (the **Compounded/Term MTR**).

As these references may be different in other versions of the Investment Grade Agreement and numberings 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.

Slaughter and May
1 November 2022

IMPORTANT NOTE

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. It 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.

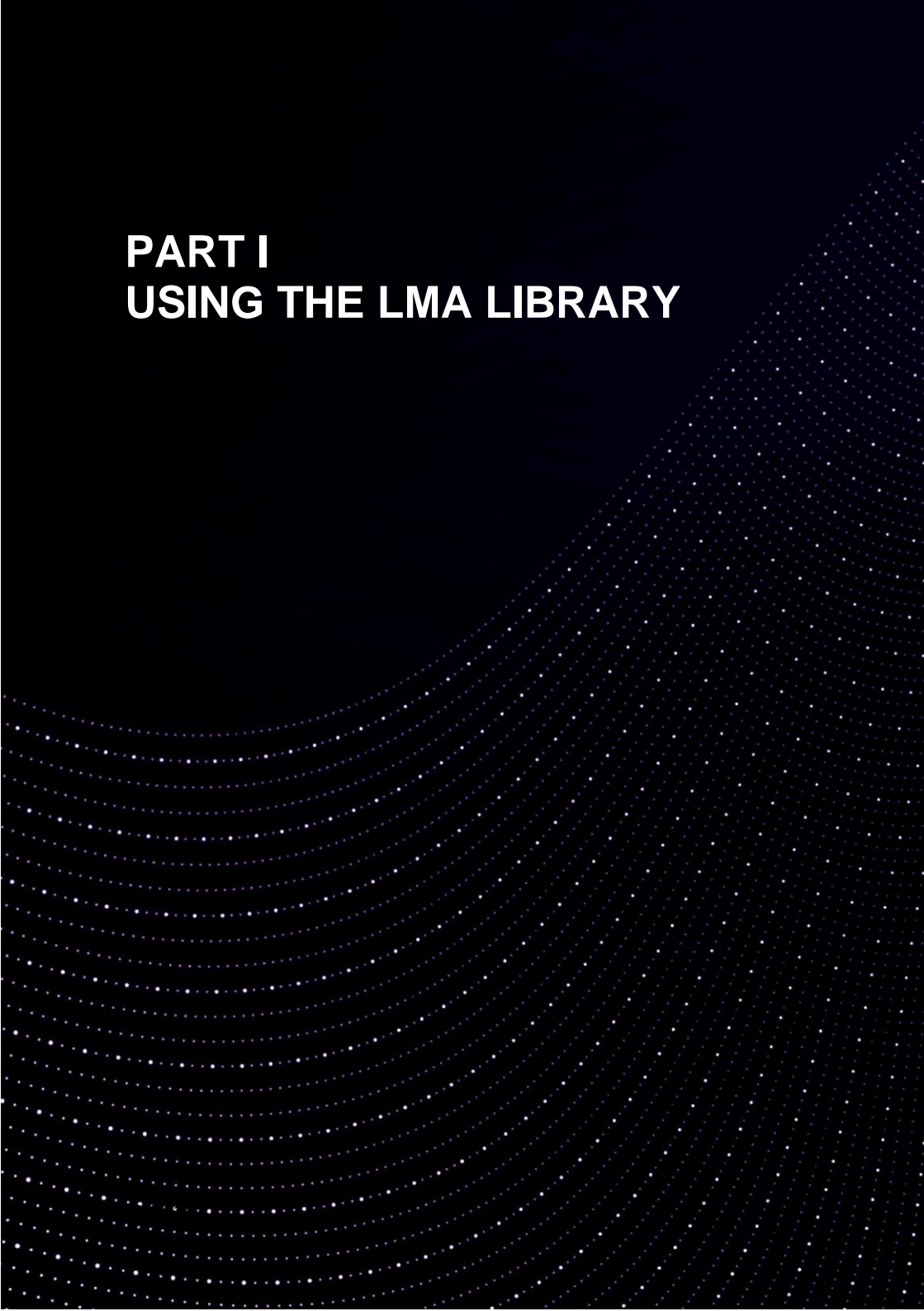
Readers should therefore take their own professional advice. This guide does not constitute legal advice and should not be relied upon as a substitute for such advice. Although Slaughter and May has taken all reasonable care in the preparation of this guide, no responsibility is accepted by Slaughter 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.

The LMA has consented to the quotation of, and referral to, its documentation for the purpose of this Guide, but assumes no responsibility for any use to which its documents, or any extract from them, may be put. The views and options expressed in this guide are the views of Slaughter and May and the ACT and do not necessarily represent those of the LMA. No responsibility is accepted by the LMA for any cost, loss or liability, however caused, occasioned to any person by reliance on it.

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PART I

USING THE LMA LIBRARY



PART I / USING THE LMA LIBRARY

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.

The various Investment Agreements published by the LMA apply the same investment grade terms to different facility structures. There are single currency and multi-currency Investment Grade Agreements for term and/or revolving facilities. Versions are also published incorporating dollar and euro swingline facilities. There is also a version which caters for the revolving facility to be drawn by way of fronted letters of credit.

The current library of Investment Grade Agreements includes templates referencing LIBOR, the **LIBOR Agreements**, alongside the most up to date templates that reference RFRs, the **RFR Agreements**. As the LIBOR Agreements are largely of historic interest only, the clause-by-clause commentary in Part IV of this guide has been prepared by reference to the RFR Agreements.

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 the equivalent English law Investment Grade Agreement to reflect the requirements of

the applicable governing law. As a result, many of the points made in Part IV of this guide will also be relevant 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.
- The approach to RFRs is based on the conventions developed in the UK for the sterling loan market.

As discussed further 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.”

The front page of each RFR Agreement contains a further statement:

“In particular nothing in this document is intended to, or should be construed as, a recommendation of, or support for, any particular pricing methodology by the LMA.

This document provides a documentary reflection of the recommendations for SONIA Loan Market Conventions issued by the Working Group on Sterling Risk-Free Reference Rates. Individual parties choosing to use this document as the basis for preparing loan documentation for transactions should note that in the absence of established market or operational practice in relation to the SONIA Loan Market Conventions this document seeks only to reflect those conventions and does not purport to offer any standardised position in relation to a number of issues associated with the use of compounded risk-free reference rates or the operation of those conventions. Those issues are outlined in the Commentary but will require consideration and resolution by the relevant parties in the context of the relevant transaction.”

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 when the first of the documents were published:

“The recommended forms of syndicated facility agreement (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. Bilateral loans may not follow the LMA format, which is designed for the syndicated market, at all (although equally, many do). The LMA format is also generally not as prevalent in domestic transactions governed by the laws of other European or of African 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.

The provisions relating to RFRs represent a material change to pre-existing LIBOR terms and it is particularly important to consider these carefully.

The transition of most of the LIBOR-referencing loan market to RFRs was a very extensive documentation project, which was required to be completed (given the volume of transactions requiring individual amendment) over a relatively short period. The publication of the LMA's RFR Agreements was considered an important catalyst for the transition of the syndicated loan market to RFRs. This turned out to be the case, but as a result, the RFR Agreements, which involved very extensive changes to the pre-existing LIBOR Agreements, were published under some time pressure.

While in the main, the RFR terms put forward by the LMA are adopted in most English law transactions, it is important that the parties appreciate the basis on which they have been prepared (and where applicable, any alternative options). The RFR terms contain a number of options. Certain aspects may need to be discussed and some provisions may not be suitable for all transactions. This topic is discussed in detail in Part II (Risk-Free Rates in the Loan Market).

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/or 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 transfers of a lender's participation in the facility in most cases.

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 highlighted in this guide.

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, Clause 22.3 (*Negative pledge*) and Clause 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 or on which there is no clearly defined market consensus. This is discussed further in section 3 (What's not in the Investment Grade Agreements?) below.

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 any 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. WHAT'S NOT IN THE INVESTMENT GRADE AGREEMENTS?

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, for example, as in the years immediately following the 2007-9 financial crisis), there is a discussion between the LMA, the ACT and their respective advisers. When discussions have concluded, the document is revised and republished as swiftly as possible. However, LMA documentation cannot reasonably be expected to reflect the implications of all current issues:

- **Sometimes issues are capable of identification but continue to develop over time.** Major regulatory initiatives affecting the financial sector, for example, can take years to develop. A key example here is the process of transitioning from LIBOR. The LMA agreements have been adjusted a number of times as the project developed, and the project is not yet complete in all respects. The first adjustments reflected the reforms to the LIBOR calculation process initiated in 2012. These were followed by various interim changes and culminated in the publication of the first recommended forms of RFR Agreements in 2021. See further Part II (Risk-Free Rates in the Loan Market).
- **It may not be immediately clear whether a particular risk is likely to be an enduring feature of the market.** To justify making already complex template documentation even more so, it must be clear that provisions addressing the risk in question are likely to be required in the longer term (especially where there is also uncertainty with regard to its precise effects). Recent examples here include some of the adjustments that were made to loans put in place or amended during the COVID period.

- **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. For example, there are differing views in the banking community with regard to what level of provision should be made in loan documentation in relation to sanctions matters. 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. Similarly, the terms applicable to ESG-linked loan products are still in the development phase, which is why the LMA has not yet sought to produce any drafting.
- **To be elevated to the status of the template, the provision must be of sufficiently wide application.** Different transaction structures and borrowers bring in different credit and due diligence considerations that lenders may wish to address contractually. Legislative or regulatory developments may only affect certain types of borrower or certain jurisdictions, in which case they are more appropriately addressed as necessary. Examples of some UK legal developments in this category are described in Part III (Hot Topics).

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.

The background to some current discussion points and hot topics including RFRs and sustainability-linked loans, are covered in some detail in this guide. The discussion includes, where applicable, the LMA's response alongside some thoughts on how the relevant issues are or might be managed in practice. These thoughts are based on the position at the time of writing. Treasurers should seek legal advice with regard to the latest position.

Some examples of provisions commonly added to the Investment Grade Agreements and their typical formulation are highlighted in Part IV (Commentary on the Investment Grade Agreements).

4. 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. A separate user guide has been prepared more recently to explain the compounded rate terms of the RFR Agreements (the **RFR User Guide**).

Among the most heavily used of the slot-in clauses in the investment grade market 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 often 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 over the last decade or so are likely to be familiar with them. The aspects of the Lehman provisions of most interest to borrowers are discussed in Part V (Commentary on the Lehman Provisions).

5. THE LMA LIBRARY

The Investment Grade Agreements, and the broader investment grade documentation suite, are part of a very large library of lending documentation and guidance material 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 of the LMA templates, in part due to the multiplicity of LMA sources from which the provision might originate.

Since the Investment Grade Agreements were first published, the LMA's documentation collection has expanded to cater for loans with many different purposes. The LMA's first documentation project following the publication of the Investment Grade Agreements was focussed on leveraged lending, a busy and developing sector of the European loan market in the early 2000s. A form of facility agreement for senior/mezzanine leveraged acquisition financing (the **Leveraged Agreement**) was published in 2004 and has been updated multiple times since, as the terms applicable to leveraged lending products have evolved. Documentation for real estate financing, private placement transactions, leveraged financing structures involving bonds and many other types of loan transaction followed. There are currently more than 30 forms of English law facility agreement in the LMA library (including the LIBOR Agreements), 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 a number of 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 are used as a clause library from which lawyers are able to build the document that suits their transaction. A facility for a borrower at the lower end of the investment grade spectrum or in the cross-over space for example, might be based on an Investment Grade Agreement supplemented with additional representations and undertakings modelled on those in the Leveraged Agreement.

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. Treasurers should be aware

that the Investment Grade Agreements and the Lehman provisions remain the only documents in the LMA library that carry the ACT's specific endorsement.

6. ACCESS TO LMA DOCUMENTATION

LMA documentation is available to LMA members only, although it can be provided to non-members (for example, by legal advisers or relationship banks) in the course of a transaction. The commentary in this guide has been prepared on the assumption that readers may not be LMA members and so will not have access to the LMA documentation library. Throughout, attempts have been made to summarise the key provisions of the relevant LMA drafting alongside the observations on those provisions.

Some borrowers that use LMA documentation regularly, have joined the LMA, providing them with direct access to LMA documentation and guidance materials, including the LMA's training programme. Further information on LMA membership is available on the [LMA website](#).



PART II
RISK-FREE RATES IN THE
LOAN MARKET

PART II / RISK-FREE RATES IN THE LOAN MARKET

1. ESSENTIAL BACKGROUND

1.1 Transition timetable

The demise of LIBOR has taken place over a protracted period. The UK Financial Conduct Authority (**FCA**) announced its intention to cease to support the production of LIBOR in 2017. The FCA finally confirmed the dates on which all 35 LIBOR rates would either cease to be published or would be considered to “lose representativeness” on 5 March 2021.

This [FCA announcement](#) of 5 March 2021 specified, that after 31 December 2021:

- 24 of the 35 LIBOR rates would cease; and
- 6 further rates, the 1 month, 3 month and 6 month LIBOR rates for GBP and JPY, would become non-representative.

The announcement further states that the 5 remaining LIBOR rates (the overnight/spot next, 1 month, 3 months, 6 month and 12 month rates for USD), will cease or become non-representative on 30 June 2023.

The continued publication of these 5 USD LIBOR tenors is intended to allow more time for the run-off of legacy USD LIBOR contracts. Both the FCA and the US supervisory authorities made clear during 2021 that there should be no new USD LIBOR loans after the end of 2021.

The 6 LIBOR rates that were designated as “non-representative” have been replaced with “synthetic” LIBOR rates. These synthetic rates have been made available for a short period to support the transition of certain “tough legacy” contracts. Synthetic LIBOR and its uses are discussed further at section 5 (Transition Issues) below.

In short, since the end of 2021, LIBOR rates (for any currency) have not been available as reference rates for new lending and refinancing transactions. Loans in GBP, USD, CHF, JPY and euro that would previously have referenced a LIBOR rate, must reference an alternative rate.

1.2 A market-led process

The execution of the regulators' decision that LIBOR should be replaced has been predominantly a market-led effort. National regulators convened working groups made up of market participants and trade associations in each LIBOR currency jurisdiction (the **Working Groups**). Each main Working Group had a network of sub-committees and task forces made up of specialists with a remit to focus on particular products or particular aspects of the transition project (such as systems and infrastructure). These Working Groups and their offshoots took the lead in recommending replacement rates and related calculation conventions and practices.

The Working Groups' recommendations, the product of extensive consultation and industry engagement, have had a material influence on practice, and were strongly backed by regulators. The Bank of England and the FCA, for example, told regulated firms that they were expected to adhere to industry and Working Group transition targets. The FCA also stated that firms were more likely to be able to demonstrate compliance with their regulatory obligations to treat customers fairly in this context if the solutions adopted were those recognised by the relevant Working Groups.

1.3 The role of the LMA and the ACT

The LMA led the development of a recommended approach to the use of RFRs in loans, as chair of the loans sub-committee of the Working Group on Sterling Risk-Free-Rates (**UK RFRWG**). The UK RFRWG was the trailblazer in terms of identifying solutions to address the many difficulties of transitioning LIBOR loans to RFRs.

The LMA also, of course, had to reflect those solutions in its documentation suite. In the syndicated loan market, attainment of the various Working Groups' targets for the cessation of new LIBOR business was heavily dependent on the availability and socialisation of standardised documentation terms. The LMA's RFR Agreements and related documentation, as well as significant volumes of educational material, were produced by a dedicated LMA documentation committee. The LMA's first RFR Agreements were published in Exposure Draft form during 2020. Following a number of adjustments to accommodate agreed conventions and market feedback, the RFR Agreements were released as LMA recommended forms in March 2021. These were

updated again in minor respects in May 2021, when the current forms (on which this guide is based) were published.

The ACT played a leading role in facilitating the transition from LIBOR in the loan market and more broadly. Alongside a small group of treasurers representing larger corporates, the ACT participated in the main UK RFRWG, the loans sub-committee and the LMA documentation working party that produced the RFR Agreements and related documentation. The ACT was also represented on a number of other product sub-committees and task forces (both in the UK and other countries) and held regular co-ordination meetings with the LMA, other financial sector trade associations and with corporates.

2. USING RFRS IN LOANS






2.1 The RFRs

The LIBOR transition project and the Working Groups' efforts were focussed on the pursuit of RFRs as alternatives to LIBOR, in line with the 2014 Financial Stability Board's (**FSB**) recommendations. The first task of each Working Group was therefore to identify an RFR to replace LIBOR.

Some of the RFRs chosen by the Working Groups were well-established rates, for example, the sterling RFR, SONIA. Others, such as SOFR (the USD RFR) and €STR (the euro RFR), were new.

The RFR for each LIBOR currency is set out in the table below, together with details of the national Working Group and links to sources of further information on the composition and operation of the relevant rate.

RISK-FREE RATES /

LIBOR Currency	IBOR/ Administrator	RFR	RFR Administrator	Working Group
	LIBOR / IBA	Sterling Overnight Index Average (SONIA)	Bank of England	Working Group on Sterling Risk-Free Reference Rates
	LIBOR / IBA	Secured Overnight Financing Rate (SOFR)	Federal Reserve Bank of New York (NY FED)	Alternative Reference Rates Committee (ARRC)
	LIBOR / IBA	Euro Short-Term Rate (€STR)	European Central Bank (ECB)	Working Group on Euro Risk-Free Rates
	EURIBOR / EMMI			
	LIBOR / IBA	Swiss Average Rate Overnight (SARON)	SIX Swiss Exchange	National Working Group on Swiss Franc Reference Rates (NWG)
	LIBOR / IBA	Tokyo Overnight Average Rate (TONAR)	Bank of Japan	Cross-industry Committee on JPY Interest Rate Benchmarks
	TIBOR / JBATA			
	EuroYen TIBOR / JBATA			

2.2 Calculation of interest using RFRs

RFRs are quite different to LIBOR. LIBOR is a term interest rate available over a range of maturities. Its aim is to benchmark the inter-bank lending market in the relevant currency over the relevant tenor. RFRs are backward-looking overnight interest rates on a pool of virtually risk-free investments which are compiled to reflect the most appropriate underlying local market, which is different for each currency. RFRs do not embed the same risk or term premium as LIBOR. The Working Groups' identification of an RFR was therefore only the first step in the process of replacing the LIBOR benchmark. The key challenge, was to determine how to calculate interest using those RFRs across a wide range of LIBOR-referencing products, each with different needs.

For loans (and other cash products), the priority was to develop methods for calculating interest over a period based on an overnight RFR, that was workable on a market-wide basis. Initially, there was a strong desire among loan market participants for a forward-looking term rate version of the RFRs. The use of term RFRs, which would be reliant on an underlying reference methodology was not popular with the official sector, whose priority was to ensure that the market transitioned to the most robust rate possible. The focus of the Working Groups was therefore on developing methods for the use of "raw" RFRs, compounded or averaged over a period.

Product-by-product, the Working Groups had to determine how to calculate interest using the RFR. The various national Working Groups were mindful of the need to co-ordinate the approach to LIBOR transition across products and currencies. However, the fact that LIBOR, a benchmark with a single consistent methodology, was being replaced with a menu of single currency rates with differing characteristics, inevitably resulted in variations in terms of applicable conventions, which need to be documented separately. It quickly became clear that complete homogeneity in terms of the drafting and conventions applicable to replacement rates would not be possible in a multi-rate environment, nor across products.

While methods for using "raw" RFRs in loans have been developed for all ex-LIBOR currencies, RFR term rates were eventually made available for certain currencies. These screen rates (using RFR derivatives as a reference) reflect the market's expectation on the future movement of the relevant RFR over a specified period. However, their practical

relevance has been severely curtailed by the official sector in some cases. In particular, views on whether the term rate is considered to be an appropriate reference rate for loans, varies by currency. The rate options for each ex-LIBOR currency are discussed further in section 3 (Risk-free Rates – the options) below.

Another key point the Working Groups had to consider in the context of how to use RFRs, was how to account for the economic difference between LIBOR and the RFR rate in a transparent fashion. As already noted, RFRs are inherently different from LIBOR, in part because RFRs are risk-free (or nearly risk-free), whereas LIBOR includes a credit risk and term premium. In the loan market, this difference has mostly been addressed using a “credit adjustment spread” as a separate element of the pricing for transition purposes. This is discussed further in section 5 (Transition Issues) below.

3. RISK-FREE RATES – THE OPTIONS

3.1 Overview

The rate options for RFR-referencing loans vary by currency, both in terms of the conventions for referencing “raw” RFRs directly and in terms of other rates that are acceptable. For loans in certain currencies it is possible to reference a forward-looking term rate based on the relevant RFR (a published screen rate) rather than referencing the RFR directly.

If the RFR is referenced directly, it will need to be compounded or averaged over the interest period – either on a backward-looking basis, or on what is called a “**last re-set**” basis, using historic rates. For most currencies, compounding is preferred to simple averaging because it more accurately reflects the time value of money.

The rate options in the London-originated/English law loan market are currently as follows:

- ***Sterling***: The market standard is SONIA, calculated on a compounded in arrears basis as recommended by the UK RFRWG. While forward looking term rates based on SONIA are available as screen rates (**Term SONIA**), the authorities have determined that such rates should not be used in syndicated loans or for bilateral loans to larger businesses.

- **USD:** Forward-looking term SOFR screen rates (**Term SOFR**) are available and may be used as reference rates in USD loans (in contrast to sterling loans, where, as noted above, Term SONIA is not an option). In the US, the emerging preference appears to be for Term SOFR rather than simple average SOFR or compounded in arrears SOFR. In London-originated/English law USD facilities, a standard position is yet to develop. Both compounded in arrears SOFR and Term SOFR are being used. There are further rate options for USD loans (see section 3.4 (USD loans) below), but they are not being widely used.
- **Euro:** EURIBOR remains the market standard given the authorities' decision to support its continuing publication. As EURIBOR can continue to be used, there appears limited appetite so far for transitioning euro facilities to an €STR rate. Conventions for referencing €STR as a primary benchmark in loans have not yet been finalised (see section 4 (Conventions for referencing RFRs) below), which may also be a contributing factor.
- **CHF:** The rate recommended by the Swiss Working Group for loans is SARON compounded in arrears or used on a "last re-set" basis. SARON compounded in arrears is the market standard in the London-originated/English law loan market. No SARON term rate has been published nor is one anticipated. This is due to insufficient depth of liquidity in SARON-referencing derivatives.
- **JPY:** Most JPY loans in the London-originated/English law loan market appear to have transitioned to TONAR compounded in arrears, although other options are available. These include TONAR compounded on a last re-set (historic) basis, TORF (the forward looking term rate derived from TONAR) and TIBOR which continues to be published.

The remainder of this section 3 considers the factors borrowers might take into account in selecting the appropriate rate option (where there is a choice), and some further background to the rate options for Sterling, USD and euro summarised above.

3.2 Choosing a rate (where a choice is available)

The difference in rate options by currency means multi-currency borrowers have choices to make. The most appropriate rate from the

borrower's point of view may be influenced by a number of factors. These include:

- **Operational considerations:** For many multi-currency borrowers, LIBOR transition has been a phased process. The operational adjustments that have been made to accommodate the first currencies transitioned, may therefore influence that borrower's approach to RFRs for subsequent currencies. Borrowers who have adapted to borrowings referencing compounded in arrears SONIA or SARON, for example, may prefer to use compounded in arrears RFRs for their USD facilities too. USD-only borrowers, in contrast, might choose to prioritise the convenience of Term SOFR. In certain sectors of the market, a backwards-looking methodology may simply be unworkable. Concerns about the ability to make timely payments using a backward-looking rate have been raised, for example, in transactions involving borrowers in developing markets. This is the reason why the LMA's first Term SOFR agreement (still in Exposure Draft form at the time of writing), was an iteration of one of its facility agreement templates for developing markets borrowers.
- **Availability of documentation terms:** The availability of standardised documentation terms has been an important catalyst for transition to particular rate options (alongside the availability of systems updates) for the ex-LIBOR currencies. The RFR Agreements reference compounded in arrears RFRs and EURIBOR. LMA forms of facility agreement referencing Term SOFR are work in progress, but have not yet been finalised as recommended forms (see section 6 (Documentation) below).
- **Hedging requirements:** The availability of hedging and hedge accounting considerations may influence the choice of rate. ISDA has developed documentation terms for a wide range of rate options, but certain rate options may be commercially less attractive and more challenging to hedge. More specifically, as compounded in arrears RFRs are the standard in the derivatives market, Term SOFR hedging (or indeed term rate hedging for any other term rate based on an RFR) may be more challenging and/or expensive to procure.

The borrowers' choice of rate (and choice of fallback rate) may also be affected by the policies and views of the lending banks, which may in

turn be influenced by their own operational constraints. As discussed further below, this is most evident in relation to USD facilities.

3.3 Sterling loans

The UK RFRWG's recommendation for sterling loans was that, in the majority of cases, LIBOR should be replaced by SONIA compounded in arrears:

“Overnight SONIA, compounded in arrears, will and should become the norm in most derivatives, bonds, and bilateral and syndicated loan markets given the benefits of the consistent use of benchmarks across markets and the robust nature of overnight SONIA. The future use of a forward-looking term rate in cash markets should be more limited than the current use of LIBOR. So, where possible, counterparties are encouraged to transition to overnight SONIA compounded in arrears.” ([Report of the UK RFRWG Use Case Task Force](#))

This recommendation, as already noted, was aimed at ensuring the market transitioned to the most robust rate possible. An additional consideration was the benefits of aligning the cash markets (loans and bonds) with the derivatives market (in terms of the availability of hedging), which had already selected compounded in arrears SONIA as the replacement for sterling LIBOR.

As noted above, Term SONIA rates have been developed and are published by Refinitiv and ICE Benchmark Administration. Both administrators are publishing 1-month, 3-month, 6-month and 12-month tenors. Both sets of rates are based on a “waterfall methodology”, although methodological differences mean that the rates published by each administrator can be marginally different.

Term SONIA is of limited practical significance to loan market participants. In a January 2020 paper [Use Cases of Benchmark Rates: Compounded in Arrears, Term Rate and Further Alternatives](#), the UK RFRWG acknowledged term SONIA as an appropriate option where operational necessity precludes the use of a compounded in arrears RFR or another alternative rate, but noted that those instances are very limited. As a result, while forward-looking term rates are an option for certain other ex-LIBOR currencies, Term SONIA is not being used in syndicated loans nor in bilateral loans to larger businesses.

Transactions where there is a use case for Term SONIA include those for smaller corporate, wealth and retail clients for whom simplicity and/or payment certainty is a key factor. In addition, the UK RFRWG noted

some products where the use of SONIA compounded in arrears would likely create operational difficulty regardless of the sophistication of the borrower. These include trade and working capital products such as supply chain finance and receivable facilities, export finance and developing market loans, and Islamic facilities. In such cases, although fixed rates or the Bank of England's Bank Rate may be used, the UK RFRWG acknowledged that there may be instances where a forward-looking term rate is the appropriate choice.

3.4 USD loans

The USD market has been provided with a wider range of RFR options for replacing LIBOR. These include Term SOFR, simple average SOFR, compounded in arrears SOFR and last re-set SOFR. In addition, certain "credit-sensitive" rates such as the [Bloomberg Short-Term Bank Yield Index \(BSBY\)](#) have been published by commercial providers and the Fed publishes [SOFR averages](#) for certain periods. The Loan Syndications and Trading Associations ([LSTA](#)), the LMA's sister organisation in the US, has produced forms of New York law loan agreement catering for a number (although not all) of these options.

The ARRC's focus, like the other Working Groups has been on the promotion of "raw" RFRs. However, it has also recognised a use case for Term SOFR in loans. The ARRC's [best practice recommendation](#) on this topic states that while as a "general principle", market participants should use overnight SOFR and the SOFR averages "given their robustness" and also "where a party wishes to hedge in the most efficient manner", it supports the use of Term SOFR in loans, including syndicated facilities:

"The ARRC supports the use of SOFR Term Rate in addition to other forms of SOFR for business loan activity - particularly multi-lender facilities, middle market loans, and trade finance loans - where transitioning from LIBOR to an overnight rate has been difficult and where use of a term rate could be helpful in addressing such difficulties."

Early adopters of SOFR in the US loan market appeared to favour simple SOFR, whereby the daily SOFR rate is multiplied by the outstanding principal of the loan. This was apparently due to simple interest being operationally easier to implement (notwithstanding that the sterling market had mostly already adapted to SONIA compounded in arrears). However, once Term SOFR became available and the ARRC announced its support for its use, Term SOFR emerged as the popular rate choice for New York law syndicated and bilateral business loans.

While the loan market in the US appears to prefer Term SOFR as the primary reference rate, simple daily SOFR remains relevant as a fallback for Term SOFR (and is an option in the LSTA's fallback drafting).

These developments in the US/New York law loan market led to some uncertainty for USD borrowers in the London/English law market. The initial uncertainty was whether Term SOFR was an option at all for London-originated loans, given the UK authorities' view that Term SONIA should not be used in sterling loans. The UK authorities subsequently expressed the view that the ARRC's recommended best practices for Term SOFR are relevant to USD business in London, confirming that Term SOFR is equally an option for the London loan market². The current question for USD borrowers is whether Term SOFR is preferable to the alternatives – compounded in arrears SOFR or, indeed daily simple SOFR³. There is no right or wrong answer here. The factors to be taken into account include those outlined at section 3.2 (Choosing a rate (where a choice is available)) above. Issues to consider in relation to the terms applicable to Term SOFR loans are discussed at section 6 (Documentation) below.

3.5 Euro loans

Euro loan facilities have historically referenced EURIBOR in preference to euro LIBOR. Treasurers will be aware that the EU authorities decided some time ago to reform, rather than discontinue, EURIBOR. Therefore so far, there has been no need to transition euro facilities from EURIBOR to an €STR rate.

As the loan market becomes more familiar with using RFRs, it could be that the euro loan market moves to €STR. To date, there appears limited appetite on either the lender or the borrower side for €STR compounded in arrears (or indeed, if permitted, the Term €STR rates that are in development). The expectation is that the market for €STR referencing loans and other products will develop over a longer timeframe.

² See [minutes of the UKRFRWG meeting of 15 September 2021](#).

³ UK regulators are strongly discouraging the use of BSBY and other credit sensitive rates so neither these, nor simple SOFR/SOFR averages are a feature of the London/English law loan market.

€STR may be considered as a fallback rate for EURIBOR. In May 2021, the Euro Working Group recommended [€STR-based fallbacks for EURIBOR](#), to cater for a future scenario in which EURIBOR may permanently cease. They suggest that parties to corporate lending arrangements might consider either:

- a backward-looking €STR rate; or
- a two-level waterfall comprising a forward-looking methodology, or if not available, a backward looking €STR rate,

as fallback rates in EURIBOR-referencing loans.

These fallback recommendations have not been incorporated into the RFR Agreements should EURIBOR be temporarily unavailable. This is because the Euro Working Group's recommendations are formulated for a permanent cessation of EURIBOR. Further, a forward-looking Term €STR rate is yet to be developed. The notes to the RFR Agreements do, however, reference the existence of these recommendations, in case users wish to consider incorporating them.

The RFR Agreements contain optional reference rate terms for loans referencing €STR compounded in arrears, which could be used as a starting point for €STR-based fallbacks or to apply a “rate switch” to EURIBOR loans. Rate switch provisions can be used to cater for a scenario where EURIBOR ceases to be published. Pursuant to these provisions, loans in euro will switch from referencing EURIBOR to referencing €STR automatically upon the occurrence of specified triggers.

Neither the use of €STR-based fallbacks nor the application of rate switch provisions to euro loans appears to be particularly widespread at the time of writing, certainly in multi-currency facilities. Rate switch provisions are discussed further at section 5 (Transition Issues) below and under Clause 9A (*Rate Switch*) in Part IV.

As noted above, euro LIBOR was rarely used in loans. However, the overnight euro LIBOR rate and EONIA were used to price swingline facilities. Both euro LIBOR and EONIA have ceased, meaning euro swingline facilities should by now, have transitioned to €STR.

4. CONVENTIONS FOR REFERENCING RFRS

4.1 Sterling loan conventions

The options for calculating SONIA compounded in arrears in loans were analysed by the UK RFRWG and market participants in some detail during 2020. The UK RFRWG's [Recommendations for SONIA Loan Market Conventions](#) (the **Sterling Loan Conventions**) were published in September 2020. These conventions are further explained in the UK RFRWG's [Best Practice Guide for GBP Loans](#), last updated in March 2021. The Best Practice Guide contains links to the key UK RFRWG's documentation for loan market participants, including [Supporting Slides](#) and [worked examples](#) of the application of the conventions. These documents are essential reading for sterling borrowers.

In summary, the Sterling Loan Conventions recommend the use of a **non-cumulative compounded** daily SONIA rate for loans, with a five banking day **lookback period** and **no observation shift** (although an **observation shift** is also a valid option). Any **interest rate floor should be calculated daily**. These concepts are explained in the sections that follow.

The Sterling Loan Conventions differ in some respects to the conventions applicable to the use of SONIA compounded in arrears in other sterling products such as bonds and, importantly, derivatives. There are differences, for example, between the Sterling Loan Conventions and the conventions applicable under ISDA's IBOR fallbacks documentation. There are also differences between the Sterling Loan Conventions and the conventions recommended by other of the Working Groups for loans and other products in the relevant currency. These differences are discussed at section 4.6 (Conventions applicable to other ex-LIBOR currencies) below.

4.2 Non-cumulative daily compounding

There are a choice of approaches to the calculation of compounded rate interest on loans. The additional amount of interest owed each day can be calculated either by applying the daily RFR to the balance of the loan or to the rate itself:

- **Compounding the balance:** The daily RFR is multiplied by the outstanding principal and unpaid accrued interest (collectively, the balance).
- **Compounding the rate:** The rate itself is compounded and multiplied by the outstanding principal.

If the second option is chosen, there are two approaches to compounding the rate:

- **Cumulative compounded rate (CCR):** The compounded rate is calculated at the end of the interest period and that rate is then applied to the whole period. This method allows interest for the whole period to be calculated using a single compounded rate.
- **Non-cumulative compounded rate (NCCR):** This rate is derived from the CCR. The NCCR for a given day is the CCR for that day minus the CCR for the previous day. This generates a daily compounded rate which allows the calculation of a daily interest amount. These daily interest amounts are added up to provide a rate over the required period, enabling accurate calculation of accrued interest at any point in time.

ISDA uses the CCR method in its IBOR fallbacks for derivatives. The CCR method is also used in capital markets products. The Sterling Loan Conventions however, recommend the NCCR method for loans, because it better supports intra-period events such as prepayments and trading.

The RFR Agreements apply an NCCR formula to the calculation of interest in line with the Sterling Loan Conventions. However, a CCR formula also features, although it is included only for limited purposes. The use of the NCCR and CCR in the RFR Agreements is discussed in the comments at Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*) in Part IV.

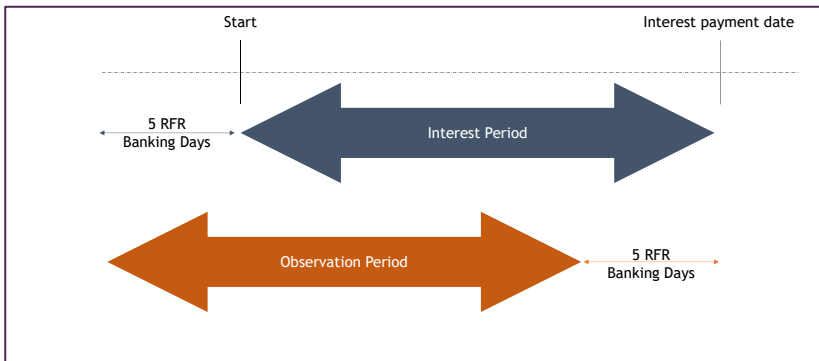
4.3 Lookback period

RFRs are backward-looking overnight rates, so the daily RFR will be available only at the end of the day to which it relates or the beginning of the next day. If the interest payable for a given interest period is calculated based on the RFRs observed each day during the interest period, the total interest payable will only be known with precision at the end of that interest period or just after.

The parties to a loan facility will need to determine the amount of interest payable some period in advance of the end of the interest period if they are to mobilise payments within the required settlement time. The solution that has been developed to deal with this is known as the “lookback”.

The lookback involves observing the RFRs each day over an “observation period” which starts and ends a certain number of days prior to the start and the end of the interest period. Interest is payable on the basis of the rates compounded over the observation period, meaning interest payable will be determinable before the end of the interest period.

The Sterling Loan Conventions recommend a five banking day lookback period for loans referencing SONIA compounded in arrears, although both the conventions and the RFR Agreements recognise that there may be instances where a shorter or longer lookback period is necessary or desirable. Further discussion can be found in the comments at Schedule 13 (*Reference Rate Terms*) in Part IV.



4.4 Observation shift

When compounding a rate over a period, the rate applied on days on which the rate is not published (for example, weekends and bank holidays) will be the rate for the preceding business day. The rate is not compounded on the non-business day. Instead, the RFR for the preceding business day is weighted more than once in the compounding calculation. The RFR for a Friday, for example, when the next business

day is the following Monday, will have a weighting of three days in the compounding calculation to account for the fact that it is used for the Friday, Saturday and Sunday.

If the lookback convention is adopted such that interest is calculated over an observation period that is different from the interest period, there is a question as to how the weighting is derived - namely, whether to adopt the “observation shift” convention or not:

- The observation shift convention (**shift** or **lookback with observation shift**) weights the rate according to the number of calendar days in the observation period rather than the number of calendar days in the interest period. In other words, the daily rates are weighted according to where they fall in the observation period, rather than the interest period.
- The lookback without observation shift convention (also known as **observation lag**) weights the rate according to the number of calendar days in the interest period to which the calculation is relevant.

The difference between the two approaches is best illustrated by example. The UK RFRWG’s [Supporting Slides](#) containing the detailed loan conventions are helpful here.

The Sterling Loan Conventions recommend the adoption of a five banking day lookback *without* observation shift as the preferred option for sterling loans. The Sterling Loan Conventions do, however, recognise that a lookback with observation shift can be a viable and robust alternative. The observation shift might be required, for example, to align payments of interest under the loan with related hedging. The concept of an observation shift is used in RFR-linked derivatives. The RFR Agreements cater for both options.

4.5 Interest rate floors

Whether or not a zero floor should apply to LIBOR, EURIBOR and other benchmark rates has been a live issue in the debt markets for a number of years, as certain rates, for a period, fell into negative territory. It has become fairly common in the loan market for reference rates to be floored at zero. The objective of such provisions is to prevent the Margin from being eroded if the relevant reference rate dips below zero. In some sectors of the market, positive floors may apply to reference rates.

In LIBOR and EURIBOR loans, if a zero (or other) floor is agreed to apply, it is applied to the benchmark for the relevant period.

The rise in interest rates more recently has made the debate about whether a zero floor should apply to most benchmarks, somewhat redundant as a commercial point. However, floor conventions needed to be developed for RFR-referencing loans, in case negative rates become relevant in the future, as well as for cases where a positive rate floor is to apply.

In the context of compounded in arrears RFRs, the Working Parties debated how to build interest rate floors into the calculation. As the RFRs are daily rates, there is a choice: either the floor can be applied to each daily RFR rate when fed into the compounding calculation or, alternatively, the floor can be applied to the final compounded RFR rate for the period. The Sterling Loan Conventions recommend that, where a floor applies, it should be calculated daily rather than at the end of an interest period. In other words, the applicable interest rate floor is applied to each daily RFR before compounding. This approach was selected because loans accrue interest daily. From the lenders' perspective, it is useful to have daily interest amounts that reconcile to the total interest due for prepayments and interest accounting accruals.

In the context of transitioning legacy LIBOR deals, there is a commercial point to be considered in relation to the application of any floor, daily or otherwise. If a RFR is floored at zero, when previous practice was to floor the LIBOR rate (which includes a credit premium) at zero, this could have a potentially adverse impact on the borrower should negative rates apply (as the floor is applied to a lower rate than previously). The Sterling Loan Conventions acknowledge this, recommending in relation to legacy contracts, that any zero floor should be applied to the aggregate of SONIA and any credit adjustment spread (**CAS**, discussed at section 5 (Transition Issues) below). If the aggregate of SONIA and any CAS is less than the applicable floor, in the compounding calculation, the SONIA rate (rather than the CAS) is then adjusted to ensure that the aggregate of the SONIA rate and the CAS is floored at the applicable rate (e.g. zero). However, it is also recognised that some may prefer to adjust the CAS.

The approach taken to these points in the RFR Agreements is discussed in the comments at Schedule 13 (*Reference Rate Terms*) in Part IV.

4.6 Conventions applicable to other ex-LIBOR currencies

Conventions for referencing RFRs in loans have been separately developed for other ex-LIBOR currencies. The ARRC, the Swiss Working Group and the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks have published conventions for referencing SOFR, SARON and TONAR, respectively.

The Working Group on Euro Risk-Free Rates' recommendations on conventions for using a backward-looking €STR methodology as a fallback rate are set out in its recommendations for [€STR-based fallbacks for EURIBOR](#).

The differences between the headline conventions by currency for referencing the RFR directly⁴ are set out in the table below. The table also notes, for comparison purposes, the conventions used for compounding RFRs in the derivatives market and reflected in the ISDA IBOR fallbacks (discussed further in section 7 (Hedging Considerations) below).

As is apparent from the table, the national Working Groups have different views on the application of the observation shift convention, although a number recognise that the alternative approach to that recommended remains a viable option in certain circumstances.

Recommendations for a lookback with observation shift seem to be based on the fact that this approach is consistent with that being taken by ISDA to fallbacks for derivatives as well as other cash products in the relevant currency. The recommendation of the UK RFRWG for a lookback without observation shift in the loans context was driven in part by a preference for consistency with the US recommendations for loans.

⁴ Note that different conventions may be applied to rates based on RFRs. For example, the ARRC has published [Conventions for referencing Term SOFR and the SOFR Averages](#) in loans for the US market.

CONVENTIONS BY CURRENCY/

	Source	RFR	Observation shift	Lookback	Floors
Sterling	Sterling Loan Conventions	SONIA compounded in arrears	No (or shift if preferred)	5 banking days	Daily floor
USD	SOFR syndicated loan conventions SOFR bilateral loan conventions	Simple daily SOFR or SOFR compounded in arrears	No	No recommendation	Daily floor
Euro	€STR-based fallbacks for EURIBOR	€STR compounded in arrears (or simple daily €STR if preferred)	Yes (or no shift if preferred)	No recommendation	Apply floor at end of period (or daily floor if preferred)
CHF	Minutes of 29.09.20 meeting of Swiss Working Group	SARON compounded in arrears	Yes (or no shift if preferred)	5 Business Days	Apply floor at end of period (or daily floor if preferred)
JPY	TONA (Fixing in arrears) conventions for loans	TONAR compounded in arrears (or simple daily TONAR if preferred)	No (or shift if preferred)	5 Business Days	No recommendation
ISDA IBOR Fallbacks	ISDA IBOR Fallbacks	RFR compounded in arrears	Yes	2 banking days	Apply floor at end of period typically

4.7 RFR calculations and data sources

The production of a screen rate data source is challenging because the calculation of a RFR compounded in arrears requires an RFR for each day in the period. There is therefore, no definitive “screen rate” source for compounded in arrears RFRs that is suitable for cross-referencing in the loan market. Rather than identifying the rate by reference to a screen page, the LMA’s RFR Agreements document the rate calculation

formulae and conventions. Calculations of interest are effected by the Agent and other parties based on the terms of the agreement.

Treasurers should be aware that RFR calculators are available to assist with this, which are currently free to access. The [UK RFRWG's guidance note](#) explains and compares the available resources and the conventions they take into account.

While they are not being used in loan documentation, treasurers should be aware that on screen index tools exist to assist with compounded rate calculations. These compounded indices comprise a series of daily data that represents the returns from a rolling unit of investment earning compounded interest at the RFR each day. The change in the index between any two dates can be used to derive a compounded rate for a chosen period.

Official sector indices include:

- The Bank of England's [SONIA Compounded Index](#).
- The New York Fed's [Index for Compounded SOFR](#).
- The ECB's [Compounded Index based on €STR](#).

The shortcoming of these indices (in general terms) is broadly that they may not adopt a calculation methodology that is consistent with the desired conventions for the use of compounded RFRs in loans. For example, the SONIA Compounded Index adopts the observation shift convention; if that is not adopted, the index will not be suitable. Similarly, the use of benchmark floors, which are common in the loan market, inhibit the use of the indices if rates are negative. This is a key reason why the RFR Agreements, which reflect the Sterling Loan Conventions, do not contemplate the use of any compounded RFR index.

In addition to the indices, official sector compounded averages are also available for some currencies. For example:

- The Fed publishes 30 day, 90 day and 180 day [compounded SOFR averages](#).
- The ECB publishes [average compounded €STR rates](#) (1 week, 1 month, 3 months, 6 months and 12 months).

The Bank of England does not produce such averages for SONIA. It consulted in early 2020 on whether to produce SONIA period averages

(compounded SONIA rates calculated over a series of set time periods) and, if so, whether there was market consensus on the relevant time periods. The conclusion, at that point, was not to produce averages given a lack of consensus on their utility and the appropriate methodologies.

These compounded average rates are based on historic data. In other words, the rates, when published, are for a period just ended. They are not useful for loans referencing backward-looking RFRs for that reason alone, although may be useful for other purposes where rates over fixed periods can be used. The ARRC, for example, has recommended the use of the SOFR compounded averages for [intra-group loans](#).

Certain private sector providers and financial institutions have developed compounded RFR indices that are compatible with loan market conventions for referencing compounded in arrears RFRs. For example, in March 2021, ICE Benchmark Administration Limited launched a set of ICE SONIA Indexes. These indices operate in a similar way to the Bank of England's SONIA Compounded Index, but seek to support the varying needs of the sterling lending market by providing optionality in terms of the use of an observation shift or not, the length of the lookback period (if any) and the incorporation of a zero floor. The fact that the indices address a range of different conventions, in theory, makes them much better suited to use across the sterling loan market. There is no evidence so far, however, of take up of these amongst loan market participants as a documentation short-cut.

The advantage of the official sector indices and compounded averages as compared to certain tools developed by the private sector is, of course, that data is likely always to be freely available. Potentially, therefore, these would be good reference points for corporates for certain purposes, for example, intra-group transactions, enabling a reduction in the calculations to be performed. The availability of freely available indices, averages or rate calculators that are compatible with loan market conventions might be revisited as the market matures.

5. TRANSITION ISSUES

5.1 Continuing relevance of transition tools

A key focus in the earlier stages of transition project, was on developing mechanisms that could be built into LIBOR documentation to facilitate

the transition from LIBOR when the time was right, commercially, operationally and in accordance with the timetable set by the regulators.

As corporate loans were amended to cater for the replacement of LIBOR, some facilities moved directly to RFR terms (so-called **active transition**) in advance of cessation deadlines. However, in many cases, provisions were added to LIBOR loans that paved the way for RFRs, in the form of either a **replacement of benchmark** clause, or a **rate switch** mechanism. A replacement of benchmark clause enables the applicable benchmark to be replaced with an alternative, and related amendments to be made to the Agreement (in most cases) with Majority Lender consent. A rate-switch mechanism provides for the automatic implementation of an alternative benchmark, upon the occurrence of specified events. A rate switch agreement contains full LIBOR terms, and full RFR terms, the latter replacing the former upon the occurrence of the applicable trigger events.

Most legacy LIBOR loans which have been transitioned to RFRs, whether consensually via an amendment process, or automatically via a rate-switch, adopt a three-part pricing structure. This is designed to accommodate in a transparent manner the difference between the LIBOR rate and the RFR that replaced it. Interest on legacy LIBOR loans mostly comprises the RFR compounded in arrears, the Margin and a credit adjustment spread or “CAS”. The CAS represents the difference between the RFR and LIBOR, and the aim is to ensure that the transition is economically neutral for both the borrower and the lenders.

While the majority of legacy LIBOR loans (other than those in USD) were transitioned prior to the end of 2021, the concepts and techniques developed to facilitate widespread transition have continuing relevance to lending documentation. This is for a number of reasons:

- the LIBOR transition project is not quite finished (with many USD LIBOR loans still to be amended);
- projects are underway around the world to facilitate the transition from other major IBOR rates to RFRs, which, as they are finalised, are likely to prompt a further wave of amendments (see further section 8 (Beyond LIBOR) below); and
- the desirability of making sure that all loans referencing a floating benchmark are better “future-proofed” than the LIBOR generation, in

case another major transition requirement should arise at some point in the future.

The RFR Agreements therefore contain optional replacement of benchmark provisions, rate switch provisions and CAS concepts based on the tools developed for the purposes of LIBOR transition. The operation of these provisions is explained briefly below. The drafting in the RFR Agreements is discussed further in the relevant sections of Part IV (Commentary on the Investment Grade Agreements).

5.2 Transition trigger events

The triggers for a transition process – whether a rate switch process that enables the automatic replacement of the existing benchmark with a replacement on pre-agreed terms, or an amendment mechanism, that provides the basis on which the parties will agree on a replacement – must be both comprehensive and clearly defined. In most cases, the triggers will extend beyond the cessation of the relevant benchmark. They will also cater for circumstances where the relevant benchmark exists, but is unusable, where it can no longer fulfil its purpose or perhaps where the benchmark is simply (in the view of the lenders and the borrower), “inappropriate”.

During the LIBOR transition process, there were concerns that as the cessation deadlines drew closer, the rate would become “**un-representative**” – in other words, it would become distorted such that it ceased to be representative of the market it was supposed to represent. This is why the FCA agreed that it would give the market advance guidance of the dates on which LIBOR would either cease, or cease (in the eyes of the regulator) to be representative. The FCA’s [announcement of 5 March 2021](#) confirmed the dates on which each of the 35 LIBOR rates would either cease to be published, or would be considered to “**lose representativeness**” (i.e. considered by the FCA to have ceased to be representative of the market or economic reality the rate is supposed to represent in circumstances where that representativeness will not be restored). Certainty that the FCA would make this announcement allowed contracting parties to include so-called “**pre-cessation**” triggers in contractual benchmark transition measures – enabling the transition process to start in advance of the LIBOR cessation deadlines.

The LIBOR fallback drafting used in loans, bonds and derivatives all featured pre-cessation and cessation triggers. These triggers have been

carried through to the RFR Agreements, featuring in the optional rate switch provisions as well in the amendments and waivers provision catering for any future benchmark transition event. See comments at Clause 9A (*Rate Switch*) and Clause 35.4 (*Changes to reference rates*) in Part IV.

The FCA's pre-cessation announcement, in addition to triggering fallback provisions, rate switch provisions and replacement of benchmark processes in loans and other contracts, has regulatory significance. If a rate such as LIBOR loses representativeness, regulated financial institutions are prevented from using it in many contexts by the UK and EU regulatory framework that govern the use of important benchmarks (the UK Benchmark Regulation and the EU Benchmark Regulation respectively). For all practical purposes, this means that if a LIBOR rate becomes non-representative, the consequences are no different to those applicable had it ceased.

The FCA's formal announcement that certain LIBOR rates would lose representativeness on a particular date also paved the way for the FCA to take steps under the UK Benchmark Regulation to replace the non-representative rate with a synthetic LIBOR rate. Synthetic LIBOR and its use is discussed at section 5.6 ("Tough legacy" contracts) below.

5.3 Three-part pricing

As already noted, RFRs are inherently different from LIBOR, in part because RFRs are risk-free or nearly risk-free whereas LIBOR includes a credit risk premium. This means that there is an economic difference between the two that needs to be accounted for in the pricing of a loan if economic neutrality is to be preserved for both lenders and borrower on the transition from LIBOR to the RFR.

There are two ways of incorporating this economic difference into the pricing of a loan:

- increase the Margin, so that the loan is priced at the compounded RFR + increased Margin; or
- maintain the LIBOR Margin and add a separate CAS to the interest calculation so that the loan is priced at the compounded RFR + CAS + Margin.

Whether to maintain two-part pricing or to use a separate CAS, and adopt three-part pricing is largely a presentational issue. Three-part

pricing has been widely used for the purposes of transitioning legacy LIBOR deals to RFRs. Expectations are that three-part pricing will continue to be used as the remaining USD legacy LIBOR loans are transitioned to SOFR and in the context of transition from other IBORs to RFRs.

During 2021, many new RFR-linked facilities adopted three-part pricing. As the market has become more familiar with loans referencing RFRs, two-part pricing appears to have become the more common approach. However, some RFR-linked facilities choose to retain the three-part pricing structure. This is largely a matter of preference but may also be a by-product of the secondary implications of an increased Margin. For example, an increased Margin may have an impact on the amount of commitment fees and any margin ratchets – and may be relevant to the operation of the market disruption clause (if retained).

Where two-part pricing is applied to the loan from Day 1, a CAS may nonetheless feature in fallback or rate-switch provisions. The RFR Agreements contain three concepts of CAS:

- **“Baseline CAS”** - which applies if it is agreed to apply three-part pricing to a loan referencing a RFR from Day 1.
- **“Rate Switch CAS”** – this may be a component of the pricing applicable to a loan after a Rate Switch Trigger Event has occurred. In other words, if loans in a currency reference an IBOR on Day 1 and that currency is designated as a Rate Switch Currency, so will convert to RFR pricing on the occurrence of a pre-agreed trigger, the post-switch pricing will be three part. For example, it might be agreed that a EURIBOR loan will, upon the occurrence of the specified triggers, switch to €STR compounded in arrears plus the Rate Switch CAS.
- **“Fallback CAS”** - the Fallback CAS may be a component of the pricing of a currency that references an IBOR on Day 1, but is subject to RFR-based fallbacks. For example, if EURIBOR is unavailable, the parties may agree that the fallback is €STR compounded in arrears plus the Fallback CAS.

Unlike the Baseline CAS which is presented as optional, the Rate Switch CAS and the Fallback CAS are both assumed to apply as a means of addressing the economic difference between the relevant IBOR and compounded RFR on a shift from one to the other. Note that while the

RFR Agreements incorporate a framework for these CAS provisions, they do not specify how any of the CAS numbers should be calculated.

The rate switch and fallback provisions of the RFR Agreements, including the appropriate CAS, are discussed further at Clause 9A (*Rate Switch*), Clause 11.1 (*Interest Calculation if no Primary Term Rate*) and Schedule 13 (*Reference Rate Terms*) in Part IV.

5.4 How is the CAS calculated?

For the purposes of transitioning legacy LIBOR contracts, the UK RFRWG recommended the use of a CAS based on the historic median between LIBOR and the relevant RFR over a five-year lookback period from an agreed date (the **5YHLB**). This recommendation was driven by a preference for consistency across products. The 5YHLB was also selected by ISDA for the purposes of transitioning LIBOR derivatives to RFRs (see section 7 (Hedging Considerations) below).

ISDA appointed Bloomberg Index Services Limited (**BISL**) to publish the fallback rates and CAS for use in derivatives being transitioned from LIBOR. Bloomberg began to publish the adjusted RFR (compounded in arrears), the CAS (based on the 5YHLB) and the “all in” fallback rate (being the adjusted RFR + CAS) for all LIBOR currencies and tenors, on an indicative basis, in July 2020. On 5 March 2021, when the FCA announced the dates on which LIBOR rates either cease or lose representativeness, the BISL CAS was fixed for all LIBOR currency-tenor pairs. The **BISL CAS** rates, fixed as of 5 March, are set out in [Bloomberg’s technical announcement](#).

While the BISL rates, including the BISL CAS, were made available for the purposes of ISDA’s IBOR transition arrangements for derivatives, the UK RFRWG’s recommendation of the 5YHLB approach meant that in many cases, parties transitioning legacy loans used the BISL CAS, taking the applicable numbers from the [Bloomberg’s technical announcement](#).

The BISL CAS was not, however adopted in all cases. Where the CAS was negotiated by borrowers, it was normally because the relevant BISL CAS (which is a fixed number) was higher than the relevant LIBOR/RFR spread at the point the loan in question was being transitioned. In such cases, some borrowers chose to use the 5YHLB method, but with the amount calculated on the transition date. These borrowers specified the methodology to be applied to calculate the CAS at the time of transition.

Other borrowers simply agreed a fixed number for the CAS which was more reflective of the position at the relevant time. Some borrowers adopted a “forward approach” to the calculation of the CAS (which was acknowledged by the UK RFRWG as a valid option). The forward approach references the forward-looking basis swap market. It involves using forward-looking basis swaps to calculate the implied future spread between the relevant RFR and LIBOR over the life of the loan. It is calculated using linear interpolation between differing tenors of LIBOR swaps and RFR swaps.

The differences between the 5YHLB and the forward approaches are explored in the UK RFRWG’s December 2020 paper [Credit adjustment spread methods for active transition of GBP LIBOR referencing loans](#), which includes a number of worked examples.

For the purposes of transition from USD LIBOR and the US **tough legacy** legislation (see section 5.6 (“Tough legacy” contracts) below), the ARRC has mandated Refinitiv, to publish a spread adjusted rate for SOFR compounded in arrears, simple SOFR and Term SOFR. These spread adjusted rates use the BISL CAS as the spread adjustment (regardless of which SOFR rate option applies)⁵. However, this does not mean that parties are not free to agree alternative approaches where appropriate (in the US or otherwise).

In practice, whether or not to use the BISL CAS numbers for the purposes of transitioning from USD LIBOR remains a live issue. During the first half of 2022, it seemed that in many cases, the BISL CAS was not being used for the purposes of transitioning USD LIBOR loans, because for most tenors, USD LIBOR was lower than SOFR plus the BISL CAS. To use the BISL CAS would therefore result in the borrower paying more in interest for the SOFR loan, than under the original USD LIBOR loan. In the US market, we understand that during this period, the CAS was instead typically set at a negotiated rate – either a single blended rate (e.g. 10bps), or rates by tenor – to provide a more accurate representation of the spread. Treasurers with USD LIBOR loans that are yet to transition to RFR are advised to investigate the latest position at the time of transition.

⁵ See the [ARRC’s summary of fallback recommendations of October 6 2021](#).

5.5 Should the parties specify a methodology or a fixed CAS?

If a CAS is to be included, the parties will need either to specify the methodology to be used to calculate it in the agreement, or if it is to be a fixed amount, insert the agreed percentage amount (or number of basis points).

In loans referencing a RFR from the outset (as opposed to LIBOR deals in which a rate switch mechanism was inserted), a fixed CAS, either a number of basis points or by reference to the BISL CAS seemed to be the more common approach during the LIBOR transition period. This was, of course, in deals where a separate CAS was included, which was not always the case.

If a fixed CAS applies, there may be a question as to whether it should vary according to the length of the Interest Period applicable to the relevant loan. The BISL CAS rates illustrate that spreads can be different across Interest Periods. Some borrowers may prefer a single or blended CAS that applies across all tenors.

If the parties prefer to specify a methodology rather than a fixed CAS, the Agent will need to be willing to make those calculations. An additional point to consider if a methodology is specified, is whether a zero or other benchmark floor should apply.

5.6 “Tough legacy” contracts

What is “tough legacy”?

LIBOR-referencing instruments which were impossible to transition became known during the transition project as **tough legacy** instruments. The tough legacy problem, and whether it would be addressed by legislative means, was debated to a fairly late stage in the LIBOR transition process. This was in part because of the complexity of legislating in this area, but also because the official sector wanted as few LIBOR-referencing instruments as possible to fall into the tough legacy category. There was concern that the transition process might decelerate if the market believed a safety net would be available.

In the UK and elsewhere, legislation designed to mitigate the impact of the cessation of LIBOR on tough legacy instruments was eventually passed. However, none of this legislation provides a comprehensive solution nor, in general terms, a long-term solution to the tough legacy problem.

UK approach to “tough legacy”

The UK’s approach to tough legacy instruments, **synthetic LIBOR**, is narrow in scope. This was deliberate, driven (as noted above) by official sector concern that a statutory fix would dis-incentivise parties from taking active steps to amend legacy LIBOR exposures.

The legislative basis for synthetic LIBOR is in the UK Benchmark Regulation, the UK’s post-Brexit iteration of the EU Benchmark Regulation that previously applied. Under the UK Benchmark Regulation, as amended by the Financial Services Act 2021, a determination that a critical benchmark is or will become non-representative (which was made in the case of certain LIBOR rates, in the FCA’s pre-cessation announcement of 5 March 2021), enables the FCA to take steps, if the statutory conditions are satisfied, to replace the non-representative rate for a specified period with a rate produced according to a synthetic methodology. FCA-regulated institutions are only allowed to use these synthetic rates to the extent specifically permitted by the FCA in regulated instruments. Such instruments do not include loans – see further below.

The FCA has exercised its power to direct the production of synthetic rates in relation to 6 LIBOR currency/tenor pairs so far: synthetic LIBOR rates are being published for GBP rates and JPY rates for one, three and six month tenors. The synthetic methodology for both rates comprises the forward-looking term rate version of the relevant RFR (Term SONIA for sterling and TORF for JPY) plus the BISL CAS rates (see section 5.4 (How is the CAS calculated?) above).

The thought behind synthetic LIBOR was that production of those rates for the most commonly used LIBOR tenors, would enable tough legacy contracts referencing those tenors to be read as referencing the synthetic rate in place of LIBOR. Concerns about whether, as a matter of contractual interpretation, that would work, led to an additional piece of tough legacy legislation in the UK: the Critical Benchmarks (References and Administrators Liability) Act 2021. This provides (in summary) that where a synthetic LIBOR rate is published, references to that LIBOR rate in any contract or arrangement (financial or otherwise) governed by the laws of the UK legal systems will be read as references to synthetic LIBOR (if a synthetic LIBOR rate has been made available).

The synthetic LIBOR rates are aimed solely at preventing disruption to certain tough legacy LIBOR instruments that could not or cannot be

transitioned and do not contain appropriate fallback triggers dealing with the cessation or pre-cessation of LIBOR. Synthetic LIBOR has had extremely limited application in the syndicated loan market, where almost all legacy LIBOR transactions were actively transitioned by consensual means in advance of the 31 December 2021 deadline. However, the synthetic rates have been useful for individual transactions which for various reasons, were challenging to transition. Synthetic LIBOR is also not available for use in new loans and re-financings – which is another reason why the rates have been of limited significance to the loan market in practice.

The life of the existing synthetic LIBOR rates is in any event, likely to be short. The JPY rates will cease at the end of 2022 and the 1 and 6 month sterling LIBOR tenors will be retired at the end of March 2023. At the time of writing, the FCA had not reached a conclusion on the cessation date for the 3 month tenor.

Synthetic LIBOR rates may also be made available for certain USD LIBOR tenors following the cessation of USD LIBOR in June 2023. While the position is not yet certain (the FCA is yet to announce the results of its consultation), it seems reasonably likely that some synthetic USD rates will be considered necessary. The number and size of USD LIBOR exposures in the international (non-New York law) loan market is significantly larger than for sterling LIBOR, involving a diverse range of lenders and borrowers in multiple jurisdictions (including developing markets), some of whom may be less advanced in their preparations.

Other “tough legacy” legislation

Countries are limited in their ability to override effectively the provisions of contracts governed by foreign laws. While the provisions of the UK’s Critical Benchmarks (References and Administrators Liability) Act 2021 do not expressly limit its application to contracts and arrangements governed by the laws of the UK legal systems, the Explanatory Notes to the Act confirm that intention – as it is only in such contexts that there is certainty that the Act’s provisions will operate as expected.

To address the tough legacy problem comprehensively would therefore require a seamless international patchwork of legislation. The expectation is that LIBOR-referencing contracts and arrangements governed by the laws of countries which have legislated separately for LIBOR transition, will be determined primarily according to the local regime (under local conflict of laws principles).

In the EU, the EU Benchmark Regulation was amended, to empower the European Commission to replace LIBOR references in contracts governed by the law of a member state. The Commission's powers are also expressed to extend to contracts governed by the laws of any other country where all parties are established in the EU and the other country has not put in place its own legislative solution. The Commission has so far exercised these powers only in relation to certain CHF LIBOR and EONIA referencing contracts.

In the US, legislation to replace USD LIBOR references was passed first in New York. Federal legislation and further state-level legislation along similar lines followed. USD LIBOR-referencing contracts and arrangements governed by the laws of any US state which have not been actively transitioned, will therefore be managed via the applicable local regime.

Further detail on the EU and US tough legacy regimes is outside the scope of this guide. The main objective of this section is to highlight to treasurers faced with a tough legacy instrument that while legislative solutions exist, they are limited in scope. Further, the applicable solution will most likely be driven by the governing law of the instrument and it is possible that conflict of laws questions may arise. For example:

- Contracts under New York law referencing a LIBOR setting in a currency that is not USD are outside the scope of the US legislation. A question therefore arises as to whether the New York law rules of contractual interpretation apply or, potentially, a New York court might consider the EU or UK legislative solution.
- Similarly, a contract governed by English law, with EU-established parties and referencing CHF LIBOR would not be supported by the UK's legislation as there are no synthetic LIBOR rates for CHF. An English court would therefore need to decide whether to apply the usual English law rules of contractual interpretation, or whether to consider the EU regime.

The interaction of the various legislative solutions (both in terms of scope and the designation of replacement rates for LIBOR) will require the parties to seek legal advice on a case by case basis.

6. DOCUMENTATION

6.1 LMA RFR documentation

To support the transition of the syndicated loan market from LIBOR to RFRs, the LMA has produced a substantial body of facility documentation, supplementary drafting and guidance materials, as well as a series of educational videos. The RFR Agreements for investment grade borrowers were the first facility agreement templates to be finalised, but the RFR-related terms they incorporate have since been, and continue to be, rolled out across all of the LMA templates.

At the time of writing, the RFR-related terms of the RFR Agreements (catering for the use of compounded in arrears rates) have been incorporated into the LMA's Leveraged Agreement, the real estate finance facility agreements and the developing markets facility agreements (amongst others). The LMA is still working on incorporating the RFR-related terms of the RFR Agreements into its wider documentation library.

Pending completion of this very significant documentation project, destination tables and guidance notes are available to assist users wishing to use LMA templates that have not yet been transitioned. While as already noted, the LMA's documentation library is generally accessible to LMA members only, many of the webinar and educational materials are open to all on the LMA's [LIBOR transition microsite](#).

6.2 The RFR Agreements

The RFR Agreements for investment grade borrowers are based on the LIBOR Agreements that preceded them. The RFR Agreements (like the previous LIBOR Agreements) are available in multiple variations:

- Single currency facility agreements that reference SONIA compounded in arrears. These are available as separate term and revolving facilities or as a single facility that incorporates both term and revolving facilities.
- Multi-currency facility agreements that reference a range of currencies and cater for a mix of compounded in arrears rates and IBOR term rates, depending on the currency. These are similarly available as separate term and revolving facilities or a single facility that incorporates both term and revolving facilities.

- Versions of the multi-currency RFR Agreements are also available which incorporate drafting for a euro or USD swingline facility and for the revolving facility to be drawn by way of fronted letters of credit.

The RFR Agreements – as well as all of the other LMA facility agreements that have so far been updated to incorporate RFR terms - provide for interest on loans referencing an RFR to be calculated on a compounded in arrears basis. The RFR terms and calculation methodologies reflect the Sterling Loan Conventions and the recommendations of the UK RFRWG for the use of compounded in arrears SONIA.

The RFR Agreements include full terms for loans referencing RFRs in sterling (SONIA), USD (SOFR), euro (€STR) and CHF (SARON), plus a framework for the incorporation of the terms applicable to other currencies. The LMA has produced skeleton RFR terms for JPY loans referencing compounded in arrears TONAR (the **TONAR Schedule**), which can be used in conjunction with the RFR Agreements. It has not yet started work on RFR terms applicable to other currencies. In those instances local advice will need to be sought in relation to appropriate terms and conventions.

The RFR Agreements do not make specific provision for loans referencing Term SONIA, Term SOFR or any other forward-looking term rate based on an RFR. The LMA has published two forms of facility agreement that make provision for the use of Term SOFR, but these are in exposure draft form and at the time of writing, are yet to be finalised. The documentation of Term SOFR loans (including the LMA's exposure draft documentation) is discussed at section 6.5 (Term SOFR facilities – discussion points) below.

6.3 RFR terms – modular drafting

Recipients of a draft RFR Agreement might wonder why certain provisions, which may have been agreed at term sheet stage to be excluded, appear to be included in the Agreement. This is a function of the LMA's modular approach to RFR terms, which can be confusing at first sight.

The front end of the RFR Agreements has been set up to cater for the full range of terms that might be chosen to apply for a particular currency. This framework is designed to be left intact in every deal;

whether or not particular terms apply is left to be specified in the RFR terms applicable to that currency. These are set out in Schedule 13 (*Reference Rate Terms*), which is divided into a separate part for each currency. In the relevant Reference Rate Terms schedule, the parties are invited to select whether the particular term applies or not.

This approach means that certain definitions in the RFR Agreements as well as aspects of the interest rate clauses in the RFR Agreements may, once the Reference Rate Terms are agreed, be superfluous, by virtue of the options chosen in the relevant Reference Rate Terms. For example, the definition of Break Costs and Clause 11.5 (*Break Costs*) will have no substantive effect if the parties specify that Break Costs shall not apply in the relevant Reference Rate Terms.

Clearly it is possible that the parties could agree as a drafting matter to shorten the negotiated form of their RFR Agreement by deleting the superfluous provisions and definitions. However, in most cases, parties are leaving such provisions intact. There are two reasons for this. Firstly, it provides flexibility if Reference Rate Terms evolve and need to be amended, or if the lenders approve drawings in new currencies and Reference Rate Terms are required for those currencies (which may be different in scope). Secondly, the retention of a common framework for every deal makes an assessment of the terms of individual deals more efficient. In this regard, most of the provisions of the RFR Agreements relating to the calculation and payment of interest might be viewed as akin to an ISDA Master Agreement – which is not altered. The Reference Rate Terms schedules are, in turn, akin to the swap confirmation, which is where the parties will find details of how the Master Agreement applies to the swap in question.

6.4 RFR terms – discussion points

The RFR terms of the RFR Agreements were developed by consensus and are technically complex. For these reasons, they are, in most cases, being used with minimal adjustment.

Where it is agreed that loans in a particular currency will reference a RFR, the discussion points are fairly limited. Some are operational, rather than commercial points. Some may require more discussion among the banks in a syndicated deal, rather than between bank and borrower. Most internationally active banks are familiar with the discussion points and well aware of the different solutions that may be proposed by borrowers and are adopted in practice. Banks who are

newer or less experienced with RFRs may benefit from the direction of the Arrangers/Agent and/or other more experienced Lenders in the syndicate on certain issues.

The checklist below summarises the key aspects of the RFR terms to be settled, those which may require discussion. It also includes an indication of where to find further information on the relevant provisions of the RFR Agreements in Part IV (Commentary on the Investment Grade Agreements).

Note that some of the discussion points are slightly different if Term SOFR is the chosen reference rate. See section 6.5 (Term SOFR Facilities – discussion points) below in relation to facilities referencing Term SOFR.

RFR TERMS – CHECKLIST/

Issue	Summary	RFR Agreements
Calculation of RFR	<p>RFR Agreements use compounded in arrears methodology reflecting the Sterling Loan Conventions. This is generally accepted without adjustment. No observation shift is adopted in most cases.</p> <p>Will require discussion if alternative methodologies or term rates derived from RFRs are to be used.</p>	<p>Clause 9 (<i>Interest</i>) and Schedule 13 (<i>Reference Rate Terms</i>), Schedule 14 (<i>Daily Non-Cumulative Compounded RFR Rate</i>) and Schedule 15 (<i>Cumulative Compounded RFR Rate</i>).</p> <p>See section 6.5 (Term SOFR Facilities – discussion points) below in relation to facilities referencing Term SOFR.</p>
CAS component in pricing	<p>RFR Agreements cater for optional Baseline CAS in interest rate calculation as well as possibility of CAS component of fallback and rate switch provisions.</p> <p>Requires discussion. Range of approaches to CAS currently.</p>	<p>Clause 1.1 (<i>Definitions</i>) (“Baseline CAS”, “Fallback CAS” and “Rate Switch CAS”), Clause 9A (<i>Rate Switch</i>), Clause 11.2 (<i>Interest calculation if no RFR or Central Bank Rate</i>) and Schedule 13 (<i>Reference Rate Terms</i>).</p>

Issue	Summary	RFR Agreements
Margin	<p>RFR Agreements provide the option for two-part pricing (RFR plus Margin) or three-part pricing (RFR plus CAS plus Margin).</p> <p>If two-part pricing is adopted on a refinancing, parties may need to discuss the impact on other provisions of the agreement that depend on the applicable Margin e.g. calculation of commitment fees and margin ratchets.</p>	<p>Clause 1.1 (<i>Definitions</i>) ("Margin") and Schedule 13 (<i>Reference Rate Terms</i>).</p>
Interest rate floors	<p>RFR Agreements apply a daily floor in the RFR calculation. This is not typically adjusted.</p> <p>May be a discussion with regard to how the CAS element should be taken into account.</p>	<p>Schedule 13 (<i>Reference Rate Terms</i>).</p>
Interest Periods	<p>RFR Agreements require the parties to specify the agreed Interest Period for loans in each relevant currency.</p> <p>Requires discussion. 6 months is the maximum recommended Interest Period if the loan references a compounded in arrears RFR.</p>	<p>Clause 10 (<i>Interest Periods</i>) and Schedule 13 (<i>Reference Rate Terms</i>).</p>
Fallbacks	<p>RFR Agreements adopt adjusted central bank rates as the primary fallback rate if the RFR is unavailable.</p> <p>Adjusted central bank rates along these lines are the market standard primary fallback rate in loans referencing compounded in arrears RFRs.</p>	<p>Clause 11 (<i>Changes to the Calculation of Interest</i>) and Schedule 13 (<i>Reference Rate Terms</i>).</p>

Issue	Summary	RFR Agreements
<i>Cost of funds as fallback</i>	<p>RFR Agreements include drafting for lenders' cost of funds to apply optionally as a fallback (if, in the case of RFR-referencing loans, adjusted central bank rates are not available).</p> <p>May require discussion. In many cases, parties take the view that cost of funds is unnecessary as a fallback rate in loans referencing compounded in arrears RFRs.</p>	<p>Clause 11 (<i>Changes to the Calculation of Interest</i>) and Schedule 13 (<i>Reference Rate Terms</i>).</p>
<i>Market Disruption</i>	<p>RFR Agreements present the market disruption clause (which substitutes lenders' cost of funds for the benchmark rate if a specified proportion of Lenders cannot fund themselves at that rate) as optional.</p> <p>May require discussion – Lenders' views on whether this clause can be omitted vary. In many investment grade loans referencing compounded in arrears RFRs, it is omitted.</p>	<p>Clause 11.3 (<i>Market Disruption</i>) and Schedule 13 (<i>Reference Rate Terms</i>).</p>
<i>Break Costs</i>	<p>RFR Agreements provide for the optional application of Break Costs.</p> <p>The omission of Break Costs is market standard in loans referencing compounded in arrears RFRs.</p>	<p>Clause 1.1 (<i>Definitions</i>) ("Break Costs"), Clause 11.5 (<i>Break Costs</i>) and Schedule 13 (<i>Reference Rate Terms</i>).</p>
<i>Limits on prepayments</i>	<p>RFR Agreements provide for optional limits on voluntary prepayments.</p> <p>May require discussion. Some lenders are placing caps on mid-period prepayments as a quid pro quo for the loss of</p>	<p>Clauses 8.4 and 8.5 (<i>Voluntary prepayments</i>).</p>

Issue	Summary	RFR Agreements
	Break Costs in loans referencing compounded in arrears RFRs.	

6.5 Term SOFR facilities – discussion points

LMA drafting for Term SOFR

As discussed in section 3 (Risk-free Rates – the options), USD borrowers have a choice of SOFR rate. For most, the choice is between SOFR compounded in arrears and Term SOFR. A preference between the two is yet to emerge in the London/English law loan market, which may remain the case, given the preferred option is likely to depend on the circumstances (see section 3.4 (USD loans) above).

The multi-currency RFR Agreements that have been published as LMA recommended forms apply a consistent approach across all currencies and assume that USD drawings will reference SOFR compounded in arrears. The LMA has developed two templates that reference Term SOFR, but at the time of writing, both remain in exposure draft form (together, the **Term SOFR Exposure Drafts**).

The single currency term and revolving facilities agreement for use in Developing Markets jurisdictions (the **Term SOFR DM Exposure Draft**) was the first of the two exposure drafts to be made available. The LMA chose to road-test drafting for Term SOFR in the context of its templates for lending to borrowers in developing markets because of concerns that the use of compounded in arrears RFRs would be a challenge in such jurisdictions. Forward-looking term rates facilitate cash management, which may be particularly important in jurisdictions where the mobilisation of payments requires a longer time period.

Given levels of interest in Term SOFR, the LMA subsequently developed a form of multi-currency facility agreement which provides for USD drawings to reference Term SOFR. An exposure draft of this document (the **Term SOFR MTR Exposure Draft**) was published during October 2022. The Term SOFR MTR Exposure Draft uses the terms of the Compounded/Term MTR but replaces compounded in arrears SOFR with Term SOFR as the primary reference rate for USD drawings.

Term SOFR is a forward-looking screen rate and therefore optically similar to LIBOR. However, Term SOFR is nonetheless a fundamentally different rate in relation to which market practice is yet to develop in certain areas. The Term SOFR Exposure Drafts therefore provide the parties with various options and blanks to consider. The main points are as follows:

- **Term SOFR rate:** Interest on USD drawings is calculated using the CME Term SOFR rates. [CME Term SOFR](#) was the first published Term SOFR rate and was the only Term SOFR rate available when the Term SOFR DM Exposure Draft was published. While CME Term SOFR rates have been endorsed by the ARRC (and have been referenced in most of the Term SOFR transactions so far), [ICE Term SOFR](#), is an alternative option should the parties prefer (and features in the Term SOFR MTR Exposure Draft as a fallback for CME Term SOFR, see further below). From a documentation perspective, the key point is to be clear which Term SOFR rate is to be used. From a practical perspective, the parties must ensure that whatever Term SOFR rate is chosen, the relevant administrator's licensing requirements are complied with⁶.
- **Interpolation for sub 1-month interest periods:** Both Term SOFR administrators produce Term SOFR rates for a range of maturities: 1 month, 3 months, 6 months and 12 months. For sub 1-month Interest Periods, the Term SOFR Exposure Drafts provide, optionally, for the calculation of an interpolated rate using the overnight SOFR rate published by the Fed. While SOFR and Term SOFR are different rates (prompting questions about whether SOFR is the appropriate reference point for interpolation), this approach appears to have been adopted in most transactions to date (although there may be some discussion round the date of the overnight SOFR rate used for this purpose).

⁶ The [CME Term SOFR FAQs](#) indicate that CME Term SOFR is available for use cash market products such as loans for no fee until 2026 and further, that end users such as corporate borrowers do not need a licence for Term SOFR-based borrowing. The [ICE website](#) indicates that fees payable in respect of any ICE Term Reference Rates are waived until 2023. IBA will notify licensees in advance when licence fees will become applicable (and will publish the applicable fee information on its website).

- **Two-part or three-part pricing:** The addition of a CAS to the applicable Term SOFR rate is optional as in the RFR Agreements, if a CAS applies, it is left blank for the parties to agree. As discussed at section 5 (Transition Issues), a CAS may be included for the purposes of transitioning from LIBOR but is less common in new RFR-linked transactions. If a CAS is agreed, see section 5.4 (How is the CAS calculated?) above in relation to how it is typically set in USD facilities.
- **Zero floors:** Treasurers should note that the optional zero floor is applied to the Term SOFR rate, rather than Term SOFR plus a CAS. The implications of this may need to be considered in the context of legacy deals (see section 4.5 (Interest rate floors) above).
- **Fallbacks:** The replacement of reference rate process in the amendments and waivers clause (see Clause 35.4 (*Changes to reference rates*) in Part IV) provides a framework for reaching agreement on a replacement rate. This process is also a feature of the Term SOFR Exposure Drafts, but the parties are left to agree a suitable interim fallback rate to apply pending such agreement. There is no clear consensus on the most appropriate fallbacks for Term SOFR facilities. The Term SOFR Exposure Drafts each contain different fallback options, and a variety of approaches have been seen in practice. These are discussed in more detail below.
- **Break Costs and Market Disruption:** The application of Break Costs and the market disruption provisions are optional. The LMA's Commentary to the Term SOFR DM Exposure Draft (the **Term SOFR User Guide**) notes that this is "in the absence of established market practice or consensus" as to whether they should apply.

Whether these concepts should apply to Term SOFR facilities in essence involves similar considerations as in relation to compounded in arrears RFRs. These concepts are based on the assumption that Lenders are match-funding their participation in the Loan on a term basis. Term SOFR is (like LIBOR) a forward-looking term rate, but it is based on SOFR futures. Like compounded in arrears RFRs, Term SOFR does not measure bank funding costs in the same way as LIBOR.

In practice, there are some indications that Lenders are more resistant to the omission of Break Costs in the context of Term SOFR lending. Lenders may argue that if a forward looking term

rate such as Term SOFR applies, their funding arrangements will be based on the expectation that interest is paid at the end of the term; if that is not the case, there will be a broken funding cost, albeit not on a match funding basis.

See further comments at Clause 1.1 (*Definitions*) (“**Break Costs**”), Clause 11.3 (*Market Disruption*), Clause 11.5 (*Break Costs*) and Schedule 13 (*Reference Rate Terms*) in Part IV.

The Term SOFR User Guide notes that as market practice develops in these areas, the LMA will be able to develop more complete documentation that can be published in the LMA recommended form.

Fallbacks for Term SOFR - in practice

There are a number of different fallback options that might be considered for Term SOFR loans. A range of approaches have been seen in the English law Term SOFR facilities completed to date. These include:

- ***LIBOR-style fallbacks:*** An abbreviated version of the LMA fallback drafting more often used in LIBOR-referencing deals has been adopted in some cases. Interpolated Term SOFR rates are the first fallback rate, and if interpolation is not possible, the fallback is lenders’ cost of funds. This might be viewed as a practical stop-gap. However, from the borrower’s point of view, this may not be ideal. Lenders’ cost of funds may not be reflective of an RFR-based rate and further, as the LIBOR experience illustrated, if a widely-used screen rate becomes unavailable, cost of funds quotations are unlikely to be practical to obtain on a market-wide basis.
- ***US-style fallbacks:*** Some parties have modelled fallbacks in English law Agreements on the approach reflected in the New York law LSTA Term SOFR Concept Document⁷. The LSTA drafting provides for the use of last published (historic) Term SOFR and rates for adjusted interest periods as interim fallbacks. There is also an option to incorporate daily simple SOFR as an interim fallback. If the non-availability of the Term SOFR rate is permanent, the ultimate fallbacks are to replacement rates agreed by the Agent and borrower or recommended by the official sector (subject to negative

⁷ LSTA documentation, like LMA documentation is available only to members through the [LSTA website](#).

consent of the lenders). The downside where parties have sought to replicate these LSTA fallbacks (often in syndicated deals involving certain US banks), is that the drafting has required some adjustment for use in conjunction with an LMA-style loan agreement. The ultimate fallbacks, for example, may be omitted in favour of the replacement of reference rate process in the LMA's amendments and waivers clause (see Clause 35.4 (*Changes to reference rates*) in Part IV). The substantive point is that simple average RFRs have not been a feature of the transition to RFRs in the English law market, which has preferred the compounded in arrears methodology where RFRs are referenced directly.

- **Compounded in arrears SOFR as a fallback:** Compounded in arrears SOFR may be an obvious choice for the English law market, where the compounded methodology is preferred to simple average RFRs. This has been used in a few transactions. If compounded in arrears SOFR is adopted as the primary fallback, as noted in section 6.5 (RFR terms – discussion points) above, the customary next level in the fallback waterfall will be a rate calculated using an adjusted central bank rate. The use of a central bank rate, in most cases, will permit cost of funds to be dispensed with as an ultimate fallback.
- **Other options:** The use of compounded in arrears SOFR as a fallback may be appropriate (in economic terms) for some borrowers. However, that option may not be suitable if Term SOFR was chosen to avoid working with compounded in arrears rates (such as, as noted above, in developing markets transactions). An alternative option (as put forward in the Term SOFR MTR Exposure Draft, see further below) is to adopt an adjusted central bank rate as the primary fallback for Term SOFR. Other alternatives may include the use of “last re-set” compounded SOFR rates or even fixed rates. The Term SOFR User Guide highlights a number of possibilities and some of their pros and cons.

Fallbacks for Term SOFR – the LMA Exposure Drafts

The fallback provisions in the Term SOFR Exposure Drafts are presented as optional. As noted above, the options contained in the drafts are different:

- **DM Exposure Draft:** The Term SOFR DM Exposure Draft includes the same optional fallback rate waterfall used for other forward-looking term rates in the Investment Grade Agreement. If Term

SOFR is unavailable, the Agreement provides for the use of interpolated and historic rates and rates for shortened Interest Periods. The use of Lenders' cost of funds as the final fallback rate in the waterfall (pending agreement on a replacement rate) is optional. The document notes that the parties need to consider whether those fallbacks are appropriate.

- ***MTR Exposure Draft***: The fallback options in the Term SOFR MTR Exposure Draft are more developed. If Term SOFR is unavailable, the Agreement provides for the use of interpolated and historic rates and rates for shortened Interest Periods (as applicable in the Term SOFR DM Exposure Draft). The next option in the waterfall is to use ICE Term SOFR as an “***Alternative Term Rate***”. The waterfall continues with two alternative options, either:
 - compounded daily SOFR (substituted with an adjusted central bank rate if daily SOFR is unavailable) using the compounded daily rates methodology that applies in the existing RFR Agreements; or
 - the immediate use of a central bank rate (fixed at the level prevailing at the start of the relevant Interest Period) with the option to add a specified adjustment spread.

As in the Term SOFR DM Exposure Draft, cost of funds can be adopted as the final level in the fallback waterfall.

The fallbacks in the Term SOFR DM Exposure Draft were included largely as a placeholder. When the document was published, the market had not yet developed a view on the appropriate options. The Term SOFR MTR Exposure Draft, having been developed with the benefit of feedback from the LMA's LIBOR Working Party, presents a wider range of options that may be more appealing to lenders and borrowers.

Fallbacks for Term SOFR - the borrower's perspective

As will be apparent from the various options outlined, this is an area where practice is taking time to settle. The publication of the Term SOFR MTR Exposure Draft is a step forward. The key for the borrower is to make sure that whichever fallback option is selected, it will be workable should it be needed.

In addition, the extent of any basis risk between the fallbacks in the loan and the fallbacks under ISDA terms may be a relevant consideration in hedged transactions. The ISDA fallbacks for Term SOFR (in both the 2006 and 2021 definitions) provide for the use of last published rates. If the rate is permanently unavailable, the official sector recommended replacement applies or (if no replacement is available), a commercially reasonable replacement rate determined by the Calculation Agent. Last published rates which reflect the ISDA interim fallbacks can be adopted for alignment purposes where the borrower's Term SOFR exposure is hedged. Whether the ultimate fallback of an official-sector endorsed rate is needed or whether the parties wish to rely on the replacement of reference rate clause referred to above will, however, need to be considered.

Fallbacks for RFR-referencing loans are discussed in more detail at Clause 11 (*Changes to the Calculation of Interest*) in Part IV.

7. HEDGING CONSIDERATIONS

7.1 Legacy LIBOR derivatives – the ISDA IBOR Fallbacks

ISDA's drafting for the transition of legacy LIBOR derivatives was set out in two documents: its IBOR Fallbacks Supplement (the **ISDA Supplement**) and a Protocol (the **ISDA Protocol**). These were finalised in October 2020 and became effective on 25 January 2021. The ISDA Supplement and the ISDA Protocol (together the **ISDA IBOR Fallbacks**) were designed primarily to facilitate the transition of derivatives from LIBOR by substituting applicable LIBOR rates with new non-LIBOR fallbacks, although they are also capable of application to certain non-LIBOR currencies.

The fallback rates that replace LIBOR under the ISDA Supplement and the ISDA Protocol comprise the relevant RFR compounded in arrears, plus a CAS calculated based on the 5YHLB basis. As discussed in section 5.4 (How is the CAS calculated?) above, the compounded RFRs, CAS and all-in fallback rates are being published by BISL.

Both the ISDA Supplement and the ISDA Protocol replace the relevant LIBOR with compounded in arrears RFRs on the permanent cessation of the relevant LIBOR. The fallbacks may also be applied if the relevant LIBOR ceases to be representative of the underlying market it is intended to measure (the so-called "pre-cessation trigger", and the

subject of the FCA announcement on 5 March 2021, see section 5.2 (Transition trigger events) above). Note that if only certain LIBOR rates are discontinued for a particular currency, the fallbacks are not triggered and the continuing LIBOR rates are interpolated. This is important to bear in mind in the context of USD LIBOR rates. The cessation of certain USD LIBOR rates on 31 December 2021, according to these terms, does not mean that SOFR will replace USD LIBOR for such time as other USD LIBOR rates continue to be published.

The ISDA Supplement and the ISDA Protocol contain the same fallbacks. They are, in essence, two methods of achieving the same outcome. The difference is in their scope i.e. the trades which they were designed to apply to.

The ISDA Protocol was aimed at legacy LIBOR transactions i.e. pre-existing LIBOR transactions entered into prior to 25 January 2021 (although there are some limited circumstances in which it can apply to later transactions). When two parties have adhered to the ISDA Protocol, all IBOR-referencing transactions existing between them are automatically amended to incorporate the non-LIBOR fallbacks. The ISDA Protocol applies not only to transactions governed by the 2006 ISDA Definitions but also the 2000 ISDA Definitions, amongst others. The ISDA Protocol can even apply to certain non-ISDA documents.

The effective date of 25 January 2021 is simply the date on which the amendments in the ISDA Protocol took effect in transactions between parties that chose to adhere to it prior to that date. It was not a cut-off date for adherence. The terms of the ISDA Protocol become effective to amend existing trades at the point both adherents have adhered to it, whenever that happens. ISDA has indicated that it will give notice if the ISDA Protocol becomes subject to a cut-off date.

The ISDA Supplement, on the other hand, was aimed at LIBOR transactions entered into from 25 January 2021 (the effective date of the ISDA Supplement). The ISDA Supplement amends the 2006 ISDA Definitions to incorporate the new non-LIBOR fallbacks. This means that any derivatives contracts entered into after 25 January 2021 which, according to their terms, incorporate the 2006 ISDA Definitions, incorporate the non-LIBOR fallbacks without further action.

7.2 2021 ISDA Definitions

On 11 June 2021, ISDA published the 2021 ISDA Interest Rate Derivatives Definitions (the **2021 ISDA Definitions**). Many of the provisions in the 2006 ISDA Definitions are retained, including the triggers and fallbacks introduced by the IBOR Supplement. Some aspects have been updated with the aim of reflecting market practice, making them more standardised and easier to read. For example, floating rate options have been transposed from a narrative format into a grid or matrix structure. Other updates have been made with the intention of making transactions more robust when faced with difficulties including market closures and benchmark-related events. For instance, a new “unscheduled holiday” concept was introduced which will enable certain dates (such as payment dates) to shift to the next business day where there is insufficient notice of a market closure or holiday.

ISDA anticipates widespread adoption of the 2021 ISDA Definitions. When considering adopting the new 2021 ISDA Definitions in hedging transactions, treasurers should consider whether the formulation in the 2021 ISDA Definitions is aligned with the terms of the hedged cash product, the loan or other debt. Some of the differences between the terms applicable to derivatives and applicable loan conventions are noted in the table at section 4.6 (Conventions applicable to other ex-LIBOR currencies) above. Areas to be considered include lookback periods, compounding methodologies, rounding, business day and day count conventions as well as any floor to be applied to the floating rate.

7.3 RFR hedging

Many treasurers will have used ISDA IBOR Fallbacks to effect the transition of legacy LIBOR derivatives to RFRs – either by adherence to the ISDA Protocol or by agreeing amendments bilaterally perhaps using the ISDA Supplement as a reference point. Now the transition project is largely complete, the provisions of the ISDA IBOR Fallbacks are outlined above to provide context for the hedging considerations that are likely to apply to RFR-linked loans as the RFR hedging market continues to evolve.

As already touched upon, the conventions applicable to RFR-linked derivatives (i.e. those reflected in the ISDA IBOR Fallbacks and the 2021 ISDA Definitions) are broadly, but not entirely, consistent with the conventions being adopted in the loan market. For example, SONIA

derivatives use the observation shift and a two banking day lookback, as noted in the table in section 4.6 (Conventions applicable to other ex-LIBOR currencies) above, whereas the Sterling Loan Conventions recommend a five banking day lookback without observation shift for sterling loans. The differences may not necessarily lead to the conclusion that the standard ISDA drafting is unsuitable for derivatives hedging loans (many treasurers will have considered this question in the context of legacy LIBOR deals). It is simply to point out that for deals where close alignment is desirable, the scope of any basis risk arising out of the methodologies not being exactly matched – and whether that basis risk is sufficiently material to warrant deviation from standard ISDA terms – is a point to be explored with counterparties and debt advisers.

ISDA has produced additional “rate options” for daily RFRs (additional provisions and template confirmations), reflecting more closely the compounding conventions for RFRs being used in the loan market. These form part of the 2021 Definitions (and 2006 Definitions), as noted above. These are helpful for transactions where close alignment between the terms of the derivative and the hedged item is desirable. The key point for treasurers is that conversations with hedging providers should be initiated at an early stage, with a view to assessing alignment options and pricing. RFR hedging is readily available; but in some cases, the implications of any differences between the compounded RFR conventions used in the loan and in related derivatives may require attention.

As noted in section 3.2 (Choosing a rate (where a choice is available)) above, the hedging may, in some cases be a factor in choosing between a term rate (e.g. Term SOFR) and referencing the RFR directly. Liquidity in the Term RFR markets will be more limited which may affect hedge availability and pricing.

8. BEYOND LIBOR

The FSB’s recommendations for benchmark rate reform in 2014 extended beyond LIBOR to all major interest rate benchmarks (referred to as **IBORs**). Many jurisdictions beyond the five LIBOR currency jurisdictions are therefore engaged in their own benchmark reform exercises to implement the FSB’s recommendations.

While the benchmark reform project in each jurisdiction has the same ultimate aim of strengthening existing benchmarks and promoting the

development and adoption of RFRs where appropriate, the precise approach being taken differs between jurisdictions, as do the timetables for reform. There are jurisdictions which are adopting a multiple rate approach, promoting a new or reformed RFR alongside maintaining and strengthening an existing IBOR. Others, where the markets that underpin the relevant IBOR have become too thin to support a robust IBOR, are adopting an approach akin to that taken with respect to LIBOR, replacing the existing IBOR with a new or existing RFR.

The FSB's [2020 progress report](#) on reforming major interest rate benchmarks provides a helpful summary of the status of benchmark reform in a number of non-LIBOR currency jurisdictions as at that date and may be a useful starting point for treasurers wishing to investigate how to manage borrowings in non-LIBOR currencies. Treasurers are advised to refer to regulatory and working group resources in the relevant jurisdiction for fuller and more up to date information on rate options for specific currencies.

While the RFR Agreements do not specifically cater for benchmarks beyond the RFRs replacing LIBOR and EURIBOR, they do provide a framework into which the parties can slot in any relevant provisions to deal with the transition from other IBORs.

PART III
HOT TOPICS



PART III / HOT TOPICS

1. NAVIGATING CHALLENGING CONDITIONS

1.1 2022/23 outlook

In the five years since the last edition of this guide, virtually all treasurers will have experienced macro-economic conditions and a business environment that might be described as “challenging”. This looks set to continue. Whilst the worst of the COVID-19 pandemic may have receded, the economic and geopolitical outlook remains uncertain. Concerns about businesses’ ability to rely on supply chains, and the resulting emphasis on the adequacy of supplies of stock and raw materials are increasing working capital requirements. The outbreak of war in the Ukraine and the imposition of wide-ranging sanctions on Russia, rising energy prices, inflation and rising interest rates and exchange rate movements add further pressure.

ACT research in early 2022 suggested that many treasurers expect significant year on year increases in corporate expenditure and working capital (potentially driven by supply chain pressures) and distributions to shareholders. In the UK, this pressure has increased as the year has progressed. This may mean that some companies need to refinance or enter into new debt facilities. Others may consider options for raising more debt by amendments to existing arrangements.

While there are clear signs that economic headwinds are affecting the terms and pricing on offer in the loan market, in particular for borrowers in more vulnerable business sectors, the supply of loan finance remains relatively healthy overall (in particular for investment grade borrowers). Economic and political events and uncertainty tend to have a more obvious impact on the capital markets. Public debt issuers have become accustomed to this, the need to be ready to issue at short notice as the opportunity arises. While credit terms may tighten, loan market liquidity is typically more resilient.

Current conditions may also present opportunities. The pandemic years brought M&A to a virtual standstill, but during 2021, transaction volumes rebounded significantly. Russia’s invasion of Ukraine muted activity levels during the early part of 2022, but more recently, activity has

picked up again, perhaps signalling that sellers and buyers have recognised that economic and geopolitical risk levels are (sadly) unlikely to change materially in the near future. A pause in the M&A pipeline tends to reap positive outcomes for stronger borrowers seeking event-driven financing.

In most cases however, borrowers are likely to be considering their financing needs and the timing of upcoming fundraising activities carefully. Syndicate composition may require attention in some deals; there is evidence that certain banks are reviewing where and how their capital is deployed. Whether lending terms are crafted to weather current uncertainties and any storms that might blow up during the tenor of the loan will also be a key area of focus.

While techniques for “navigating challenging conditions” may have been on the radar of treasurers at a number of points in the last several years, contingency planning for the worst (while hoping for the best) therefore remains a “hot topic”. The remainder of this section 1 discusses in more detail some of the tools and issues that treasurers navigating such conditions might bear in mind.

1.2 Amend & extend or full refinancing?

At the start of lockdown, and again, as Europe emerged from the COVID-19 pandemic, a number of companies embarked on amend and extend transactions, which illustrated the range of techniques that can be employed to shore up liquidity short of a full re-refinancing. At the time of writing, a number of these techniques are again coming to the fore in the UK, as companies seek to secure liquidity in light of the ongoing political uncertainty.

Extension options and **accordion** facilities are common in investment grade loans. These rights within existing debt facilities to extend the maturity and/or the amount of those facilities proved helpful to many. Borrowers continue to seek such rights in new facilities where possible. The operation of such provisions is discussed at Clause 2 (*The Facilities*) and Clause 7 (*Repayment*) in Part IV.

During the COVID period, a few borrowers employed more innovative techniques, such as the creation within existing facilities of new or **hollow tranches** (a new tranche of debt within a facility into which lenders’ commitments are “rolled”). There was also a limited revival of 2008/9-era **forward start** loans – parallel loan facilities, which become

available for drawdown on the maturity of the existing facility, in which existing lenders are invited to participate.

Transactions along these lines aim to lock in the support of key banks. A downside to these types of structure is facility shrinkage if the required level of lenders do not sign up. However, there are ways to mitigate the risk of shrinkage. Following the 2007-9 financial crisis, for example, we saw some forward starts with accordion features, which enabled borrowers to ask lenders to increase their commitments (up to a cap) or bring new lenders into the forward start before the beginning of the availability period.

As amendment transactions build on existing terms rather than re-opening them completely, negotiations can be less complex and time-consuming than a full refinancing. Whether they are the right option for a particular borrower tends to depend on a variety of factors; what amendments are permissible within the terms of existing financing arrangements, moods within the bank group and the financial position and prospects of the business. For example, a full refinancing may offer more attractive terms to a business that has accepted more onerous lending terms to bolster its balance sheet during a difficult period, but is emerging in better health than expected.

Another structural option for loan financing requirements that some corporates might consider is reverting to bilateral loans in preference to syndicated loan arrangements. Bilaterals are perceived by some as a means of putting pressure on lenders to improve terms. This approach can be successful for stronger credits, although in some cases, in particular where syndicated loan arrangements are collapsed into bilaterals, lenders often look for **most favoured nation** protection to ensure that they continue to enjoy the same rights as other creditors.

1.3 Interest rates, inflation and rising energy costs

Rising inflation and its impact on buying power, alongside rising interest rates and energy costs are at the top of the agenda for many treasurers. Rising interest rates will clearly filter into loan pricing. As ever, the effects of rising base rates on margins tend to be comparatively subtle at the relationship-driven, top end of the investment grade market.

Nonetheless, in the UK and the EU, there are indications that spreads on corporate lending are widening⁸.

Rising interest rates have an obvious impact on cashflows and therefore the borrower's credit profile more generally. Interest costs also feed directly into financial covenant provisions such as interest cover ratios (see discussion at Clause 21 (*Financial Covenants*) in Part IV).

Borrowers may therefore wish to revisit whether those covenants are set at appropriate levels (see further below).

A specific consequence of rising inflation under lending and other debt documentation may be pressure on exceptions and limits which are set at a monetary amount. Many of the key restrictive covenants in loan agreements, for example, the negative pledge, restrictions on disposals and restrictions on the incurrence of Financial Indebtedness contain exceptions which can be set by reference to a basket that is capped at a monetary amount. In a few more recent transactions, borrowers have sought to make provision for such baskets and other limits to be indexed. For example, amounts expressed in sterling might be construed as increased from time to time (or annually) by the percentage increase (if any) in the United Kingdom Consumer Price Index over the relevant period.

All of these topics, alongside the impact of exchange rate movements (discussed further below) may prompt a consideration of the comparative benefits of fixed rate debt products such as US private placements and capital markets finance. They may also prompt a review of hedging strategies. Whether it is desirable to hedge particular exposures is anticipated to be a key area of focus for treasury teams in the coming months.

Many treasurers will be familiar with interest rate and foreign exchange hedging. Rising energy prices during 2022 have prompted more corporates to enter into energy derivatives. In the context of loan finance, the availability of hedging is relevant to (and hopefully has a positive effect on) the stability of the borrower's credit profile. Borrowers will, however, need to ensure that their ability to hedge ordinary course exposures is not constrained by the terms of their loan documentation.

The Investment Grade Agreements do not contain specific restrictions on hedging, but the terms of some more general covenants – for

⁸ See e.g. [Bank of England Credit Conditions Survey Q2 2022](#).

example, the negative pledge – may have the effect of restricting certain arrangements (see comments at Clause 22.3 (*Negative pledge*) in Part IV). Further, negotiated loan agreements may include specific restrictions on certain hedging arrangements and/or the incurrence of financial indebtedness, which typically includes the marked to market value of any indebtedness (see comments on the definition of Financial Indebtedness in Clause 1.1 (*Definitions*) in Part IV).

1.4 Exchange rate movements

Currency requirements

At the time of writing, sterling and euro continue to weaken against other world currencies, most notably, the US dollar. For some companies, for example those with dollar exposure/reporting and sterling/euro revenues, this may have an impact under their lending terms. It may affect their capacity to draw or to take certain actions and remain in compliance with applicable restrictive covenants. Conversely, companies with dollar revenues and sterling/euro exposure/reporting may find that the weakening of sterling and euro against the dollar has a positive impact. Moving exchange rates can have a variety of implications under lending documentation.

For some lenders (e.g. those with a euro-denominated capital base), the cost of lending in certain currencies (e.g. US dollars) is increasingly expensive. Accordingly, the pricing offered on drawings in particular currencies may be higher than for others. Even if such currencies remain undrawn, this is likely to have an impact on commitment fees (which are typically set at a percentage of the applicable margin). Borrowers will wish to think carefully about which currencies they are likely to need over the life of the loan as well as their currency hedging strategy.

Facility headroom

Currency movements can mean that the available headroom under multi-currency facilities is, in effect, reduced (in terms of the amounts of foreign currency the borrower was anticipating would be available). The Investment Grade Agreements provide for the conversion of drawings in a currency other than the Base Currency into the Base Currency using the “***Agent’s Spot Rate of Exchange***” (“*the Agent’s spot rate of exchange for the purchase of the relevant currency with the Base*

Currency in the [London] foreign exchange market at or about 11:00 a.m. on [the specified] day”).

See comments at Clause 1.1 (*Definitions*) in Part IV.

Borrowers with letter of credit facilities may need to pay attention to revolving facility drawings by way of letters of credit on an ongoing basis. Revolving facilities on LMA terms that can incorporate letter of credit facilities will typically provide for letter of credit drawings in Optional Currencies (i.e. currencies other than the Base Currency) to be revalued on a regular basis (e.g. half yearly). The exposure is converted into the Base Currency at the Agent’s Spot Rate of Exchange to determine whether sufficient headroom continues to exist under the revolving facility (see e.g. Clause 6.8 of the Leveraged Agreement).

Financial covenants

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 position to a measure of profitability, usually a defined concept of EBITDA. Variations in exchange rates during the period over which profitability is measured and the rates applicable at the balance sheet date which determine the debt figures have the potential to impact leverage multiples. In extreme cases, such exchange rate movements can affect the outcome of covenant tests.

This issue is discussed at Clause 21 (*Financial Covenants*) in Part IV.

Other monetary and financial limits

Exchange rate movements can impact the amount of headroom available under certain monetary or financial limits that are relatively common in loan documentation. For example, adverse currency movements 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, as noted above, in negative pledge provisions, restrictions on disposals and restrictions on the incurrence of Financial Indebtedness).

Baskets are often set in the currency of the facility (or in the Base Currency “or its equivalent” in multi-currency facilities). If a member of the borrower 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, a currency conversion, either of the basket limit or of the amount to be incurred will be required. Where amounts are incurred in a foreign currency, it is also necessary (in theory at least) to monitor on an ongoing basis the extent to which subsequent exchange rate movements might affect basket capacity and compliance, a risk which under LMA terms, falls on the borrower.

The potentially temporary or arbitrary effects of exchange rate movements under loan documentation can, if necessary, be excluded by express contractual provision. The appropriate solution tends to vary according to the borrower’s circumstances and the nature of the issue. This point is discussed further in relation to basket exceptions in the introduction to Section 8 (*Representations, Undertakings and Events of Default*) in Part IV.

Currency hedging

If the group has currency hedging in place, movements may result in collateral calls and/or changes in the marked to market values. This, in turn, may have implications under applicable lending terms, for example, in the context of covenants restricting the incurrence of “Financial Indebtedness”. The definition of “Financial Indebtedness” in the Investment Grade Agreements captures the marked to market value of any “Treasury Transaction”. An exception for “*indebtedness arising under a foreign exchange transaction for spot or forward delivery entered into in connection with protection against fluctuation in currency rates in the ordinary course of business and not for investment or speculative purposes*” (along the lines included in the Leveraged Agreement as an exception to the covenant restricting Financial Indebtedness) may be helpful.

This point may also warrant attention in the context of other clauses that use the defined term Financial Indebtedness, for example, Clause 22.3 (*Negative pledge*) and Clause 23.5 (*Cross-default*).

1.5 Lessons from lockdown

COVID-19 and lending arrangements

The options for maintaining adequate liquidity and debt headroom in nervous markets were thrown into focus by the onset of the COVID-19

pandemic. Lockdown announcements put immediate pressure on cashflows for many businesses. The acceleration of the pandemic in Q1 2020 coincided with the end of the audit cycle for those with 31 December financial year ends, prompting borrowers to take swift action (using a number of the tools noted above) to secure access to sufficient amounts of loan finance to support going concern analyses.

Alongside the focus on liquidity and fundraising, during the COVID-period many treasury teams had to look closely at their lending terms to identify potential areas of vulnerability. Debt documentation was stress-tested against financial projections, to identify potential covenant challenges. Financial covenant terms and restrictive covenants, as well as MAC (and possibly force majeure) provisions were a key area of focus. Another common topic of discussion was whether loan and other debt covenants restricted changes to the nature of the business.

All of these topics – and how they were addressed – continue to be relevant to the current environment.

Is covenant headroom sufficient?

During the COVID period, the drop in income or profits experienced by certain companies as a result of suspensions, shutdowns, or simply slowdowns in trading flows, coupled in many cases with an increase in drawn debt and an uncertain outlook, prompted concern about upcoming financial covenant tests. For those finalising accounts, auditors' views on covenant compliance also fed into "going concern" considerations.

Addressing these concerns involved a range of approaches. Some companies approached lenders for waivers of upcoming tests and/or amendments to their covenant tests (with some challenging issues to navigate in terms of preparing forecasts and business plans). Other companies elected simply to wait and see and monitor their covenant position very closely.

Where covenant provisions were amended, this quite commonly involved the replacement (or supplementation) of the existing covenant tests with covenants enabling lenders to monitor the liquidity position of the business more closely (liquidity ratios or minimum liquidity requirements).

In some cases, elective mechanisms for the temporary relaxation of certain covenants (for example, leverage ratios) were discussed. These include so-called "spike" provisions, which are a feature of some loan

agreements where the borrower plans to make acquisitions or can foresee other temporary increases in leverage during the tenor of the facility. A spike provision typically gives the borrower the flexibility to elect to relax the financial covenants (or certain covenants) one or two times during the facility.

The key takeaway here, is the need to keep a close eye on covenant headroom in working capital facilities, in particular, should unexpected events prompt the drawing of standby facilities, which have in normal circumstances, rarely been used. In choppy markets borrowers should allow plenty of time for refinancing and consider how they might respond should lenders seek to strengthen their contractual protections (by tightening financial covenants and/or via requirements to provide additional guarantees and/or security).

Do lending terms anticipate changes to the business adequately?

The lockdown forced many companies to suspend or shut down operations. Some changed the nature of their operations immediately – and some have since chosen to evolve or diversify further to fit the post-pandemic circumstances. A waiver of covenants or events of default on this topic was not necessary in all circumstances due to the different fact patterns and variations in applicable terms; but the experience focussed attention on the limitations that loan and other debt documentation can place on a borrower's ability to adapt quickly to changing circumstances.

The fallout from the recent and continuing stream of geopolitical events (for example pressure on “just in time” supply chains), has made it important for businesses to respond to changing conditions in an agile way, without being hampered by banking covenants. Transformation strategies must be considered with the group's obligations to lenders in mind.

The Investment Grade Agreements contain an undertaking, Clause 22.6 (*Change of business*), which restricts the borrower from changing the general nature of the business of the Group. This is discussed further in Part IV (*Commentary on the Investment Grade Agreements*). Some facility agreements may contain more extensive undertakings and/or Events of Default which affect the borrower's ability to evolve or change the direction of its business – including by making acquisitions and disposals.

These are points for borrowers to consider each time they refinance. Are provisions that restrict changes to the business (that may have been in place for many years) still appropriate?

MAC provisions vary in scope

The occurrence of any significant market event will quite often prompt a consideration of whether a material adverse change or “**MAC**” has occurred. This is an issue of particular relevance to the loan market as MAC provisions are extremely common in loan documentation. Virtually all loan agreements will contain a representation (usually given only on the date of the first drawdown) to the effect that there has been no material adverse change in the Group’s business or financial condition since the date of the “Original Financial Statements” (i.e. the financial statements provided prior to entry in to the loan which will have formed the basis of the Lenders’ credit assessment). Most loan agreements (save for those applicable to the strongest borrowers) also contain a Material Adverse Change Event of Default, which often operates by reference to a definition of “Material Adverse Effect”. Formulations are often modelled on the provisions of the LMA’s Leveraged Agreement, although these contain lots of optionality and will be negotiated.

MAC provisions in loan agreements, often turn on whether the event prompts a MAC in the “financial condition of the business” so come into particular focus when covenant challenges are anticipated. During early 2020, a number of companies (particularly with undrawn term loans or revolving credit facilities) sought advice as to whether COVID or the lockdown could constitute an “event or circumstance” that could trigger a MAC, and therefore, a drawstop. As many found out, whether waivers of MAC provisions are required or desirable in response to a particular set of circumstances is, quite fact specific. It depends on the underlying circumstances, but also, on the drafting of the relevant provisions.

Tips for approaching MAC provisions in loan agreements are discussed at Clause 1 (*Definitions*) (in relation to the defined term “**Material Adverse Effect**”) and at Clause 23.12 (*Material Adverse Change*) in Part IV.

1.6 Sanctions

What are sanctions?

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; and knowingly participating in activities that directly or indirectly circumvent the prohibitions on making funds available and dealing with funds,

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

Financial sanctions may also include restrictions on financial markets and services such as bans on investment, restrictions on access to capital markets and directions to cease certain banking relationships. Engaging in actions that directly or indirectly circumvent the financial sanctions is also typically prohibited.

These restrictions can emanate from multiple sources. Sanctions can also have an impact, to varying degrees, on the activities of both natural and legal persons located beyond the territorial limits of the imposing country.

Sanctions and loan transactions

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. Lenders are subject to obligations to report to regulators with regard to their exposure to sanctions targets. Inaccurate reporting or failure to report is, of itself, an offence.

Historically, due diligence, coupled with the general contractual assurances customarily included in loan documentation addressing

illegality and unlawfulness (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 protection for lenders in most cases. Specific contractual assurances on sanctions topics were normally required only from borrowers operating in sectors or countries perceived to be higher risk (meaning such provisions were more common in developing markets transactions and certain project financings).

Over the last decade or so, sanctions enforcement action has become more frequent and the penalties imposed, increasingly significant, especially in the US. This has prompted lenders to ask borrowers for contractual assurances on sanctions topics in loan agreements of all types (in the form of specific representations and undertakings). These provisions do not protect lenders from being tainted by a sanctions issue within the borrower group should a breach occur. However, they have come to be considered an important protection for lenders, to reinforce the lenders' due diligence and, where necessary, provide a means of monitoring the group's compliance and business activities on an ongoing basis (and thus facilitating compliance with lenders' reporting obligations to sanctions authorities).

Although some strong investment grade credits are able to borrow without contractual sanctions provisions (where lenders can be comfortable that due diligence is an adequate response), sanctions provisions of some type are now included in the majority of syndicated loan agreements. The Investment Grade Agreements do not include any drafting dealing with sanctions issues, so appropriate provisions (if any) must be agreed on a case-by-case basis.

There are no "standard" sanctions provisions for English law loan agreements. Most lenders that are regularly active in the loan market will have a set of standard sanctions provisions, to which borrowers must pay close attention to ensure they are not unduly restrictive. Lenders take a range of views on the appropriate scope of such provisions. The more wide-ranging protections sought by certain banks reflect the breadth and global web of legislative regimes they are intended to address, as well as the risk-tolerance of that institution for business in certain countries. This can result in quite detailed negotiations on sanctions provisions between lenders and borrowers.

While lenders, borrowers and their advisers have become more familiar over the years with the nature of sanctions provisions, the issues that

can be contentious and the possible compromise positions, sanctions provisions remain a common discussion point in lending transactions. The content of representations and undertakings relating to sanctions and some of the key issues for borrowers to focus on are discussed in the introduction to Section 8 (*Representations, Undertakings And Events Of Default*) in Part IV.

Recent developments – Russia/Ukraine

The invasion of Ukraine in early 2022, prompted a comprehensive and swift response from sanctions authorities around the world. The full range of trade and financial sanctions was imposed against Russia by the US, the UK, the EU, Japan and Australia among other countries.

In the UK, the Russian sanctions were implemented under the UK's post-Brexit sanctions framework. The UK Government also took the opportunity to strengthen the powers of the Office of Financial Sanctions Implementation (**OFSI**) to impose penalties for breach of the UK's financial sanctions. Since 15 March 2022, OFSI is no longer required to demonstrate that a person had knowledge or reasonable cause to suspect they were in breach of a financial sanction to issue a monetary penalty (although OFSI's guidance indicated that knowledge will remain a factor that is relevant to the scale of penalties imposed)⁹.

The new round of sanctions and changes to enforcement penalties prompted lenders and borrowers to revisit sanctions provisions. The immediate action point was to analyse the implications of the Russia sanctions under existing loan documentation. The next step was to consider whether the Russia sanctions should result in a change in approach to sanctions provisions in new transactions.

Most businesses will have in place policies and procedures designed to ensure compliance with sanctions. In the event a new round of sanctions is imposed, these should enable an appropriate response to be swiftly implemented. Such policies will typically highlight (or should highlight) the need to review the terms of loan and other debt documentation to determine whether either the sanctions themselves – or the impact of those sanctions on the business and its proposed

⁹ The Policing and Crime Act 2017 which contains the powers to impose monetary penalties for breach of financial sanctions was amended by the Economic Crime (Transparency and Enforcement Act) 2022.

response – conflict with any provisions of the relevant loan or other debt instrument and therefore require engagement with lenders.

Some borrowers with operations or relationships in Russia found that applicable terms required them to brief lenders on their proposals to exit Russia and the implications of that under the relevant loan agreement. There were also instances of borrowers needing to seek legal advice and/or engage with lenders because they wished to continue certain activities, which were not in breach of sanctions, but nonetheless conflicted with the terms of the relevant agreement. These situations might arise, for example, because the sanctions provisions in the loan agreement restricted all members of the group from doing any business in or with particular countries (legal or otherwise).

In many cases, the Russia experience (as has been the case in past situations) has involved a tricky analysis of the legality of the borrower's position under the sanctions laws of a number of countries. The US, the EU and the UK for example, and as if often the case, imposed sanctions that covered a certain amount of common ground, but were not identical.

Many lenders reviewed their approach to sanctions provisions in new transactions in light of the Russian sanctions, which continue to evolve. Following the initial round of sanctions in the first half of 2022, there was some evidence that lenders were seeking to introduce more extensive sanctions language. Whether this is justified or not (one might argue) should depend on whether the sanctions risk presented by the borrower and its business has changed. Experience suggests that this approach is often accepted, and in most cases lenders recognise that a new round of sanctions, of itself, is not a reason to adjust the scope of existing provisions.

Sanctioned Finance Parties

The sanctions against Russia involved wide-ranging restrictions against dealing with certain Russian banks. These measures prompted loan market participants to focus on an issue that has not historically been a significant concern: what rights the borrower (and other parties to the agreement) have or should have in the event that a lender or administrative party becomes subject to sanctions.

In the context of syndicated facilities, if a lender or the agent is designated under sanctions legislation, all other parties to the facility agreement (the other lenders and the borrower) may benefit from express rights to manage that lender's participation, to ensure they are

not tainted by association and also to enable the facility to continue with minimal disruption. As some borrowers discovered, most loan agreements do not make specific provision for this situation.

Experience with the Russian sanctions has prompted some lenders and borrowers to propose provisions for dealing with sanctioned lenders (and other “**Finance Parties**”) in new transactions. The inspiration for such provisions is often the LMA’s Lehman provisions. The Lehman provisions prescribe a number of consequences should a lender default or become insolvent, including the cancellation of its undrawn commitments (and reinstatement in favour of another Lender) and the disenfranchisement for voting purposes of its drawn commitments.

Many of the consequences specified in the Lehman provisions for “**Defaulting Lenders**” (which are described more fully in Part V (Commentary on the Lehman Provisions)), are also potentially helpful if extended to a lender that is the subject of sanctions. However, it is important to recognise that the sanctions themselves may inhibit the exercise of some of these rights in practice; the most obvious example is that while a sanctioned lender may be able to sell its participation in the loan (if willing), the existence of sanctions may mean few are able legally to buy it.

Provisions addressing the management of sanctioned lenders are starting to appear in certain loan agreements, but they are by no means being included in all cases. The potential appearance of sanctioned finance parties may not be viewed as a material risk in all transactions. Investment grade facilities with relationship banks, for example, where the borrower has the right to veto transfers of lenders’ participations, might be viewed as lower risk. On the other hand, in cross-border transactions involving multiple currencies and a wide and evolving syndicate, or lenders in particular geographies, such provisions may be considered important.

Some borrowers may also consider seeking comfort from the lenders (and any new lenders that come into the syndicate thereafter) that they are not the subject of sanctions. This may take the form of a representation along the lines the borrower typically provides to the lenders. This is not a point often raised, but is a protection that certain stronger borrowers have customarily sought from their relationship banks for some years.

2. SUSTAINABILITY-LINKED LOANS

2.1 Introduction

Sustainable investing has, over the last few years, become an increasingly important strategy for many financial institutions. This is being driven by a number of factors including increasing demand from stakeholders (and society at large) to factor in sustainability considerations, a growing body of research into the positive correlation between sustainability and financial performance/investor returns as well as an expanding universe of regulation requiring lenders to disclose and report on sustainability-related risks. This has fuelled the development of a number of sustainable loan products - namely, green, social and sustainability-linked loans. Each product has distinct characteristics.

Green loans are loans made available exclusively to finance new and/or existing eligible green projects. Social loans are loans made available exclusively to finance new and/or existing social projects. In each case, the main determinant of the classification of a loan as “green” or “social” is a requirement to use the loan proceeds for green or social projects respectively.

Restrictions on the use of proceeds are not required for a loan to be categorised as a sustainability-linked loan (**SLL**). SLLs can comprise ordinary working capital facilities or event-driven term facilities, for example for acquisition purposes. SLLs seek to improve the borrower’s sustainability profile by aligning the pricing of the loan with the borrower’s sustainability performance. The borrower’s sustainability performance is assessed against predetermined sustainability performance targets (**SPTs**) as measured by predefined key performance indicators (**KPIs**).

KPIs may relate to environmental, social and/or governance matters (**ESG**). They might include for example, reductions in emissions, or targets relating to diversity within the borrower group. The range of possible ESG-related KPIs means that there is a suitable KPI for almost every type of business.

The SPTs are set by reference to the chosen KPIs. Depending on whether or not the SPTs are achieved by the borrower, the applicable margin will adjust upwards or downwards. Increasingly, an independent third party is engaged by the borrower to verify whether the SPTs have been satisfied. In addition, the lenders will usually expect ongoing

information on the borrower's performance in relation to the SPTs during the life of the loan.

SLLs have become very common, very quickly in Europe. ESG features (which turn a loan into an SLL) were fairly novel in 2020, but are now being incorporated into the majority of new financings.

2.2 A principled market

Sustainable finance products in the cash markets have been developed within the parameters of principles published by the relevant trade associations. The first set were the Green Bond Principles, first published by the International Capital Markets Association (**ICMA**) in 2014. These were followed by the LMA's Green Loan Principles in 2018. Equivalent principles now exist for social bonds and social loans as well as sustainability-linked products.

All of the principles are voluntary recommended guidelines. They are designed to promote consistency and integrity in the markets to which they relate (and thereby avoid claims of so-called "greenwashing"). They are under regular review as the underlying products evolve.

Borrowers will find that the applicable principles have a bearing on how the terms of the sustainable finance product in question are approached. They are all quite closely followed in practice. However, none of these principles are mandatory rules that of themselves dictate detailed terms in particular cases. Practice, and the views of individual lenders, may vary. Some lenders may take different (in some cases inaccurate) views of certain aspects of the principles and their status.

2.3 The LMA's approach to ESG

The LMA's principles were produced in conjunction with its sister organisations, the LSTA and the Asia Pacific Loan Market Association (**APLMA**). They currently comprise:

- **Green Loan Principles (GLP)**: published in 2018 (and updated since), the GLP clarify the criteria to be met if a loan is to be categorised as "green". The GLP build on, and refer to the Green Bond Principles published by ICMA. The GLP cover topics such as the use of proceeds and process for evaluation and selection of green projects, together with guidance on monitoring and reporting on the project and the use of the proceeds of the loan.

- **Sustainability-Linked Loan Principles (SLLP)**: published in 2019 (and updated since), the SLLP provide a framework for lending to incentivise the borrower's achievement of predetermined SPTs. The SLLP cover topics such as setting KPIs and SPTs, as well as reporting on and verifying the borrower's performance against those SPTs.
- **Social Loan Principles (SLP)**: published in 2021, the SLP provide a framework for social loans, where the proceeds of the loan are used for predetermined social projects. The SLP build on the Social Bond Principles published by ICMA. Similar to the GLP, the SLP cover topics such as the use of proceeds and process for evaluation and selection of social projects, together with guidance on monitoring and reporting on the project and on how the proceeds of the loan are applied.

It is worth noting that the development of the above principles has been quite strongly influenced by the evolution of ICMA's Green Bond Principles and other sustainability-related bond market principles. For this reason and also because ESG frameworks tend to be prepared with an eye on both loan and bond financing, treasurers may find it helpful also to familiarise themselves with the relevant aspects of ICMA's various [principles, guidelines and other material](#).

More generally, the LMA continues to take a very active role in the development of the market for these products, providing regular updates to the principles and guidance to reflect developing market practice. Alongside each set of principles, the LMA has also published guidance notes to aid interpretation of the principles in the market covering matters such as, for example, the external review and verification of KPIs and SPTs.

All of the principles mentioned above, and related guidance, are available on the LMA's [Sustainable Lending Microsite](#). Recommended to those new to sustainable finance is the LMA's [Sustainable Lending Glossary](#).

As ESG features become the norm in corporate lending, certain terms will become more settled and this is already evident in some areas. As a result, work on some LMA drafting is underway, to provide market participants with a starting point. The proposed LMA SLL rider (which at the time of writing, remains under review by the ESG documentation committee) is a potentially useful reference point for SLL terms, but like

all LMA drafting, its provisions will inevitably require adjustment and supplementation to reflect individual circumstances.

Negotiations on SLL terms generally focus on the setting of the KPIs and SPTs, the operation of the margin adjustment, the nature and extent of the borrower's reporting obligations and the manner of verification of the borrower's performance. Each SLL is, to some extent, unique, with KPIs and the associated SPTs varying widely between borrowers and across sectors. These aspects will still require discussion on a case-by-case basis even if the market coalesces, in time, around a generally agreed approach to the more mechanical aspects of SLL terms.

The remainder of this section 2 outlines the parameters that inform SLL terms and some of the key topics to be considered from the borrower's point of view. The commentary focuses on SLLs, as this is the product of broadest interest to investment grade borrowers (and the most likely to be documented within an Investment Grade Agreement). Further detail on green and social loans is outside the scope of this guide, although many of the topics touched on below will also be relevant to these use of proceeds products.

2.4 Selection of KPIs and SPTs

How are KPIs selected?

The key task for a borrower embarking on its first SLL is to set, and agree with the lenders, appropriate KPIs and SPTs. This requires an understanding of both the overarching criteria in the SLLP, as well as current guidance for particular industries and the KPIs that have been adopted by comparable businesses.

The SLLP require that KPIs are "*relevant, core and material to the borrower's overall business, and of high strategic significance to the borrower's current and/or future operations*". KPIs must also be measurable or quantifiable on a consistent methodological basis, and able to be benchmarked.

The Guidance to the SLLP states that a SLL is intended to reflect or support the borrower's existing sustainability strategy rather than to form part of it. Where a borrower already has a broader sustainability framework or objectives in place (which will often have been disclosed by way of public announcement or in the borrower's annual report or

separate sustainability report), this often serves as a starting point in the selection of KPIs (and associated SPTs).

Many treasury teams will have found themselves taking a leading role in the overall sustainability strategy of the business and the data collection process that underpins its targets. The development of a sustainability framework – or publicly announced targets – can involve significant investment in terms of time and costs. However, it lays the ground effectively for the implementation of sustainable financing. A framework is particularly useful for borrowers who plan to embed their sustainability goals across a range of debt products and wish to do so consistently.

Where KPIs cannot be neatly drawn from an existing sustainability strategy or framework (or alternative financing arrangements such as an existing bond issuance) for the purposes of the SLL, the lender group may take a more prominent role in the selection process (possibly via a Sustainability Coordinator, see further below). In such cases, there is a significant amount a borrower can do to prepare itself for discussions with lenders. In particular, it is useful to have an overview of the nature and scope of the KPIs and SPTs which are more common in SLLs generally as well as those put forward by other similar borrowers.

What is relevant, core and material for my business?

The SLLP include a short non-exhaustive list of common categories of KPIs, but (due the nature of the SLLP) do not include detailed lists of examples. Where a borrower requires additional assistance with selecting its KPIs, it may choose to appoint an ESG consultant, something which many borrowers choose to do in practice. There are also a number of public resources that borrowers (and lenders) can draw on in relation to the selection of KPIs. These include:

- **ICMA's registry of illustrative KPIs:** this was prepared with sustainability-linked bonds in mind, but the content is equally applicable to SLLs. The KPIs are organised by sustainability theme and sector. It is available in the [sustainable finance section](#) of ICMA's website.
- **Guidance produced by a number of organisations on issues considered material by industry sector:** the Sustainability Accounting Standards Board, for example, has developed a [Materiality Map](#) which identifies likely material sustainability issues industry-by-industry.

- **Market precedents (to the extent publicly available) and the experience of legal and debt advisers:** this can provide valuable insight into the types of KPIs recently selected by borrowers in similar sectors.

Note that it is possible to use one or more third party ESG ratings as a KPI. The Guidance to the SLLP notes, however, that given diverging and evolving rating methodologies or rating scales, where an ESG rating is not accompanied by other KPIs, the borrower is expected to explain why an ESG rating is the best indicator to reflect their core business ESG challenges.

There are ongoing discussions, at both UK and EU level, with regards to bringing ESG rating providers within the regulatory perimeter. Whether, and how, this might impact the use of ESG ratings as metrics in SLLs remains to be seen.

E, S or G?

Whether the KPIs relate to “E”, “S” or “G” (or indeed all three) is to be decided by the borrower and agreed with its lenders.

Environmental/climate-related KPIs remain dominant, with KPIs related to reductions in Scope 1, 2 and/or 3 greenhouse gas or CO2 emissions, the most common. Social/governance KPIs, such as the percentage of women in leadership positions in the organisation are becoming more common, but in general, KPIs focussing on ‘S’ and ‘G’ are still relatively few. In practice, KPIs are heavily specific to the individual borrower and the sector within which it operates.

How many KPIs do I need?

Lenders are increasingly looking for the inclusion of multiple KPIs in SLLs. While some SLLs do include only one KPI, two or three KPIs have become more common. Where multiple KPIs are included, the implications of meeting (or failing to meet) SPTs in relation to only some of the applicable KPIs will need to be considered - see further below.

What about the SPTs?

An SPT must be set for each KPI. The SLLP require that SPTs should be ambitious i.e. represent a material improvement in the chosen KPIs and be beyond a “business as usual” trajectory.

As with KPIs, where the borrower has a broader sustainability strategy or framework, and especially where the chosen KPIs are drawn from

that strategy or framework, the metrics used and targets set as part of that broader strategy or framework are likely to serve as a starting point in the calibration of the SPTs. The SLLP emphasise that the SPTs should be consistent with the borrower's overall sustainability/ESG strategy, assuming it is sufficiently ambitious. In addition, the Guidance to the SLLP stresses that SPTs should not be set at lower levels, or on a slower trajectory, to those already adopted internally and/or announced publicly by the borrower.

Where the borrower does not have existing targets to draw on, the SLLP offer guidance on how the SPTs should be set. SPTs should be based on recent performance levels and based on a combination of benchmarking approaches, including the borrower's own performance over a recommended minimum 3 year timeframe (where available), the borrower's peers and industry standards and/or reference to the science or to official country/regional/international targets. A borrower may also appoint an ESG consultant to assist with SPT calibration.

It is also necessary to consider how the SPTs are to be framed. For example, is the SPT to be framed by reference to an absolute value, a percentage change or a range? Where a percentage change, what is the appropriate benchmark against which the change is to be assessed? Is there to be an over/under performance threshold? Is the target to be cumulative or dynamic or static? Will the target change each year to encourage continued improvement or will there be an unchanging target which would enable the borrower to enjoy an economic benefit over the life of the deal once the target is met? Where the targets continue to change, should they be set on a non-linear basis to cater for a situation where improvements are unlikely to be seen in the initial years?

By way of example, where the KPI is the reduction of greenhouse gas emissions, there are various ways of framing the related SPT. The SPT could, for example, be framed as a specified % reduction in Scope 1, 2 and/or 3 emissions, calculated by reference to the level of emissions in a particular previous year. Alternatively, the SPT could be framed as the level of emissions not exceeding a specified value in each year or as falling within a specified target range. In each case, the %, maximum level of emissions, or range could be static over the life of the facility, or (as is more commonly seen) adjusted for each year over the life of the facility to encourage continued improvement.

The SLLP recommend that borrowers seek input from an external party via, for example, a second party opinion, as to the appropriateness of

their KPIs and SPTs as a condition precedent to the loan. In cases where no external input is sought, it is recommended that the borrower demonstrates or develops the internal expertise to verify its methodologies. In practice, where a borrower draws its KPIs and SPTs from its broader sustainability strategy, a second party opinion is not typically sought. This is in contrast to the bond market position, where pre-signing second party opinions are typically required (which might be viewed as appropriate, given the relative inflexibility of bond terms once set, in comparison to loans).

The *recommendation* in the SLLP that an external review is conducted pre-signing should be contrasted with the *requirement* for post-signing verification (as to which, see below).

Do I need to set my KPIs and SPTs on Day 1?

Some SLLs have been completed without any KPIs and corresponding SPTs being specified. The loan agreements include ESG mechanics (the margin adjustment and reporting provisions) but the KPIs and SPTs that bring those mechanics into operation are left to be agreed at a later date.

These deals, and whether it is in fact possible, at the outset, to categorise them as SLLs, have been somewhat controversial, against a backdrop of concerns about standards in the sustainable finance market and greenwashing. However, provided lenders have appropriate rights to approve KPIs/SPTs and related reporting mechanisms before the ESG mechanics go live (in the same way as would be the case were they agreed at the outset), this approach could be viewed as a practical solution for a borrower which is not quite ready to set KPIs/SPTs, but wants to take the first step on its SLL journey.

As the market is moving at some speed towards virtually all corporate loans being SLLs, there are good reasons to attempt to future-proof a loan with a three to five year tenor. Borrowers should, however, anticipate that lenders may need persuasion and a satisfactory case to support putting in place a structure along these lines.

What happens if I need to adjust my KPIs/SPTs?

Most SLLs now make provisions for adjustments to the KPIs and/or SPTs. This is important for a number of reasons, including:

- to ensure the KPIs remain relevant and fit for purpose;

- to ensure the SPTs remain ambitious, for example where a borrower overshoots its existing targets;
- to cater for situations where the borrower is no longer able to report on a specific KPI, for example, due to a lack of data;
- to cater for changes to the nature borrower's business through mergers/acquisitions/disposals, for example if the borrower acquires a business with a significant carbon footprint, any SPT related to the carbon footprint of the Group as a whole would need to be adjusted; or
- to cater for changes in the economic or business environment due to global events and rising costs. How and whether KPIs and SPTs, or the timetable for their attainment should be adjusted to take account of necessary cost reduction measures (such as changes to supply chains, freight options or capital investments) is a topic that is coming to the fore at the time of writing.

An amendment mechanism may be especially important for loans with longer tenors or those subject to extension options.

The amendment provisions often require the borrower and Agent/Sustainability Coordinator to negotiate in good faith to agree any amendment to the KPIs/SPTs. The precise circumstances in which the amendment mechanism is triggered (including whether lenders, as well as the borrower, should have the right to instigate a review of the KPIs/SPTs if believed necessary) and the level of consent required to effect any amendment (all lender or "Majority Lender") require attention. More recently, it seems that such amendments are considered to be a Majority Lender matter (save where such changes result in a Margin adjustment).

Borrowers may also find that some lenders look for most favoured nation (**MFN**) provisions in the context of the ESG provisions of the loan. These are designed to ensure that if the borrower sets more ambitious targets in other financing products or as part of its broader sustainability strategy, the SLL will be updated automatically by reference to the more ambitious target. MFN provisions are not currently a common feature of SLLs, although in general terms, it is apparent that banks are increasingly focussed on the implications of changes to the borrower's overall sustainability strategy.

2.5 What is the role of a Sustainability Coordinator?

One or more of the lenders on a syndicated SLL may be appointed by the borrower as the “Sustainability Coordinator” or “Sustainability Structuring Agent”. Such an appointment is not mandatory, although borrowers may find their relationship banks actively competing against each other for this role. The role varies but, in broad terms, it involves helping to identify KPIs, leading the negotiation of the KPIs and SPTs with the borrower and managing ESG-related queries from the lending group.

The LMA released an [Introduction to the Sustainability Coordinator Role](#) in July 2022. This contains an overview of what the role might involve, and the documentation considerations. From the borrower’s point of view, a key point to note is that the Sustainability Coordinator (like the Agent and other administrative parties to a syndicated loan) will typically seek to take on limited responsibility for its role.

The terms of the Sustainability Coordinator’s appointment will initially be documented in an appointment letter. The terms of such a letter might cover the scope of the Sustainability Coordinator’s role, any limitations on its liability, representations by the borrower with regard to information provided and confidentiality provisions. If the Sustainability Coordinator’s role extends beyond the signing of the Agreement (which is increasing often the case, for example, if it is to play a role should the KPIs/SPTs require subsequent adjustment), the terms of its appointment will also need to be reflected in the facility agreement.

As well as seeking protections similar to those afforded to the Agent/Arranger, the Sustainability Coordinator may insist on specific protections, for example, to the effect that each Finance Party is responsible for making its own analysis/appraisal of the sustainable aspects of the agreement and whether the SLL terms meet its own requirements and/or any external standards. Provision may also need to be made for the borrower to pay fees and expenses to the Sustainability Coordinator, on top of the other fees and expenses payable to Finance Parties under the loan.

There is currently no standard approach to fees for the role of Sustainability Coordinator or the documentary protections sought by it. As the number of SLLs increases, it may, however, be anticipated that the market will coalesce around both documentary protections and fees to some extent.

2.6 Reporting and verification

Reporting

The SLLP provide that borrowers should, where possible and at least once per year, provide the lenders with up-to-date information sufficient to allow them to monitor performance against the SPTs.

In practice, this requirement is satisfied in most cases by the borrower reporting on the SPTs by delivering to the lenders/Agent a Sustainability Compliance Certificate at the same time as it delivers its annual report. The certificate is typically required to be signed by one or two directors, similar to the usual process for financial covenant Compliance Certificates. If the borrower produces a sustainability report, the facility agreement will usually also impose an obligation on the borrower, in the form of an information undertaking, to deliver a copy to the lenders on an ongoing basis.

Reporting requirements are not typically controversial. There may, however, be more debate around verification requirements, specifically, whether the borrower is able to self-certify compliance with SPTs or whether external review and verification is required, and if so, of what type. Early SLLs typically relied on self-certification. However, when the SLLP were updated in May 2021, external input was expressed as a mandatory requirement.

External verification

External verification involves the borrower obtaining independent and external verification by environmental or other consultants, auditors or ESG ratings agencies of the borrower's performance level against each SPT for each KPI, at least once per year. This is to be distinguished from a pre-signing external review, such as a second party opinion. The SLLP recommend a pre-signing external review is carried out. Post-signing external verification is framed in the SLLP as a necessary element of an SLL.

Such verification may take different forms, for example, a limited or reasonable assurance statement or audit by a qualified external reviewer. Parties will need to agree on the form of verification and the third party who is to carry out such verification. Where the KPIs and SPTs match those in the borrower's broader sustainability strategy, it may be that the borrower can leverage an existing verification/audit process. Whilst a full audit/reasonable assurance statement may

provide a greater level of comfort to lenders, these forms of verification may not be suitable for all KPIs (especially those which are not climate-related) and will also be more time-intensive and costly. In practice, borrowers are tending to opt for a limited assurance statement to satisfy the external verification requirement of the SLLP.

The LMA has produced a guidance document on [external reviews in the context of green, social and SLLs](#). This provides voluntary guidance relating to professional and ethical standards for external reviewers, as well as to the organisation, content and disclosure for their reports.

2.7 Financial consequences of achieving (or failing to achieve) SPTs

Failure to meet an SPT does not usually constitute an event of default under the facility agreement. SLLs instead seek to incentivise the borrower's achievement of ambitious SPTs by providing the borrower with a reduction in the margin if the SPTs are met (and increasingly, an uplift in the margin if the SPTs are not met). There are a number of points to consider in relation to the operation of the margin ratchet in an SLL:

- ***Is the margin ratchet two-way?*** Will the margin move down and up depending on whether the SPTs are met or not, or will there only be a margin reduction in the event the SPTs are met? A two-way ratchet has become common, but does not invariably apply.
- ***What is the margin discount/premium?*** In the investment grade market, the pricing on most SLLs adjusts by a maximum of between 2.5 and 5bps. In the sub-investment grade/leverage loan market, where overall pricing is higher, a maximum sustainability adjustment of between 7.5 and 15bps is the currently typical range. While pricing is not the key driver for entering into an SLL, treasurers often comment that for standby facilities in particular (where the adjustment will impact only the commitment fees), current adjustments are too minor to be meaningful, in particular in the context of overall upward pressure on Margins.
- ***Where there is more than one KPI, what will trigger the margin adjustment?*** Do SPTs in relation to all KPIs need to be met, will meeting only one SPT trigger the margin reduction, or will meeting each SPT trigger its own incremental margin reduction? Will the trigger to the margin adjustment be framed by reference to a range

of values? There are some variations in how this topic is approached.

- **Who should receive the benefit of any margin discount/premium?** Should any margin premium or saving be applied by the lenders and borrower respectively, either in whole or in part, towards charitable causes or reinvested by the borrower in sustainable initiatives? There may be sound conceptual arguments in favour of a so-called “pay-away” (is it appropriate for either party to benefit commercially from failure/achievement of ESG targets?). However, if the borrower undertakes to apply the amount of any margin adjustment (up, down or both) to a sustainable purpose, a process for verification needs to be agreed in the same way as in relation to the KPI targets themselves (see above). Donating the amount to an agreed charity may be one solution, although in syndicated deals, achieving lender consensus on the appropriate cause may not be straightforward. Pay-away structures have nonetheless been a feature of a few syndicated SLLs to date, as well as a number of bilateral loans.

In some SLL discussions, lenders may propose a so-called “**ESG controversy**” clause. This provides that where the borrower has been subject to an ESG controversy, for example, an oil spill, the ESG margin adjustment will not apply, even if the KPIs are otherwise met. The mechanics and details of such a clause, including the definition of “ESG controversy” and for how long the contractual implications of the controversy apply, vary. Such provisions are not a feature of all SLLs.

It is generally accepted that the borrower’s failure to deliver a Sustainability Compliance Certificate and inaccurate reporting will not amount to an event of default. However, they may result in a higher, or baseline, margin applying until such time as the certificate is delivered/information is corrected, or (possibly) result in the loan being declassified as a SLL (see below).

2.8 Other consequences – declassification

Declassification is a concept that came to the fore during 2021 as SLLs began to proliferate. A declassification provision describes the circumstances in which a loan will cease to be classified as an SLL (resulting in the potential pricing advantage falling away). These might include factors largely within the borrower’s control, such as misreporting

or failure to report, as well as, in some cases, the lenders' belief that that the KPIs/SPTs no longer comply with the SLLP.

Declassification has been a hot topic in green loans and other use of proceeds products where, if a borrower is in persistent breach of reporting obligations, a lender cannot verify how funds are used and may consider itself exposed to greenwashing claims. It perhaps seems less fundamental in SLLs where the loan proceeds are used for unrelated purposes and where margin increases typically apply in the event of the borrower's breach or failure to report. Declassification is nevertheless being raised increasingly in SLLs, driven by lenders' internal reporting requirements (particularly where they have targets for deploying capital towards sustainable finance) as well as greenwashing concerns.

Declassification provisions are not currently standard in SLLs. Whether they are raised at all by lenders may be a relationship point (as well as linked to lenders' internal reporting requirements as noted above). Proposals along these lines have tended to crop up in more broadly syndicated deals, where perhaps there is a wider lender group and their individual policies on SLLs need to be considered.

The loan market is a private market. Lenders' duties of confidentiality to the borrower mean that it is not general market practice for declassification of an SLL or green loan to be announced. Nonetheless, declassification could trigger disclosure requirements. Given that this may have significant reputational and even economic consequences for the borrower (for example in terms of its share price), borrowers will often resist such provisions, or at least seek to ensure that the bar for declassification is set at an appropriate level. There is likely to be quite a detailed discussion about the circumstances in which declassification would be triggered, and the borrower's involvement in the declassification discussion. Borrowers are likely to resist triggers that result in the automatic declassification of the loan as an SLL (i.e. without a grace period and/or a consultation process to determine whether the trigger issue can be resolved).

Consideration will also need to be given to the precise consequences of declassification (for example, the margin ratchet no longer applies and the loan may no longer be marketed as sustainability-linked) and the ability to reclassify (for example, if a Sustainability Compliance Certificate is subsequently delivered).

2.9 Documentation

Many lenders and legal advisers have developed their own set of SLL clauses in a form that can be added to LMA-style agreements. As already noted, there is, as yet, no standard approach or any LMA drafting (although that is likely to change in the near future).

The current position presents a challenge in terms of the efficiency with which SLL terms can be reviewed as well inhibiting the comparison of proposals to assess emerging market practice. Borrowers should anticipate longer transaction timelines when seeking to adopt SLL terms for the first time.

Approaching SLL terms in a similar way to RFR terms – in other words, gathering the substance of such provisions in schedules to the agreement under a standardised framework – can be helpful to ensure that all necessary points are properly highlighted and understood, as well as in terms of facilitating comparison with other similar transactions.

Gathering together ESG terms in schedules is not currently common practice. In most agreements, SLL terms are inserted throughout the agreement (in the pricing, amendments provisions, reporting provisions, undertakings, for example) as adjustments to existing provisions.

As already noted, the LMA is working on an SLL Rider, which may in time help build consensus on certain aspects of SLL terms. In the meantime, mindful that the approach being taken to documenting the ESG mechanics varies from facility to facility, the checklist below contains an indication of the additional provisions that might be required and where they might be added to an Investment Grade Agreement.

SLL TERMS – CHECKLIST/

Issue	Summary
Margin adjustment	The SLL must set out (i) the margin adjustment mechanics, including the financial consequences of failure to deliver a Sustainability Compliance Certificate and of inaccurate reporting; (ii) provisions permitting adjustments to the KPIs/SPTs in specified circumstances and, in some cases, (iii) declassification provisions. These terms may be included in a separate “Sustainability Margin Adjustment” clause or incorporated into Clause 9 (<i>Interest</i>).
Information Undertakings	Clause 20 (<i>Information Undertakings</i>) is typically supplemented with the requirement to deliver a verified Sustainability Compliance Certificate and sustainability report (where relevant).
Duties and responsibilities of Sustainability Co-ordinator	Certain provisions of Clause 26 (<i>The Role of the Agent and the Arranger</i>) may be extended to cover the Sustainability Coordinator. Additional protections/limitations for the Sustainability Coordinator may also be required.
Amendments and waivers	Any amendments to the ESG-related provisions requiring unanimous lender consent must be added to the list in Clause 35 (<i>Amendments and Waivers</i>).
KPIs and SPTs	These are usually described in a schedule to the agreement and cross-referenced in the Definitions section.
Form of Sustainability Compliance Certificate	These are usually included as a schedule to the agreement and cross-referenced in the Definitions section.

2.10 A note on ESG due diligence (of relevance to all lending transactions)

The foregoing discussion is focussed on SLLs, but treasurers will be aware that the generally increased focus by investors on sustainability has resulted in more detailed due diligence on the sustainability profile of borrowers in lending transactions of all types. Lenders are seeking to assess the sustainability profile of all those to whom they lend, even where the product in question has no ESG features. This is to inform their credit analysis, for reputational reasons and to meet reporting

requirements. Reporting requirements (whether internal or regulatory) are the key driver of the information the lenders and other investors will require from the borrower.

Certain borrowers will be subject to their own regulatory reporting requirements, requiring public disclosure of various ESG-related matters. For example, in the UK, the Listing Rules and the Companies Act 2006 place obligations on companies to make certain climate-related financial disclosures. For in-scope borrowers, lenders may find their regulatory disclosures sufficient or at least a fairly comprehensive starting point for additional targeted information requests.

Corporates which are not subject to regulatory reporting requirements and which do not have a publicly announced broader sustainability strategy may be asked to complete comprehensive ESG questionnaires at the pre-contract and marketing stage. This may be the case in particular, where a lending relationship is less established.

The completion of these questionnaires may be quite time-consuming and there is some pressure to develop a standardised approach to avoid borrowers having to answer multiple unique lender questionnaires. Various initiatives aimed at streamlining the process are currently underway. The LMA is involved in a project which aims to harmonise ESG reporting by borrowers across credit markets by developing an ESG reporting template with both general and industry-specific questions. In the meantime, the LMA has produced a [Guide for Company Advisers on ESG Disclosure in Leveraged Finance Transactions](#), which is a practical tool for company advisers to use in support of their ESG-related disclosures in leveraged transactions and potentially useful more broadly.

2.11 Regulatory developments – the direction of travel

As climate change and sustainability have risen to the top of the political agenda, there has been a dramatic increase in ESG-related legislation and regulation, affecting both corporate and financial institutions. There are a significant number of further developments already in the pipeline in the UK and beyond, potentially with more to come.

In the UK, many corporates and financial institutions are subject to TCFD-based climate-related reporting obligations¹⁰ under the UK Listing Rules (on a 'comply or explain' basis) and the Companies Act 2006 (on a mandatory basis). As part of its strategy to 'green' the financial system, the UK Government plans to bring existing reporting obligations together with new requirements under one integrated framework – the Sustainability Disclosure Requirements (**SDR**). The SDR will cover three types of mandatory sustainability disclosure (corporate, asset manager and asset owner, and investment product) and incorporate the global baseline reporting standards being developed by the International Sustainability Standards Board. It will also include a requirement for in-scope entities to produce transition plans setting out how they intend to meet the UK Government's commitment to net zero by 2025.

The UK Government's intention is that the SDR will achieve mandatory climate-related reporting requirements across the economy by 2025. Whilst the timing, scope and detail of the SDR are still being finalised, there is no doubt that the new framework will be far reaching and comprehensive. A similar expansion of reporting requirements is afoot in the EU, with the Corporate Sustainability Reporting Directive at the time of writing, making its way through the EU legislative process.

In addition to more stringent climate-related reporting requirements, financial institutions are also facing tighter scrutiny from regulators around the world. In the UK, for example, the Prudential Regulation Authority (**PRA**) expects banks to have embedded its supervisory expectations on the management of climate-related financial risks and is now actively supervising banks in this respect. In addition, the Bank of England's stress testing framework is now being used to assess the impact of climate-related risks on the UK financial system, and the PRA is exploring whether enhancements might be needed to the regulatory capital framework to address climate-related financial exposures.

The legal and regulatory developments outlined above are not aimed directly at the sustainable finance market – at the time of writing, the market is, by and large, unregulated, with sustainable finance products in the loan market governed instead by voluntary guidelines such as the SLLP, as discussed above. There is, however, no doubt, that increased reporting and disclosure obligations for borrowers and lenders, coupled

¹⁰ i.e. based on the recommendations of the Task Force on Climate-related Financial Disclosures.

with tougher regulatory requirements on financial institutions, will impact the ESG strategy of market participants with a resulting impact on the sustainable finance market, the financial products sought and the terms upon which those products are made available.

3. UK LEGAL DEVELOPMENTS

3.1 Pensions Schemes Act 2021

PSA 2021 – in brief

Aims: to confer new powers on the UK Pensions Regulator to deter and, where necessary, punish wrongdoing in relation to UK defined benefit pension schemes.

Relevant to: all businesses including an employer under a UK defined benefit pension scheme.

Introduction

Since the Pension Act 2004 (**PA 2004**), the UK Pensions Regulator (**TPR**) has had relatively extensive rights to intervene in corporate activities that present a “moral hazard” risk of losses to members of underfunded defined benefit (**DB**) pension schemes. Further, it has had the power to impose responsibility for such losses, in appropriate circumstances, on persons “connected or associated” with the DB scheme employer. The definitions of “connected” and “associated”, taken from the Insolvency Act 1986, are extremely wide, potentially extending responsibility for DB scheme liabilities beyond the scheme employer and its corporate group, to directors, shareholders and even, potentially, lenders in certain circumstances.

Certain more recent and high-profile corporate failures and their adverse impact on pensioners, prompted the UK Government to re-examine the efficacy of TPR and its powers under the PA 2004. The result of that review was the Pension Schemes Act 2021 (**PSA 2021**), which amends the PA 2004 to confer new powers on TPR to deter and penalise wrongdoing in relation to DB pension schemes.

The aspects of the PSA 2021 that have prompted most concern from the lending community are the new criminal sanctions and punitive financial penalties for behaviour adversely affecting DB scheme benefits. As explained further below, these can be imposed on parties with no formal connection to the scheme including lenders, investors and advisers. While in most cases, the risk that lenders might commit one of the new offences simply by providing finance is low, the PSA 2021 has prompted lenders to look more carefully at any DB schemes within a borrower’s

group structure, the funding position of such schemes and how the proposed financing might affect the scheme.

The PSA 2021 has therefore been a topic of discussion in lending transactions since it came into force. Treasurers of groups with UK DB scheme liabilities may find it helpful to be familiar with the framework of the PA 2004 as amended by the PSA 2021, the key features of which are summarised below.

Contribution notices/financial support directions

The PA 2004, among other things, conferred powers on TPR to require the provision of additional support for DB scheme liabilities in the form of “contribution notices” (**CN**) and “financial support directions” (**FSD**). A CN or an FSD can be issued to parties “associated or connected” with the scheme employer, which terms, as noted above, are broadly defined. The CN power is of most relevance to financing transactions as it considers the impact of corporate acts on the corporate creditor.

An FSD requires the provision of appropriate “financial support” for the employer’s obligations in relation to the scheme where that employer is “insufficiently resourced”, and where, in TPR’s view, it is reasonable to require the target to provide financial support. The FSD powers are unchanged by the PSA 2021.

Prior to the PSA 2021 changes, a CN could be issued where TPR believed that:

- the recipient was a party to, or “knowingly assisted” in, a deliberate act or failure to act, the main purpose of which was to prevent recovery of a pension scheme debt (the **main purpose test**), or
- the recipient’s act or failure to act has “detrimentally affected in a material way” the likelihood of accrued scheme benefits being received (the **material detriment test**).

The PSA 2021 introduced 2 additional grounds for issuing CNs, both of which focus on the resources of the DB scheme employer rather than on the scheme itself. They apply where TPR believes that:

- the recipient was a party to a deliberate act or failure to act that materially reduced the debt likely to be recovered from the employer in the event of an immediate insolvency (the **employer insolvency test**), or

- the recipient was a party to a deliberate act or failure to act that reduced the resources of the employer in a manner that was material when compared to the buy-out deficit of the scheme (the **employer resources** test).

In all four cases, it must be reasonable to require the recipient to pay the amount specified.

TPR's [guidance](#) on the "material detriment", "employer solvency" and "employer resources" tests gives examples of the sorts of events that it considers are likely to satisfy the tests. These include an increase in debt or introduction of a prior-ranking security, such as the grant of a fixed and floating charge over the employer or the assets of the employer's wider group. The risk of a CN is therefore a relevant consideration in the context of leveraged and other secured financings.

Defences to the "material detriment", "employer solvency" and "employer resources" tests apply if, in summary, the target of the CN can show that it considered the DB pension scheme and took reasonable steps to mitigate the effect of the act that triggered the CN (e.g. the financing or other transaction). In debt transactions (often more highly levered or distressed transactions) where there is concern about the moral hazard powers, the parties may choose to use the voluntary pre-clearance procedure, which enables parties to obtain a statement from TPR in advance of a transaction, that, in its opinion, it would not be reasonable for it to impose an FSD or CN in the specified circumstances.

Criminal offences/punitive financial penalties

The PSA 2021 introduces new criminal penalties for misconduct in relation to DB schemes. Anyone found guilty of these offences faces up to 7 years imprisonment and/or unlimited fines. As already noted, these offences can be committed by any person, regardless of whether there is any connection to or association with the DB scheme or its employer. This includes, potentially, lenders.

The new criminal offences are:

- avoidance of an employer debt to a DB pension scheme, committed where a person acts in a manner or engages in a course of conduct which prevents the recovery of or compromises an employer debt, where the person intended this to be the outcome; and
- conduct risking accrued DB pension scheme benefits.

It is the latter offence that lenders have perhaps been most focussed on in terms of their own potential liability. It comprises any act or course of conduct that “detrimentally affects in a material way” the likelihood of accrued DB scheme benefits being received where the person knew, or ought to have known, that it would have that effect. Defences are available, if the person had a “reasonable excuse” for their actions.

TPR’s [criminal offences policy](#) sets out how it plans to exercise its new powers to prosecute these offences and what will constitute a “reasonable excuse”. In summary, the policy indicates that TPR will look closely at the reasons for the act in question. For example, if the act is a financing, the taking or enforcement of security for example, TPR might look at whether the relevant action taken by the lender(s) was in furtherance of their own commercial interests. There is no clearance mechanism for these criminal offences.

New financial penalties of up to £1m apply in broadly the same circumstances as the criminal offences outlined above.

Impact on lending documentation

Since the PA 2004, engagement with DB scheme trustees has become a routine part of preparations for acquisition or secured financings and restructurings. In some transactions, this has meant obtaining voluntary clearance from TPR is a condition precedent to funding, impacting timetables and in some cases, terms. The process of considering whether to seek clearance involves a negotiation with the scheme trustees, who may impose conditions to mitigate the effect of the transaction on the pension creditor, which can include rights to share in any security package for example.

Contractual provisions relating to DB schemes are included in certain secured facility agreements, to enable lenders to monitor the DB scheme over the life of the facility. Such provisions include confirmatory representations regarding the existence and extent of DB scheme liabilities, undertakings with regard to the group’s compliance with its obligations to the pensions creditor, restrictions on new pensions liabilities and specific events of default, should a CN or FSD be issued in relation to a DB scheme. Optional provisions along these lines are a feature of in the LMA’s Leveraged Agreement and were added following the enactment of the PA 2004.

The impact of the PSA 2021 on non-distressed lending transactions (as noted in the introduction above) is mainly evident in lenders’ increased

focus on DB scheme liabilities in pre-contract due diligence. The funding position of any relevant DB scheme continues to be analysed in all relevant debt transactions as part of the lenders' credit assessment, but neither the substance nor the incidence of contractual provisions in loan agreements relating to DB pension schemes has changed in any material way. Contractual protections for lenders continue to be a feature of certain highly leveraged (secured) loan agreements. Contractual provisions relating to DB pension scheme liabilities, being a function of increased credit risk, are not a typical feature of loans to investment grade borrowers and that continues, so far, to be the case.

This is in line with the UK Government's intent, which was to tighten protections against abuse of pension schemes and wilful / reckless behaviour, in light of high profile corporate failures of recent years. The aim was not to inhibit genuine corporate or financing transactions.

3.2 National Security and Investments Act 2021

NSIA 2021 – in brief

Aims: empower the UK Government to intervene in acquisitions of shares and assets in sensitive sectors presenting a risk to national security.

Relevant to: acquisition financings (shares or assets) and secured financings involving security over shares in relevant sectors.

Introduction

The National Security and Investment Act 2021 (the **NSIA**) came into force on 4 January 2022. It empowers the Secretary of State for Business, Energy and Industrial Strategy (the **Secretary of State**) to review and where necessary, intervene in investments in qualifying entities and assets that have given, or may, give rise to a risk to national security.

The NSIA is engaged where a relevant "investment" takes place. This includes acquisitions of relevant shares or assets. However, it extends also to ordinary secured financings, if the security assets include shares in relevant entities. Depending on the nature of the security arrangement (see further below), a notification under the NSIA may be required when the security is taken, or at the point of enforcement.

Accordingly, the application of the NSIA must be considered in relation to all acquisition financings and also in relation to secured financings where the security package includes security over relevant shares.

The key features of the NSIA, and its impact on lending transactions and documentation are summarised briefly below. This a particularly complex piece of legislation that has prompted much legal debate. To assess the potential impact of the NSIA on any given investment and its related financing requires an analysis of the detailed criteria in the NSIA and related guidance, which is complex and in some areas, arguably uncertain in its application.

The NSIA 2021

The Secretary of State's review of a relevant investment under the Act can be initiated in three ways:

- ***Call-in notification:*** the Secretary of State issues a "call-in" notice to the parties (which may happen before or after the transaction in question).
- ***Voluntary notification:*** one or more of the parties (the investor(s), the seller or the target) voluntarily decides to give notice of the investment to the Secretary of State.
- ***Mandatory notification:*** in certain circumstances, investor(s) are required by the Act to seek approval from the Secretary of State before completing an investment.

The Secretary of State's call-in power applies to transactions involving UK and foreign investors, and can apply to foreign entities as well as UK entities, if the former have sufficient nexus to the UK. It is not limited to a particular sector of the economy, rather turning on the existence of a "trigger event" (broadly, a change of control within the meaning of the NSIA) in relation to a "qualifying entity" or "qualifying asset".

The voluntary notification regime applies in the same circumstances as the call-in power. Its purpose is to assist parties who wish to be certain that the investment/transaction will not be the subject of a call-in notice. If the Secretary of State confirms that no further action will be taken under the NSIA in relation to the relevant investment, this is known as "validation".

The mandatory notification requirement applies to a narrower range of investments than the call-in power. Mandatory notification is required

only where an acquirer “gains control” of a “qualifying entity” (it does not apply to “qualifying assets”). Further, the qualifying entity must operate in a sector of the economy specified in the National Security and Investment Act (Notifiable Acquisition) (Specification of Qualifying Entities) Regulations 2021 (the **Notifiable Acquisition Regulations**).

The Notifiable Acquisition Regulations specify seventeen areas (the **17 specified areas**) which the UK Government considers of particular risk to national security: Advanced Materials, Advanced Robotics, Artificial Intelligence, Civil Nuclear, Communications, Computing Hardware, Critical Suppliers to Government, Cryptographic Authentication, Data Infrastructure, Defence, Energy, Military and Dual-Use, Quantum Technologies, Satellite and Space Technologies, Suppliers to the Emergency Services, Synthetic Biology and Transport. The Schedule to the Notifiable Acquisition Regulations describes each in more detail.

The consequences of failure to comply with the mandatory notification requirement before the acquisition of control are serious. Criminal and monetary penalties apply and further, the investment is void. If a mandatory notification is not made when required, the NSIA does, however, include a process for retrospective validation, which, if cleared by the Secretary of State, will mean that the investment is treated as if it was valid at inception.

Impact on financing transactions

As noted in the introduction, under the NSIA, the concept of an “investment” extends some way beyond a simple acquisition of shares or assets. While the issue of most financing instruments such as loans and bonds should not give rise to notification requirements or the exercise of call-in powers, the NSIA may nonetheless have an effect on:

- the structure and terms of the financing of an acquisition with implications under the NSIA; and
- certain security arrangements and documentation (whether or not entered into in the context of an acquisition).

Acquisition financings

The application of the NSIA is a pre-contract consideration relevant to all acquisitions with a UK nexus. If the conclusion is that the transaction is in-scope, the NSIA will also be relevant to any related financing. The practical implications for the financing will depend on how the acquisition is categorised for the purposes of the NSIA and national security risk.

If the acquisition is a notifiable acquisition (i.e. the target undertakes activities in one of the 17 specified areas), clearance under the Act will most likely be a condition precedent to the acquisition itself. It will also therefore be a condition precedent to the advance of funds under the loan agreement (or any bond issue).

If the acquisition does not trigger a mandatory notification obligation, but is considered to be at risk of call-in, the lenders may require the borrower (if it has not itself determined to do so) to make a voluntary notification and obtain validation. This could be a condition precedent or condition subsequent to the advance of funds/bond issue, depending on the level of risk and the circumstances.

If the acquisition financing is secured on the target's shares and/or assets (see further below), there may be a question as to whether a separate mandatory or voluntary notification (depending on the classification of the acquisition) is desirable in relation to the grant of the security. If notification is required or considered prudent in relation to the security, that will most likely need to be a further condition precedent to the acquisition, as well as to the advance of funds under the loan agreement or bond issue.

The information undertakings may also need expressly to contemplate any notifications under the NSIA – whether made at the outset or subsequently. As voluntary notifications can be made by various parties to the transaction, the borrower may wish to ensure that lenders are obliged to co-operate with any filing it may choose to make.

Even in low-risk scenarios, lenders may want assurance that the acquisition they are financing is low risk i.e. not at risk of being unwound or otherwise disturbed under the Act. Representations with regard to the target could achieve this. Such representations might provide for example, that so far as the borrower is aware, the target does not undertake activities in or closely related to the 17 specified areas (and/or the equivalent in relation to assets). Borrowers may resist specific representations on the basis that this topic is covered by general representations relating to the absence of authorisations/consents etc., depending on the scope of those other representations. Whether the lenders have the effective ability to rely on representations and warranties in the acquisition agreement or on due diligence reports may also be a consideration.

Security over shares

Notifications under the NSIA on behalf of security-takers may arise in the course of an acquisition financing, but that may not necessarily be the case.

As noted above, the NSIA can be engaged in relation to secured financings (whether or not involving an acquisition), which are secured on shares in an entity in one of the 17 specified sectors. A consideration of the NSIA (and the non-acquisition specific points above) is necessary in relation to all secured financings.

The change of control for the purposes of the NSIA, in the context of security over shares, relates to the position of the security-taker (the lender), not the security-provider. The “control” tests are complex and how and when they apply to security over shares in entities operating in one of the 17 specified areas has been the subject of some debate. Whether the mandatory notification requirement is engaged (or when it is engaged) turns on the terms of the relevant security arrangement. In broad terms, the mandatory notification regime will be engaged where legal title to the shares or control of the voting rights attached to them is conferred on the security-taker (the lender).

Most English law security arrangements take the form of equitable mortgages or charges, which do not involve a transfer of legal title to the shares to the security-taker when the security is put in place. Further, the terms of the security arrangement typically specify that the security-provider (the borrower) will retain control of the voting rights attached to the shares pending an enforcement event. In such circumstances, the mandatory notification requirements under the NSIA (if the shares are in an entity operating in one of the 17 specified sectors), should be triggered only at the point the security becomes enforceable¹¹. It is possible, however, to create security arrangements under English law (a legal mortgage) which would constitute a change of “control” under the NSIA. Further, security over relevant shares created under the laws of other jurisdictions (notably, Scotland), may necessarily involve a change of legal title to the relevant shares.

¹¹ The Government has published some helpful [Market Guidance Notes](#) which clarify this point.

The application of the NSIA in the context of security arrangements (given the adverse consequences of failure to comply with the NSIA) is being closely monitored by lenders.

3.3 Economic Crime (Transparency and Enforcement) Act 2022

ECA 2022 – in brief

Aims: to provide greater transparency with regard to the ownership of real estate in England and Wales.

Relevant to: secured financings involving security over real estate in England and Wales owned by overseas entities.

Introduction

The Economic Crime (Transparency and Enforcement) Act 2022 (**ECA 2022**) received Royal Assent in March 2022. The ECA 2022 establishes the framework for a new Register of Overseas Entities (**OE Register**), which is designed to provide greater transparency with regard to the ownership of real estate in England and Wales. It achieves this by requiring overseas entities which already own or subsequently acquire UK property to disclose details of their beneficial owners, which will be published on the OE Register.

The establishment of the OE Register and associated Land Registry restrictions (see further below) have implications for the registration of newly created security over real estate in England and Wales, and potentially also for the enforcement of such security. In secured lending transactions involving relevant real estate, borrowers are receiving enquiries on this topic from lenders, and in cases where compliance with the ECA 2022 presents a risk, requests for contractual protections.

The ECA 2022

Under the new regime, overseas entities which own or wish to acquire a “qualifying estate” in England and Wales (being a freehold estate, or leasehold estate granted for a term of more than 7 years) must apply to Companies House to be registered on the OE Register. The information to be provided includes information about their beneficial owners. The information supplied to Companies House must be verified by a person who is a “relevant person” for the purposes of the Money Laundering Regulations 2017.

The regime applies retrospectively to overseas entities which were registered as proprietor of a qualifying estate on or after 1 January 1999. These entities have a six month transitional period from 1 August 2022 to register with Companies House. Overseas entities which have disposed of a qualifying estate between 28 February 2022 and the end of the transitional period are also required to provide details of their beneficial ownership as it was immediately prior to the disposition to Companies House.

After registering with Companies House, the overseas entity will receive a unique Overseas Entity ID, which must be supplied to the Land Registry whenever the entity wishes to register title to, or any disposition of, a qualifying estate (including the grant of security).

Once registered, an overseas entity must reconfirm/update its information with Companies House at least annually (until it successfully applies to be removed from the OE Register).

The ECA 2022 creates a number of criminal offences for non-compliance. For example, failure to register an existing interest or to comply with the updating duty is a criminal offence and may result in fines and/or imprisonment.

Registration at Companies House (and the updating of such registration as required) is also a pre-requisite for the registration of certain dispositions at the Land Registry. These include:

- registration as proprietor of a qualifying estate (meaning those not on the OE Register are prevented from acquiring legal title to the land); and
- registration of a transfer, a grant of a lease for more than 7 years or the creation of a charge.

From 1 February 2023, overseas entities who already owned a qualifying estate as at 31 July 2022 (and were registered as proprietor of that estate on or after 1 January 1999) who have not registered up to date details on the OE Register will be similarly restricted from registering certain dispositions at the Land Registry (being a transfer, grant of a lease for more than 7 years and grant of a charge).

There are some exceptions to the Land Registry restrictions described above. These include: (i) dispositions made in pursuance of a statutory obligation or court order, or occurring by operation of law, (ii) dispositions made in pursuance of a contract made before the restriction

is entered in the register, (iii) dispositions made in the exercise of a power of sale or leasing conferred on the proprietor of a registered charge or a receiver appointed by such a proprietor and (iv) dispositions made by a specified insolvency practitioner in circumstances to be prescribed by future regulations.

Implications for secured loans

The ECA 2022 will be relevant to any transaction which involves an overseas entity granting security over property in England and Wales, current or future. In such a case, lenders will wish to make sure that the entity has registered with Companies House and has an Overseas Entity ID so that the security can be registered at the Land Registry.

For existing overseas entity owners of qualifying estates, the Land Registry restrictions on registering security will not take effect until 1 February 2023, after the six-month transitional period. If the entity granting security is an existing owner of property in England and Wales, it may be that affected borrowers do not see requests from lenders relating to the ECA 2021 until late 2022/early 2023.

The Land Registry restrictions may have implications for the enforcement of security, where the overseas entity is not registered with an up-to-date registration on the OE Register. A number of the exceptions to the restrictions set out above seek to address this point, but whether they will apply in a given situation will depend on the type of security in question. Further, failure to register pre-existing interests could prompt a technical default under compliance with laws undertakings for example, in affected facility agreements.

In new transactions involving the acquisition of property in England and Wales by an overseas entity (for example, where the lenders are advancing funds to an overseas borrower for the acquisition of property in England and Wales and intend to take a legal mortgage over that property), lenders are thinking about additional contractual protections, to be sure that the overseas entity will be able to register as the proprietor of the property (as well as registering the security). These might include, for example:

- Evidence of registration at Companies House / provision of an Overseas Entity ID as a condition precedent to funding and to taking the security.

- Repeating representations that the entity has registered at Companies House and is in compliance with its ongoing obligations under the ECA 2022.
- Undertakings to the effect that the entity will maintain its registration at Companies House and will comply with its ongoing obligation to update its information annually (although borrowers may argue that the standard 'compliance with laws' undertaking in most loan agreements should be sufficient to cover this).
- Information undertakings requiring the entity to confirm to the lenders that it has met its ongoing obligation to update its information annually at Companies House.

There is currently no specified deadline for Companies House to process registration applications. Parties are seeking to allow plenty of time in transaction timetables for the registration process. Affected borrowers should initiate the registration process as soon as possible to mitigate any impact on the timetable.

PART IV / COMMENTARY ON THE INVESTMENT GRADE AGREEMENTS

1. INTRODUCTION

This Part contains a commentary on key clauses of the Investment Grade Agreement by reference to the Compounded/Term MTR. It refers to clauses of the Compounded/Term 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 an LMA template.

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

2. 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 Original Parties*).
 - 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 Investment Grade Agreements do not cater for Obligors that are not companies. Adjustments will be required if any of the Obligors are partnerships or sovereign or government entities, for example.

- 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 Original Parties*).
 - 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(*Fees*)).
 - 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 Compounded/Term MTR as drafted. Additional parties may need to be added in practice depending on the nature of the facilities, for example:

- Secured syndicated facilities, for example, require the appointment of a security agent to hold the security assets on behalf of the Lenders.
- SLLs may involve the appointment of a Sustainability Co-ordinator which (if its role extends beyond signing) will also be a party to the agreement (see discussion in section 2 (Sustainability-linked Loans) of Part III (*Hot Topics*)).

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 Compounded/Term MTR.

“Additional Business Day”

See comments under “**Business Day**” below and at Schedule 13 (*Reference Rate Terms*).

“Agent’s Spot Rate of Exchange”

See comments under Clause 6.3 (*Change of currency*) and Clause 6.4 (*Same Optional Currency during successive Interest Periods*).

“Availability Period”

This is the period for which each of the Facilities is available for drawing. It is also the period during which Commitment Fees accrue (see comments under Clause 12(*Fees*)).

“Alternative Term Rate” and “Alternative Term Rate Adjustment”

This definition is to be used if the parties agree to use a term rate other than the Primary Term Rate as a fallback rate. For example, if loans in euro reference EURIBOR as the Primary Term Rate, the parties might (subject to the availability of a Term €STR rate), choose to interpose Term €STR as the primary fallback rate for EURIBOR. Alternatively, the compounded €STR average rates published by the ECB could be used. The Alternative Term Rate Adjustment caters for the addition of a CAS to the Alternative Term Rate if one is required.

Comment

The concept of an Alternative Term Rate is not being used frequently at present, but could be relevant in the future – in particular as the use of a forward-looking term rate is part of the €STR-based fallbacks suggested by the ECB for EURIBOR loans. For now, this is an example of a definition that in most cases has no practical effect, because in the applicable Reference Rate Terms in Schedule 13 (*Reference Rate Terms*) it is not specified to apply.

See Part II (Risk-Free Rates in the Loan Market) for further background on €STR fallbacks and the LMA's modular drafting in the RFR Agreements.

Fallbacks are discussed more detail in the comments on Clause 11.1 (*Interest Calculation if no Primary Term Rate*).

“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 (the **“Base Currency Amount”**) on the date which is three Business Days prior to the Utilisation Date (date of drawing) or if later, the date on which the Agent receives the Utilisation Request.

Note that the Compounded/Term MTR assumes that both the Term Facility and the Revolving Facility are denominated in the same Base Currency.

These definitions are discussed further at Clause 6.3 (*Change of currency*) and Clause 6.4 (*Same Optional Currency during successive Interest Periods*).

“Baseline CAS”

This optional definition is relevant if the parties have agreed that interest on Compounded Rate Loans should include a CAS. Whether a Baseline CAS applies, and if it does, how it is to be calculated, is left for the parties to specify for each Compounded Rate Currency in Schedule 13 (*Reference Rate Terms*).

Comment

The inclusion of a CAS as part of the interest applicable to Compounded Rate Loans has become less common since the beginning of 2022, although it is included in some transactions.

Three-part pricing and the application and calculation of any CAS that is agreed are discussed in section 5 (Transition Issues) of Part II (*Risk-Free Rates in the Loan Market*).

See also comments at Schedule 13 (*Reference Rate Terms*) in relation to the Baseline CAS.

“Break Costs”

Whether Break Costs apply to Loans in any currency (whether a Term Rate Currency or a Compounded Rate Currency) must be specified in Schedule 13 (*Reference Rate Terms*). If Break Costs do apply, the parties must agree a definition of Break Costs in the relevant Reference Rate Terms schedule. The definition of Break Costs determines the scope of the indemnity in Clause 11.5 (*Break Costs*).

The Reference Rate Terms applicable to euro Loans referencing EURIBOR include a definition of Break Costs. The definition in summary, consists 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 definition is based on a theoretical assumption that Lenders arrange matched funding of each euro Loan over a term that coincides with the relevant Interest Period. As a result, if they are prepaid before the end of the Interest Period, the Break Costs incurred are equal to the lost return on an equivalent deposit amount. 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.

Break Costs are optional in the Reference Rate Terms for Compounded Rate Currencies.

Comment

A concept of Break Costs that assumes that Lenders are funding themselves on a matched term basis has been long accepted as a reasonable metric for actual prepayment losses in the context of a loan referencing an IBOR that takes into account inter-bank funding costs. In the context of a Compounded Reference Rate that does incorporate funding costs in the same way and is also calculated on a daily basis, such a concept seems less appropriate as a metric for the loss (if any) that might be incurred if the Lenders' expectation of funding to the end of the Interest Period turns out not to be the case. This is why Break Costs are optional in the Reference Rate Terms for Compounded Rate Currencies.

It has quickly become accepted that the Break Costs provisions should not apply to Compounded Rate Loans. In a few instances (very limited), this has prompted Lenders to seek alternative protection in the form of a prepayment premium or administrative fee to cover the costs of managing mid-Interest Period prepayments. Alternatively (and more commonly), Lenders may seek to place limits on the number of mid-period voluntary prepayments permitted in any given period to control the costs of managing multiple prepayments (see comments on Clauses 8.4 and 8.5 (*Voluntary prepayments*) below).

Where such alternative controls are agreed, Borrowers may argue that such limits, premia or fees should not apply to mid-period prepayments which are the result of circumstances involving no fault on the Borrower's part, such as under Clause 8.1 (*Illegality*), Clause 11.3 (*Market Disruption*), Clause 13 (*Tax Gross-up and Indemnities*) and Clause 14 (*Increased Costs*).

The concept (and a definition) of Break Costs may still be required for Term Rate Loans. The definition in Part IVA of Schedule 13 (*Reference Rate Terms*) applicable to euro loans referencing EURIBOR reflects the long-standing LMA formulation of Break Costs in the LIBOR Agreements. Points which Borrowers might seek to negotiate in relation to that definition are discussed under that Schedule.

“Business Day”, “Additional Business Day” and “RFR Banking Day”

The Compounded/Term MTR includes the concept of a **“Business Day”**, as well as two new defined terms – **“Additional Business Day”** and **“RFR Banking Day”**. These are subtly different and must be used with care when adapting the terms of the template.

“Business Day” is used in the Compounded/Term MTR, as in the LIBOR Agreements, to frame time periods for payment obligations, notification obligations and other actions under the Agreement. It is defined as a day on which banks are open for general business in London (reflecting that LMA terms assume the Agent is located in London) and a placeholder for any other specified financial centre. The placeholder will be typically filled to include the financial centre(s) of the currencies in which the facility is to be drawn (for example, New York for USD). In relation to euro, a Business Day is a day on which TARGET is open (see comments in relation to definition of **“TARGET Day”** below).

The definition of Business Day contains a further nuance in the RFR Agreements. It provides that for certain actions under the agreement that require a rate fixing, a Business Day means an **“Additional Business Day”**. An Additional Business Day is defined as a day on which banks are open for general business in London and such other day as is specified as an Additional Business Day for the relevant currency in Schedule 13 (*Reference Rate Terms*).

Comment

The Additional Business Day concept is required to ensure that, for actions which require a rate fixing, the relevant reference rate is available.

In relation to Term Rate Loans, the concept of Additional Business Day applies only to the fixing of the interest rate itself. Term rates are fixed on the Quotation Day specified in the Reference Rate Terms, which reflect the rate fixing convention in the relevant currency. EURIBOR is quoted on every day that TARGET is open. An Additional Business Day is therefore a TARGET Day.

In relation to Compounded Rate Loans, there are a broader set of actions which depend on the RFR being published as well as it being a Business Day in London, namely (i) the date for payments relating to Compounded Rate Loans and (ii) the determination of the

length/dates of an interest period for Compounded Rate Loans. For these actions in relation to Compounded Rate Loans, an Additional Business Day is further defined as a “**RFR Banking Day**”. A RFR Banking Day for a given currency is a day on which the daily RFR is published as specified by currency in Schedule 13 (*Reference Rate Terms*).

The concept of a RFR Banking Day is also relevant for determining the daily RFR (the “**Daily Rate**”) to be used in the compounding calculation. The references to a RFR Banking Day in that context reflect the UK RFRWG’s recommendation that interest should be compounded only on days when the RFR is published; and, in multi-currency loans, interest should be compounded on RFR Banking Days for the drawn currency, ignoring whether or not the day is also a banking day for the other currencies.

In addition, the length of the Lookback Period is determined by reference to RFR Banking Days rather than Business Days.

See section 4 (Conventions for referencing RFRs) in Part II (*Risk-Free Rates in the Loan Market*) for further background. See also comments on the relevant definitions at Schedule 13 (*Reference Rate Terms*).

“**Central Bank Rate**” and “**Central Bank Rate Adjustment**”

A key input into the compounding formulae in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*) is the “**Daily Rate**” for the relevant RFR Banking Day. This is the relevant RFR (i.e. SONIA, SOFR or SARON) or, if the RFR is not available, a fallback rate.

If the RFR is not available on any day, a “**Central Bank Rate**” plus an optional spread adjustment (the “**Central Bank Rate Adjustment**”) will be the “**Daily Rate**” input in the compounding calculation. If the Central Bank Rate is not available on any day, a historic Central Bank Rate (no more than a specified number of days old), plus an optional spread adjustment will be used.

Comment

The “**Central Bank Rate**” and “**Central Bank Rate Adjustment**” are different for each currency. They are defined by currency and are

discussed in the comments on the relevant definitions at Schedule 13 (*Reference Rate Terms*).

Note that pursuant to paragraph (f) of Clause 1.2 (*Construction*), references in the Agreement to a Central Bank Rate include references to successor or replacement rates.

Fallbacks are discussed further at Clause 11.2 (*Interest calculation if no RFR or Central Bank Rate*).

“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 8 (*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*).

“Compounded Rate Currency” and “Compounded Rate Loan”

A Compounded Rate Currency is a currency which references a compounded in arrears RFR. Compounded Rate Loans are loans in a Compounded Rate Currency.

“Compounded Reference Rate”

The calculation of interest on Compounded Rate Loans is daily, on each day during an Interest Period. This is a function of the compounding methodology recommended in the Sterling Loan Conventions and reflected in the RFR Agreements.

The Compounded Reference Rate is the reference rate applicable to Compounded Rate Loans for any RFR Banking Day. In summary, it is the sum of the compounded in arrears RFR for that day – the **“Daily**

Non-Cumulative Compounded RFR Rate” - and any CAS, if a CAS is applicable.

Comment

The definition of “Compounded Reference Rate”, in contrast to the definition of “Term Reference Rate” does not include an optional zero floor. The zero floor drafting (if a floor is agreed to apply) works differently in the context of Compounded Reference Rates. It is built into the definition of “***Daily Rate***”.

See comments on the relevant definitions at Schedule 13 (*Reference Rate Terms*).

“Compounding Methodology Supplement”

A “***Compounding Methodology Supplement***” is a document agreed between the Borrower and the Agent (acting on the instructions of the specified majority of Lenders), which (pursuant to Clause 1.2(g)) overrides any pre-existing terms relating to the relevant Compounded Rate Currency e.g. as set out in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*).

Comment

This is one of a number of future-proofing features of the RFR Agreements, which aim to facilitate amendments should conventions or market practice evolve on the more detailed aspects of using RFRs.

Borrowers may take the view that the required consent threshold here should reflect the Majority Lender threshold that has become typical in relation to amendments to replace a reference rate pursuant to Clause 35.4 (*Changes to reference rates*). A Compounding Methodology Supplement is agreed to be subject to the approval of Majority Lenders rather than all of the Lenders in most cases.

“Confidential Information”

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

“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 10 (*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 (*Confidentiality*) of the Agreement.

Comment

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 (*Confidentiality*) apply equally to the form of letter in Schedule 10 (for example, with regard to the duration of the confidentiality obligations).

“Cumulative Compounded RFR Rate” and “Daily Non-Cumulative Compounded RFR Rate”

These definitions cross-refer to the formulae in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*) which form the basis of the calculation of interest on Compounded Rate Loans.

The **“Daily Non-Cumulative Compounded RFR Rate”** is the percentage rate determined by the Agent (or any other Finance Party that agrees to do so in its place) in accordance with the methodology in Schedule 14 (or any Compounded Methodology Supplement that supersedes it). This is a daily rate as the name suggests, and is the RFR component of the **“Compounded Reference Rate”**, the daily rate of interest on Compounded Rate Loans (see comments on that definition above).

The **“Cumulative Compounded RFR Rate”** is a percentage rate determined by the Agent (or any other Finance Party that agrees to do

so in its place) in accordance with the methodology in Schedule 15, or in any Compounded Methodology Supplement that supersedes it. It is a rate for an Interest Period, rather than a daily rate. It is used in the RFR Agreements to calculate the “**Market Disruption Rate**” (if any) applicable to Compounded Rate Loans, see comments on that definition below.

Comment

The compounding methodologies in the RFR Agreements reflect the Sterling Loan Conventions. The Sterling Loan Conventions recommend the use of a NCCR in loans (see section 4 (Conventions for referencing RFRs) of Part II (*Risk-Free Rates in the Loan Market*)). This is the Daily Non-Cumulative Compounded RFR Rate.

A CCR can be used to calculate interest on loans. The Daily Non-Cumulative Compounded RFR Rate applied daily over a period is drafted to yield the same result as the application of the Cumulative Compounded RFR Rate over the same period. However, for the reasons given in Part II (*Risk-Free Rates in the Loan Market*), the CCR approach is not the standard Agents require in the syndicated loan market. In the RFR Agreements the CCR is used only for the purposes of Clause 11.3 (*Market Disruption*). That clause may not apply to Compounded Rate Loans, in which case the Cumulative Compounded RFR Rate is superfluous, see comments on that clause below.

The compounding methodologies are discussed at Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*).

“Daily Rate”

This is the benchmark rate for the relevant RFR Banking Day to be used in the compounding formulae in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*). The Daily Rate is the relevant RFR (i.e. SONIA, SOFR or SARON) or, if the RFR is not available, the fallback rate, which is an adjusted central bank rate for the relevant currency.

See comments on the relevant definitions at Schedule 13 (*Reference Rate Terms*). See also “**Central Bank Rate**” and “**Central Bank Rate Adjustment**” above.

“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, and will occur at an earlier stage than an 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.

Comment

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.

“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.

Comment

This definition permits each Lender to have more than one Facility Office, to enable it to designate a specific Facility Office for specific Loans. The reason for doing this may (as the LMA's User Guide notes) include the avoidance of the incidence of withholding tax, see further comments at Clause 13 (*Tax Gross-up and Indemnities*).

This definition also permits any Lender to alter the office through which it performs its obligations at any time after the date of the Agreement. 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.

“Fallback CAS”

The Fallback CAS is optional. If a Fallback CAS is agreed to apply as part of the fallback rates for Term Rate Loans, it must be defined in the relevant Reference Rate Terms.

Comment

A Fallback CAS may apply if the fallbacks for a Primary Term Rate include fallbacks based on RFRs. This would be the case, for example, if €STR-based fallbacks apply should EURIBOR be unavailable. Fallbacks are discussed at Clause 11 (*Changes to the Calculation of Interest*).

In relation to the CAS and how it might be set, see section 5 (Transition Issues) of Part II (*Risk-Free Rates in the Loan Market*). See also comments on relevant definitions at Schedule 13 (*Reference Rate Terms*).

“Fallback Interest Period”

This optional definition is relevant to the fallback options provided in Clause 11.1 (*Interest Calculation if no Primary Term Rate*). It should be included if agreed that historic rates are to be used if the Primary Term Rate is not available.

The length of the Fallback Interest Period is left blank to be agreed.

Comment

The use of rates for Fallback Interest Periods is intended to be temporary. The agreed period here is therefore typically fairly short. The agreed period might range from around one week to one month.

Fallbacks are discussed at Clause 11 (*Changes to the Calculation of Interest*). See also comments on relevant definitions at Schedule 13 (*Reference Rate Terms*).

“FATCA” and related definitions

These definitions are for the purposes of the provisions in Clause 13 (*Tax Gross-up and Indemnities*) which 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*).

“Finance Document”

This term describes the documents entered into by the Obligor for the purposes of the facility. The term is used in many of the representations, undertakings and Events of Default in the Investment Grade Agreements.

“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 Clause 22.3 (*Negative pledge*), which restricts the creation of “**Security**” and “**Quasi-Security**” for Financial Indebtedness. It is also used in the Clause 23.5 (*Cross-default*), 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.”*

Comment

Significance of this definition

Borrowers should consider carefully how this definition is used in any draft agreement presented to them. As noted in the LMA User Guide, it is a starting point to be adapted to individual requirements.

This definition is used for limited purposes in the Investment Grade Agreements. Whether it requires adjustment in the context of the negative pledge or the cross-default Event of Default may depend on whether those restrictions are themselves appropriately framed (see comments in relation to those clauses). In practice, any detailed negotiation of this definition is often 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.

Leases

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 here is that prior to 2019, the accounting treatment of a lease depended on the underlying economic effect of the lease.

Under IAS 17 the applicable accounting standard, if an arrangement amounted 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 was classified as a finance lease. An operating lease was any lease that was not a finance lease.

In the lessee’s accounts, a finance leased asset appeared on the asset side of the balance sheet and a discounted amount in respect of the obligation to pay rent appeared as a liability, as if the lessee had bought the asset and incurred debt to pay for it. Operating leases were not a balance sheet item. Rental payments in respect of operating leases were charged to the income statement as operating expenses.

IFRS 16, which superseded IAS 17 and became mandatory for accounting periods starting on or after 1 January 2019, abolished for the lessee the distinction between finance leases and operating leases for most purposes. Under IFRS 16 virtually all lease liabilities are balance sheet liabilities.

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 and limb (d) of Financial Indebtedness was updated as quoted above. This language was also incorporated into the definition of “Borrowings” that is used in the LMA templates that include financial covenant provisions (for example, the Leveraged Agreement).

Prior to the implementation of IFRS 16 and in its aftermath, many borrowers chose to adopt **frozen GAAP** wording in relation to leases, which enabled “old” operating lease commitments to be excluded from Financial Indebtedness. For as long as a distinction between operating leases and finance leases continues to apply for the purposes of the Agreement, it must be capable of being measured; so the inclusion of such wording requires the Borrower to continue to produce IFRS 16 accounts. Frozen GAAP was therefore intended to be a transitional fix, to apply until IFRS 16 had bedded down, and the implications of a single category of leases on the terms of the loan, digested.

Many Borrowers have had to consider the implications of IFRS 16 quite carefully both in this context and in relation to financial covenant provisions. Although a number of years after the implementation of

IFRS 16, a somewhat surprising number of loans continue to include the frozen GAAP language, many Borrowers have by now taken active steps to adapt this and any other relevant provisions of their loan agreements to accommodate IFRS 16.

Approaches tend to vary according to the significance of the balance sheet impact of the transition to IFRS 16 for the Borrower in question. Some Borrowers - often those for whom the accounting change had minimal balance sheet impact or who had significant covenant headroom or debt capacity available - simply dispensed with the operating lease/finance lease distinction. On this approach, this limb of "Financial Indebtedness" is adjusted to refer to lease liabilities generically, without the optional frozen GAAP adjustment.

Borrowers with more significant operating lease exposures have tended to adopt quite bespoke approaches to accommodating the balance sheet and income statement impact of IFRS 16 in the relevant definitions and clauses of their loan and other debt documentation. The impact of this accounting change on metrics such as leverage covenants (normally as a result of the increased debt component of such ratios that results from the addition of "old" operating lease liabilities), has been very significant for certain businesses. For such Borrowers, solutions are often designed (in the case of financial covenants or limits) to avoid the perceived disadvantages of simply increasing overall leverage tests (in terms of what the increased numbers might, at first sight, signal to investors).

Broadly speaking, Lenders appear to have taken a pragmatic view of Borrowers' proposals here, given that the replacement of IAS 17 with IFRS 16 does not, of itself, affect the cash position of the business.

Frozen GAAP wording is also a feature of Clause 20.3 (*Requirements as to financial statements*), in relation to financial covenant testing. That wording is discussed in the comments on that clause.

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 be either a guarantee by the borrower for the

payment of the debts, or 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 financier 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).

If any Obligor is likely to enter into receivables financing or debt factoring arrangements, in addition to considering the implications of such arrangements in the context of this definition and the provisions in the Agreement in which Financial Indebtedness is used, it may also be necessary to ensure such arrangements are not restricted by other provisions of the Agreement, for example, the covenant restricting disposals and the negative pledge (see Clause 22.4 (*Disposals*) and Clause 22.3 (*Negative pledge*)).

Any amount raised having "the commercial effect of a borrowing"

A wide range of transactions can be caught by paragraph (f), including 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 difficult to ascertain. From the Borrower's perspective, if there are additional categories of debt which should be included in Financial Indebtedness, it may be preferable to describe them specifically and delete this catch-all paragraph. A few strong Borrowers do achieve that position. Most Borrowers, however are required to accept the "catch-all" and will need to consider which of the Group's liabilities might be caught by it, and whether specific exclusions are required.

Derivatives

Paragraph (g) captures derivatives transactions, requiring their marked to market 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 use derivatives extensively) 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”, discussed above.

In the Investment Grade Agreement, as already noted, Financial Indebtedness is used in only two clauses: Clause 22.3 (*Negative pledge*) and the Clause 23.5 (*Cross-default*). If 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 to finance the acquisition of an asset.

If derivatives are included in the definition of Financial Indebtedness, the suspension, cancellation or close out of such transactions (which may occur as a result of circumstances affecting the Borrower’s/relevant member of the Group’s 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 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). This is 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 Obligor), 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 good practice to make clear that Financial Indebtedness will be calculated without double-counting.

Depending on how this definition is used, Financial Indebtedness may need to be calculated at a date 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 adjust the drafting here 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 be aware 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, see further comments at Clause 21 (*Financial Covenants*). As already noted, “Borrowings” 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”

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”).

Comment

This definition may require amendment (depending on how the term is used in the Agreement) if some Obligors apply different GAAP to others.

“IFRS”

IFRS is defined as UK-adopted international accounting standards within the meaning of section 474(1) of the Companies Act 2006, to the extent applicable to the financial statements.

Comment

IFRS in general parlance describes the body of accounting standards published by the International Accounting Standards Board (**IASB**).

The use of these accounting standards by companies and groups is regulated by applicable law, which is why this definition is required.

Pre-Brexit, the LMA definition of IFRS referred to the EU-adopted standards, because the application of IFRS to the financial statements of EU companies, regulated at EU level. The EU IAS Regulation¹² 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 enabled unlisted UK companies to choose whether they wish to use EU-adopted IFRS or UK GAAP.

At the end of the Brexit implementation period on 31 December 2020, the UK Government did not change the substantive obligations of UK companies. The Companies Act continues to require listed UK companies to apply UK-adopted international accounting standards. Unlisted UK companies may choose whether they wish to use UK-adopted IFRS or UK GAAP. However, for UK companies, IFRS means IFRS as endorsed and adopted by the UK Endorsement Board rather than the EU. UK-adopted IFRS comprises the bulk of the IFRS regime, but there are aspects which have not been endorsed¹³.

Borrowers should note that the LMA definition of IFRS is now only appropriate for UK companies and Groups. It will require adaptation to cater for EU or other foreign companies and groups.

“Group”

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

“Historic Primary Term Rate”

This optional definition is relevant to the Primary Term Rate fallbacks provided in Clause 11.1 (*Interest Calculation if no Primary Term Rate*). These include the optional use of the last published Primary Term Rate

¹² EU Regulation 1606/2002.

¹³ Reports on the endorsement status of IFRS in the UK are available on the [UK Endorsement Board's website](#).

quotation if the Primary Term Rate is unavailable on the relevant day. The age of the Historic Primary Term Rate is left blank to be agreed.

Comment

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

Fallbacks are discussed at Clause 11 (*Changes to the Calculation of Interest*).

“IFRS”

This definition is discussed alongside the definition of “**GAAP**” above.

“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 12 (*Form of Increase Confirmation*).

“Information Memorandum”

See comments at Clause 19.10 (*No misleading information*).

“Interpolated Alternative Term Rate”, “Interpolated Historic Primary Term Rate” and “Interpolated Primary Term Rate”

These interpolated rates are used in the fallback rate options applicable to Term Rate Loans in Clause 11.1 (*Interest Calculation if no Primary Term Rate*). For example, an Interpolated Primary Term Rate may be applied if the Primary Term Rate is not available for the required maturity.

Comment

These definitions provide for interpolation on a straight line basis. This method of interpolation reflects the method of interpolation that is ordinarily 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 and 2021 ISDA definitions.

Fallbacks are discussed at Clause 11 (*Changes to the Calculation of Interest*).

“Lookback Period”

The Lookback Period is part of the conventions applied to the calculation of interest on a Compounded Rate Loan. The length of the Lookback Period applicable to loans in each Compounded Rate Currency is specified in Schedule 13 (*Reference Rate Terms*).

Comment

The Lookback Period is typically 5 RFR Banking Days. See comments on this definition in Schedule 13 (*Reference Rate Terms*).

The reasons for the Lookback Period and its application are explained in section 4 (Conventions for referencing RFRs) of Part II (*Risk-Free Rates in the Loan Market*).

“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.

Comment

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 disenfranchised. This was spotted and addressed by the LMA some years ago. 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. This can lead to Lenders seeking to adjust this definition in some circumstances (which are relatively rare).

"Margin"

The Investment Grade Agreements all contemplate that the Margin will be a fixed percentage amount. In contrast to the LIBOR Agreements, which envisage a single Margin for all currencies, the Compounded/Term MTR provides for a Margin to be specified separately in the Reference Rate Terms for each currency.

Comment

The Margin is often fixed percentage amount in investment grade loans to stronger Borrowers. Margins that vary or "ratchet" by reference to a credit risk metric are common in the investment grade market more generally. If a Margin ratchet applies, the drafting will need to be adjusted. The nature and operation of any ratchet mechanism is an important commercial point.

Variable Margins became prevalent in the syndicated market following the implementation of Basel II, which for the first time imposed 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 may be set by reference to financial covenant tests such as leverage (see Clause 21 (*Financial Covenants*)).

If the loan is an SLL, the Margin will vary depending on the Borrower's performance towards specified ESG targets. See section 2 (Sustainability-linked Loans) of Part III (*Hot Topics*) for further information.

See comments on "**Margin**" in Schedule 13 (*Reference Rate Terms*) in relation to the impact of the transition to RFRs on Margins.

"Market Disruption Rate"

The Market Disruption Rate is the benchmark against which the Lenders are to judge their funding costs for the purposes of Clause 11.3 (*Market Disruption*). Clause 11.3 applies only if a Market Disruption Rate is specified for loans in that currency in the applicable Reference Rate Terms.

See further Clause 11.3 (*Market Disruption*) and comments on "**Market Disruption Rate**" at Schedule 13 (*Reference Rate Terms*).

"Material Adverse Effect"

The aim of the definition of Material Adverse Effect is to capture events of such magnitude that they should trigger consequences under the Agreement. The term 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. The term is employed more widely in negotiated agreements as a device to limit the scope of various representations, undertakings and Events of Default and also as the trigger for any "no material adverse change" Event of Default (see Clause 23.12 (*Material Adverse Change*)). 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.]”*

Comment

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 dependent on the opinion of Majority Lenders. English 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 relevant¹⁴. This can cause difficulty in terms of the construction and operation of provisions of the facility where this term is used.

¹⁴ 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 Obligor (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 Obligor and/or the Group as a whole.
- Limb (b) should be limited to the ability of the Obligor (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.

As discussed in section 1 (Navigating challenging conditions) of Part III (*Hot Topics*), many Borrowers have had to look carefully at their MAC provisions in recent years. In relation to the use of MAC provisions generally, see comments at Clause 23.12 (*Material Adverse Change*).

“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*).

See comments at Clause 4.3 (*Conditions relating to Optional Currencies*) and Clause 6 (*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 0 (*Initial conditions precedent*)).

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

“Primary Term Rate”

The Primary Term Rate is the term rate component of the interest rate applicable to a Term Rate Loan (the ***“Term Reference Rate”***, see below).

“Quotation Day”

The Quotation Day is the day on which the chosen benchmark rate is fixed. It is relevant only to loans in Term Rate Currencies.

The Reference Rate Terms for each Term Rate Currency must reflect the conventions for rate-fixing applicable to the rate. For example, Part IVA of Schedule 13 (*Reference Rate Terms*) reflects the market convention that EURIBOR rates are fixed two TARGET Days beforehand (see comments on definition of ***“Target Day”*** below).

Comment

The Reference Rate Terms provide the option to cater for the rate-fixing convention applicable to Term Rate Currencies other than euro. The Quotation Day for all other currencies is generally two Business Days before utilisation.

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

See also comments at Clause 5 (*Utilisation*) and in relation to Quotation Day in Schedule 13 (*Reference Rate Terms*).

“Quoted Tenor”

This definition refers to a period or maturity for which any term rates used in the Agreement are quoted on screen.

The definition is used in Clause 9A (*Rate Switch*) in the definitions that dictate when a rate switch will occur (see ***“Rate Switch Trigger Event”***). It is also used in Clause 35.4 (*Changes to reference rates*) in the definitions that determine when a renegotiation of reference rate terms will occur.

See further comments at Clause 9A (*Rate Switch*) and Clause 35.4 (*Changes to reference rates*).

“Rate Switch CAS” and “Rate Switch Currency”

This optional provision refers to any CAS that applies as part of the pricing applicable to a Compounded Rate Loan after a Rate Switch Trigger Event has occurred, whereby a Term Rate Currency becomes a Compounded Rate Currency. For the Rate Switch to apply, the Term Rate Currency must be designated as a “Rate Switch Currency” in the applicable Reference Rate Terms.

Comment

On the assumption that the Primary Term Rate applicable to a Rate Switch Currency is replaced by a compounded in arrears RFR, the expectation is that when the Rate Switch occurs, a CAS will be added to the RFR to ensure transparency and economic neutrality.

The only Rate Switch Currency contemplated in the Compounded/Term MTR is euro. The Rate Switch CAS is an option in the Reference Rate Terms applicable to Compounded Rate Loans in euro (see Part IVB of Schedule 13 (*Reference Rate Terms*)).

CAS options are discussed in section 5 (Transition Issues) of Part II (*Risk-Free Rates in the Loan Market*). See also comments on Clause 9A (*Rate Switch*) and Schedule 13 (*Reference Rate Terms*).

“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 Rate Supplement”

A “Reference Rate Supplement” is a document agreed between the Borrower and the Agent (acting on the instructions of the specified majority of Lenders) that specifies whether the currency is a Compounded Rate Currency or a Term Rate Currency and the applicable Reference Rate Terms for that currency (i.e. equivalent terms to those set out in Schedule 13 (*Reference Rate Terms*) for sterling, USD, euro and CHF).

A Reference Rate Supplement (pursuant to Clause 1.2(g)) overrides any pre-existing Reference Rate Terms relating to the relevant currency.

Comment

This provision recognises that the parties may need to agree changes to the Reference Rate Terms from time to time (for example, if market practice evolves). This is one of a number of future-proofing features of the RFR Agreements, which aim to facilitate the efficient implementation of amendments should the applicable conventions or market practice change.

Borrowers may take the view that the required consent threshold here should reflect the Majority Lender threshold that has become typical in relation to amendments to replace a reference rate pursuant to Clause 35.4 (*Changes to reference rates*). In practice, a Reference Rate Supplement is often agreed to be subject to the approval of Majority Lenders rather than all of the Lenders.

“Reference Rate Terms”

The components of the applicable Term Reference Rate or Compounded Reference Rate are specified by currency in Schedule 13 (*Reference Rate Terms*).

Comment

The approach of providing separate terms for each currency adds length to the Agreement, but enables the calculations applicable to different currencies to be easily ascertained and allows the straightforward accommodation of discrepancies between currencies. Appropriate Reference Rate Terms will need to be agreed for all currencies in which the Facilities are denominated.

For Optional Currencies, whether the currency is to be a Term Rate Currency or a Compounded Rate Currency, a “**Reference Rate Supplement**” may be agreed when the Optional Currency is needed. Clause 4.3 (*Conditions relating to Optional Currencies*) specify as a condition precedent to the drawing of an Optional Currency, that there are Reference Rate Terms for that currency.

See further comments at Schedule 13 (*Reference Rate Terms*).

“Relevant Market”

This concept must be defined by currency in the relevant Reference Rate Terms. It is designed to refer to the market where the loan is assumed to be funded. This will vary according to the reference rate against which pricing has been determined.

Comment

This term is used in certain clauses in the Agreement where conventions need to cede to accepted practice in the market where the loan is assumed to be funded: see Clause 6.3 (*Change of currency*) and Clause 32 (*Day Count Convention and Interest Calculation*).

This is discussed further in the comments on those clauses and on the definition of Relevant Market in Schedule 13 (*Reference Rate Terms*).

“Repeating Representation”

This definition, which identifies which of the representations in Clause 19 (*Representations*) are to be repeated, is only partially completed and must be 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*).

“Reporting Day” and “Reporting Time”

These terms are defined by currency in the relevant Reference Rate Terms. They are designed to capture the date and time by which Lenders must notify the Agent that they wish to invoke Clause 11.3 (*Market Disruption*) or of their cost of funds, if cost of funds has become payable.

Comment

These definitions are discussed in the comments on Clause 11.3 (*Market Disruption*) and in the comments on the relevant definitions in Schedule 13 (*Reference Rate Terms*).

“RFR”

This is the RFR by reference to which interest on a Compounded Rate Loan will be calculated in accordance with the applicable Reference Rate Terms.

See further Schedule 13 (*Reference Rate Terms*).

“RFR Banking Day”

See comments under “**Business Day**” above and at Schedule 13 (*Reference Rate Terms*).

“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*).

“Security”

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

“Subsidiary”

The parties need to select an appropriate definition of Subsidiary, which determines which entities are included 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 Companies Act 2006 definitions of “subsidiary” and “subsidiary undertaking”.

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

Comment

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 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 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.

“**TARGET2**” and “**TARGET Day**”

A “**TARGET Day**” is any day on which “**TARGET2**”, the payment system for euro, 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.

Comment

A project to consolidate TARGET2 with a new real-time gross settlement system called T2S, used for settling securities is currently underway. The new consolidated platform is to be launched on 21 November 2022. It is anticipated that the definition of TARGET2 may be adjusted in due course to reflect the name of the consolidated platform.

“Term Rate Currency” and “Term Rate Loan”

A Term Rate Currency is a currency which references a forward-looking term rate. Term Rate Loans are loans in a Term Rate Currency.

“Term Reference Rate”

The Term Reference Rate is the reference rate applicable to Term Rate Loans for the relevant Interest Period. This interest rate is the “**Primary Term Rate**” for the relevant period, or if that rate is not available, the fallback rate determined in accordance with Clause 11.1 (*Interest Calculation if no Primary Term Rate*).

The definition of Term Reference Rate includes 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. If the zero floor is included, the amount of interest payable (the sum of the relevant Primary Term Rate and the Margin), cannot fall below the amount of the Margin.

Comment

The main point to negotiate in this definition is the zero floor language. 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 Primary Term Rate 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 comments at Clause 9 (*Interest*), Clause 11.1 (*Interest Calculation if no Primary Term Rate*) and in relation to the components of the Term Reference Rate (including the zero floor), at Schedule 13 (*Reference Rate Terms*).

“Termination Date”

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

Clause 1.2: Construction

The construction provisions can alter the nature and scope of the operative provisions of the agreement quite significantly. They are easy to overlook, in particular those that ascribe meanings to terms used in

the Agreement that are not capitalised. Some examples of this are described below.

Paragraph (a)(ii) - “assets”

According to this provision, the word “assets”, as used in the Investment Grade Agreements “*includes present and future properties, revenues and rights of every description*”.

The term “assets” is used in a number of clauses in the Compounded/Term MTR and the possible implications of this wide-ranging construction provision are important for Borrowers to be aware of.

See comments on Clause 22.4 (*Disposals*) and Clause 23.6 (*Insolvency*).

Paragraph (a)(vi) - “cost of funds”

The LMA used the publication of the RFR Agreements to introduce a definition of “cost of funds” into its documentation. The LMA did so because the concept of cost of funds as previously described, which required each Lender to assess the cost of funding its participation in a Loan from “*whatever source*” it might “*reasonably select*”, gave rise to practical difficulties if invoked. The LMA expresses this difficulty (in its RFR User Guide) as “particularly acute when institutions assess the cost of their funding requirements on an aggregated non-granular basis”.

The definition of “**cost of funds**” reads as follows:

“a Lender’s “cost of funds” in relation to its participation in a Loan is a reference to the average costs (determined either on an actual or notional basis) which that Lender would incur, were it to fund, from whatever source(s) it may reasonably select, an amount equal to the amount of that participation in that Loan for a period equal in length to the Interest Period of that Loan”

This definition aims to make the determination of their cost of funds for the purposes of the Agreement more accessible to Lenders. The reference to “average” costs enables Lenders to assess their funding costs by reference to their funding activities generally (so as a percentage per annum looking at funding cost on an aggregated basis), rather than by reference to their funding costs for the relevant Loan. The reference to “notional” costs allows Lenders to do this on the basis of hypothetical rather than actual funding activities.

Comment

This definition is relevant both to the construction of cost of funds where included as part of the fallback rate waterfall and if cost of funds is to replace a Reference Rate pursuant to the market disruption clause. The application of cost of funds in both contexts is optional in the RFR Agreements.

See further comments at Clause 11 (*Changes to the Calculation of Interest*).

Paragraph (a)(vi) - “indebtedness”

The term “**indebtedness**” is to be construed broadly to include “*any obligation (whether incurred as principal or surety) for the payment or repayment of money, whether present or future, actual or contingent*”.

The term indebtedness must therefore be used with care from the Borrower’s perspective. The narrower defined term “Financial Indebtedness” is typically used in restrictive covenants and cross-default Events of Default. A separate definition of “Borrowings”, which is modelled on, but further adjusts Financial Indebtedness is typically employed in financial covenant provisions, see comments at Clause 21 (*Financial Covenants*).

Paragraph (e) - “continuing”

Paragraph (e) defines the meaning of “**continuing**” in relation to 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*)).

Comment

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.

Paragraph (e) – replacement screen pages and paragraph (f) replacement Central Bank Rates

Paragraph (e) ensures that if the screen on which any relevant rate is displayed (or the service provider) changes or is unavailable, references to that screen in the Agreement will be construed as references to the replacement screen (where available), without any further action by the Parties. Paragraph (f) makes similar provision, to ensure that references in the Agreement to a Central Bank Rate (for example, as part of the rate fallback provisions for Compounded Rate Loans) include references to any successor or replacement rates.

Comment

These construction provisions are the product of the LIBOR transition experience, which highlighted the importance of catering for changes to the reference rates (or the manner in which they are accessed) after the date of the Agreement.

Clause 1.3: Currency symbols and definitions

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

Comment

The implications of a potential fragmentation of the Eurozone were analysed in some detail by loan market participants at the height of the Eurozone sovereign debt crisis around a decade ago. 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 brought the lack of currency definitions in the LMA templates to the market’s attention. This optional clause (addressing all relevant currencies) was introduced as part of a package of relatively minor changes to the template in response to the Eurozone crisis. It is generally treated as boilerplate and is not controversial.

Clause 1.4: Third Party Rights

The UK Contracts (Rights of Third Parties) Act 1999 (**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 that person, and the parties intend that person 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.

Comment

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 such rights being granted in favour of officers and employees of the Agent. 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*)). It is specifically provided that officers and employees of the Agent may rely on this exclusion of liability (see Clause 26.10(b)).

Option 2 therefore offers protection to the employees and officers of the Agent 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, 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*).

Other third party rights may be created as required by individual transactions.

In any contract where third party rights are 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 most loan documentation, that risk is of little consequence from the Borrower’s perspective, as the choice of jurisdiction is often non-exclusive for the benefit of the Finance Parties (see Clause 41.1 (*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

Subject to conditions, this clause 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.

Comment

Clause 2.2 originally formed part of the Lehman provisions. 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, the mechanism was extended in 2011 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. The incorporation of this commonly adopted clause into the Investment Grade Agreements was 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.

See also Part V (*Commentary on the Lehman Provisions*).

Possible Supplementary Provisions - Accordion Facilities

Accordion facilities are uncommitted lines within committed facilities that can be called on as required. They enable the Borrower to increase the initially agreed amount of the facilities, within the framework of their existing documentation, providing access to additional funds which are available to meet increased working capital needs (sometimes unforeseen) 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. Accordion facilities are not catered for in the Investment Grade Agreements but are relatively common in practice.

A typical formulation (often added to this section of the Agreement following Clause 2.2 (*Increase*)), might require the Borrower to request the Lenders to increase their commitments by a pro rata amount, up to an agreed cap. Each Lender is free to accept or reject the Borrower's request in most cases. However, if any of the Lenders decline the Borrower's request, the shortfall amount will be typically offered to the accepting Lenders. If the Lenders do not wish to assume commitments equal to the total increase amount, the Borrower may seek rights to bring in new Lenders to take up the shortfall, who will accede to the Agreement on the same terms as the existing Lenders. Accordingly, Lenders are incentivised to participate to avoid losing ground to others.

Comment

Accordion facilities are often drafted along the broad lines described above, 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 varies. The conditions to which the exercise of the accordion option may be subject also vary, although access to accordion facilities is often subject to the accurate repetition of the Repeating

Representations and the absence of any continuing Default or Event of Default.

Such uncommitted facilities can be very useful. The fact that the Agreement contemplates the possibility that Lenders will 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 if the Borrower retains the option to source funds from elsewhere should any of the existing Lenders decline to participate.

Accordion options or facilities, alongside extension options (discussed in comments on Clause 7 (*Repayment*) below) proved helpful to many during the initial lockdown stages of the COVID-19 pandemic. In a number of cases, these options were exercised as corporates sought to secure access to sufficient amounts of financing to support going concern analyses. See Part 1 (Navigating Challenging Conditions) of Part III (*Hot Topics*).

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.

Comment

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 collectively¹⁵. 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

¹⁵ Charmway v Fortunessea (Cayman) Ltd & Ors [2015] HKCU 1717.

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 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 41.2 (*Service of process*), if not an Original Obligor, has accepted its appointment.
- 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.

Comment

The documents listed in Part 1 of Schedule 2 (*Conditions Precedent*) 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.

Comment

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 (which in traditional terms, refers to 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, in 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 must be listed in the Agreement, 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 and Reference Rate terms must be available.

Comment

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 and seek also to agree Reference Rate Terms for that currency. 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, euro and other widely available currencies, 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.

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 11 (*Timetables*).

Comment

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 the 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 clause 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 (sterling) instead.

The Borrower can be notified about unavailability or illegality up to the Specified Time. Schedule 11 (*Timetables*) suggests the Specified Times as follows:

- 5.30pm on the second Target Day before the first day of the Interest Period for euro; and
- 5.30pm on the second Business Day before the first day of the Interest Period for Loan in other currencies.

No time is specified for sterling, as that is the Base Currency.

Comment

Some Borrowers adjust the timeframes for notification (the Specified Times) to slightly earlier than suggested, for example, 10.00am.

Clause 6.3: Change of currency

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 of Exchange**” at 11 a.m. on the third Business Day before Utilisation.

The “**Agent’s Spot Rate of Exchange**” is the Agent’s own spot rate, or another spot rate it reasonably selects for the purchase of the relevant currency using the Base Currency in the London market at or about 11.00am on the relevant day.

This clause sets out the mechanism for currency-switching of Term Facility Loans, if the Loan is to be denominated in different currencies over successive Interest Periods. It is not relevant to Revolving Facility Loans as these are borrowed only for single Interest Periods.

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 to the Base Currency Amount for that Loan, using the Agent’s Spot Rate of Exchange at the “**Specified Time**”.

The Specified Time will depend on the currency; according to Schedule 11 (*Timetables*), the Specified Times suggested for this purpose are:

- 11.00am on the second Target Day before the first day of the Interest Period for euro;
- 11.00am on the first day of the Interest Period for sterling; and
- 11.00am on the second Business Day before the first day of the Interest Period for other currencies.

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, the Agent must pay it to the Borrower in the new currency.

Clause 6.4: Same Optional Currency during successive Interest Periods

As noted above, 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 of Exchange**” at 11 a.m. on the third Business Day before Utilisation.

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 at the Specified Time for the second period to the Base Currency Amount which was fixed at the time of the original Utilisation.

The Specified Time will depend on the currency; according to Schedule 11 (*Timetables*), the Specified Times suggested for this purpose are:

- 11.00am on the second Target Day before the first day of the second Interest Period for euro;
- 11.00am on the first day of the second Interest Period for sterling; and
- 11.00am on the second Business Day before the first day of the second Interest Period for other currencies.

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.

Comment

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 at 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.

Comment

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).

Comment

It has long been market practice for revolving advances to be rolled over by book entry, without any cash payment. However, before the 2007-9 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 were published (and where this clause originally appeared).

Possible Supplementary Provisions – Extension Option

It is relatively common for investment grade working capital facilities to incorporate options to extend their maturity. A so-called “+1” or “+1+1” structure typically denotes a fixed loan tenor coupled with a right for the Borrower to request a one year extension to the initial tenor, on one or two occasions.

The Borrower’s extension 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 any Lender to commit to the extension, so whether the extension is available will depend on the Borrower’s relationship with each Lender 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). The commitments of any Lender which chooses not to 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.

Comment

The rise of extension options is a product of the lengthy period of stable and for many, favourable loan pricing which subsisted until relatively recently. This prompted many Borrowers to focus on locking in that favourable pricing for as long as possible. Each Lender is usually free to accept or reject the Borrower's request (in contrast to extension options in the context of acquisition bridge facilities, where the extension is typically committed and priced accordingly). However the fact that the Agreement acknowledges that Lenders are willing to consider extending their commitments on the same terms, can make such provisions an effective and time efficient alternative to a full "amend and extend" or refinancing transaction.

Extension options, as noted in relation to "accordion" facilities (discussed in comments on Clause 2 (*The Facilities*) below) are particularly useful in managing unexpected events. Such rights proved helpful to many during the initial lockdown stages of the COVID-19 pandemic. In a number of cases, these options were exercised. See further section 1 (Navigating Challenging Conditions) of Part III (Hot Topics).

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) if that Lender were to continue to participate.

Comment

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 (discussed in section 1 (Navigating Challenging Conditions) of Part III (*Hot Topics*)). For example, if the parent company of a banking group is subject in its jurisdiction to sanctions laws 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 all Loans due and payable 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 ask 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 a decision for each Lender in relation to its own participation, or a Majority Lender decision in relation to the facilities as a whole. Both options are provided.

Comment

In the early years of the Investment Grade Agreements, many Borrowers were resistant to a change of control prepayment event

along these lines. Such provisions are now almost universally applicable in some form. Lenders take the view that their credit assessment and interest in the Group is dependent on its current ownership. If Lenders require rights to exit the deal on a change of control, Borrowers may prefer that a change of control is a prepayment event, rather than an Event of Default, where it might be more likely to trigger the cross-default provisions in other debt documentation (although much will depend on the drafting of the relevant provisions).

As to whether the clause should be exercised on a Majority Lender or on 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 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.

A Majority Lenders trigger is at first sight, a higher threshold, but once a collective decision to exit has been made, the Facilities are prepayable in full. If the decision can be made on an individual Lender basis, there is the possibility that the Borrower may be able to continue with a smaller facility or potentially, replace those Lenders who choose to exit (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 repayment and cancellation in relation to a single Lender*).

Whichever version 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 would ideally negotiate as long a notice period as possible (for example, one or two months) to allow time to arrange replacement financing.

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" 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 UK Borrowers, invokes the definition of a subsidiary in section 1159 of the Companies Act 2006: this covers, 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.

Comment

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).

Clauses 8.4 and 8.5: Voluntary prepayments

It is conventional to give Borrowers the right to make voluntary prepayments of both term and revolving facility loans. Clause 8.4 (*Voluntary Prepayment of Facility A Loans*) makes provision for the voluntary prepayment of Term Loans on notice at any time after the end of the Availability Period. Clause 8.5 (*Voluntary Prepayment of Facility*

B Loans) makes provision for the prepayment of revolving facility loans on notice at any time.

The Compounded/Term MTR provides for a different minimum notice period to be specified depending on whether the loan being voluntarily prepaid is a Term Rate Loan or Compounded Rate Loan.

Comment

The reason for the different notice periods here is that prepayments must be made together with accrued interest on the amount prepaid. The notice period for voluntary prepayments needs to take into account the need to calculate the amount of accrued interest payable.

The length of the notice period for voluntary prepayments of Compounded Rate Loans will, in most cases, be no less than the length of the Lookback Period, which is set taking required timings for interest calculations and payments into account (see section 4 (Conventions for referencing RFRs) of Part II (*Risk-Free Rates in the Loan Market*) and comments at Schedule 13 (*Reference Rate Terms*)). This may result in a longer minimum notice period for voluntary prepayments of Compounded Rate Loans than applies to voluntary prepayments of Term Rate Loans.

The notice period for voluntary prepayments of Term Rate Loans is commonly 5 Business Days, though it can be useful to have a shorter period, such as 2 Business Days, for maximum flexibility. If the recommended five RFR Banking Day Lookback Period applies to Compounded Rate Loans, Lenders will typically request at least five Business Days' notice of voluntary prepayments.

Break Costs may be payable on Term Rate Loans where the prepayment is not made at the end of an Interest Period. If Break Costs do not apply (as is generally the case in relation to Compounded Rate Loans), Lenders may seek to impose limits on the number of mid-Interest Period prepayments permitted in a given period. If so, Borrowers will need to negotiate any such restrictions according to their needs. See further comments on definition of Break Costs in Clause 1.1 (*Definitions*) and comments at Clause 11.5 (*Break Costs*) and Schedule 13 (*Reference Rate Terms*).

Where Term Loans are repayable 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 request that prepayments are applied in chronological order, or *pro rata*, or even at their discretion. The Investment Grade Agreements leave the parties to settle this on a case-by-case basis.

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 Clause 13.3 (*Tax indemnity*) or Clause 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.

Comment

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

INTEREST RATE PROVISIONS - OVERVIEW

The Compounded/Term MTR provides for the use of forward-looking IBORs for certain currencies (“**Term Rate Currencies**”) and RFRs compounded in arrears for others (“**Compounded Rate Currencies**”). Term Rate Currencies may be designated as “**Rate Switch Currencies**”. If so designated, the Term Rate Currency will become a Compounded Rate Currency in accordance with the terms of the Agreement.

This section contains the framework for the payment of interest on both Term Rate Loans and Compounded Rate Loans, as well as the rate switch provisions applicable to Rate Switch Currencies. The reference rate terms applicable to Loans in each currency are specified in Schedule 13 (*Reference Rate Terms*). Clauses in this section must be read in conjunction with Schedule 13 (*Reference Rate Terms*) and the relevant definitions, to determine which provisions apply to which currency in a negotiated agreement.

Schedule 13 provides Reference Rate Terms as follows:

- **Sterling, USD and CHF are Compounded Rate Currencies.** “**Compounded Rate Loans**” in these currencies reference SONIA, SOFR and SARON respectively. The compounding formulae used to calculate interest on Compounded Rate Loans are in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*).
- **Euro is a Term Rate Currency.** Loans in euro (“**Term Rate Loans**”) reference EURIBOR, with an option to designate euro as a Rate Switch Currency. If so designated, euro loans will switch from EURIBOR to €STR compounded in arrears after the date of the Agreement in accordance with Clause 9A (*Rate Switch*), discussed below.

For other Optional Currencies, whether the currency is to be a Term Rate Currency or a Compounded Rate Currency, a “**Reference Rate Supplement**” must be agreed. Clause 4.3 (*Conditions relating to Optional Currencies*) provides a new condition precedent to the drawing

of an Optional Currency, that there are Reference Rate Terms for that currency.

CLAUSE 9A RATE SWITCH

This clause provides a mechanism that can be applied, optionally, to any Term Rate Currency such that, on a pre-agreed date or following the occurrence of a specified trigger event, the interest rate for loans in that currency will automatically switch from referencing an IBOR to referencing a compounded RFR. A Term Rate Currency to which the rate switch is specified to apply is referred to as a “**Rate Switch Currency**”.

The “**Rate Switch Date**” is a key definition for Borrowers to pay attention to if Rate Switch Currencies are included. This is the date following which Term Rate Loans in the Rate Switch Currency will become Compounded Rate Loans.

The “**Rate Switch Date**” is defined as the earlier of the “**Backstop Rate Switch Date**” and any “**Rate Switch Trigger Event Date**” for a given currency:

- A Backstop Rate Switch Date is a pre-agreed date which is specified in the Agreement or subsequently agreed. This is to be used if the parties agree that on a particular date (for example, the date on which they anticipate being operationally ready to do so), Term Rate Loans in the Rate Switch Currency will become Compounded Rate Loans.
- A Rate Switch Trigger Event Date is intended to capture those dates on which Term Rate Loans in the Rate Switch Currency must become Compounded Rate Loans. In summary, these include the date on which the relevant Primary Term Rate (e.g. EURIBOR) is discontinued or (optionally) the date on which it becomes non-representative of the underlying market it is intended to measure (with the option to specify additional trigger events).

Clause 9A.2 (*Delayed Switch for existing Term Rate Loans*) provides that if the Rate Switch Date falls before the last day of an Interest Period for an existing Term Rate Loan, the switch shall occur on and from the first day of the next Interest Period.

Clause 9A.3 (*Early termination of Interest Periods for existing Term Rate Loans*) is an optional provision that provides for Interest Periods ending on a day that falls after the Rate Switch Date to be shortened to end on the Rate Switch Date in certain circumstances. It applies only if the Interest Period is selected for a period during which it is known that the Rate Switch Date will occur (i.e. the Backstop Rate Switch Date or a pre-notified Rate Switch Trigger Event Date falls within the period).

Comment

Designation of Rate Switch Currencies

A Term Rate Currency will only be a Rate Switch Currency if it is designated as such in Schedule 13 (*Reference Rate Terms*) and if Reference Rate Terms for Compounded Rate Loans in that currency are agreed. The Reference Rate Terms for a Term Rate Currency which is a Rate Switch Currency will therefore need to include two parts – one which sets out the terms that apply to Loans in that currency prior to the switch (i.e. while they are Term Rate Loans) and one which sets out the terms that apply to Loans in that currency after the switch (i.e. when they become Compounded Rate Loans).

The Compounded/Term MTR applies the rate switch provisions, optionally, to euro (euro being the only Term Rate Currency). This provides a model for Reference Rate Terms that may be helpful for any other Rate Switch Currencies that might be added. The designation of euro as a Rate Switch Currency is not, however, mandatory. If euro is not designated as a Rate Switch Currency (which may be the case until the use of €STR as a reference rate or fallback rate in loans becomes more widespread), Reference Rate Terms for euro as Compounded Rate Currency would need to be negotiated pursuant to Clause 35.4 (*Changes to reference rates*).

Now new USD LIBOR loans (in practice) are no longer available (see section 3 (Risk-free Rates – the options) of Part II (*Risk-Free Rates in the Loan Market*)), the use of Rate Switch mechanisms has dwindled. It is anticipated that it will be resurrected as an operative concept as deadlines are set for the transition of products referencing non-LIBOR benchmarks and conventions for referencing RFRs in those currencies are settled.

Optional Clause 9A.3 (*Early termination of Interest Periods for existing Term Rate Loans*) was a feature of some early rate switch facilities during the 2020/21 period, but has not been widely adopted. The

intent of this provision appears to have been to encourage “active” transition. It was perhaps considered unnecessary in most cases.

“Rate Switch Date”

The definition of Rate Switch Date provides for the switch to occur in relation to a Rate Switch Currency if a Rate Switch Trigger Event occurs in relation to one or more “**Quoted Tenors**” i.e. tenors for which the relevant benchmark is quoted. This means, that upon the planned cessation of certain tenors of the relevant benchmark, Loans in a Rate Switch Currency will switch to the replacement rate notwithstanding the continuing availability of the remaining tenors of the original benchmark. Borrowers should consider whether this is the preferred outcome, which many have had to do in the context of the staggered cessation of USD LIBOR; some tenors ceased on 31 December 2021 and some will continue to June 2023. Hedging may be a consideration – the ISDA IBOR fallbacks for USD LIBOR, for example, do not follow the LMA model; on the cessation of certain tenors, provision is made for the remaining LIBOR rates to be interpolated.

See also comments on definition of “**Quoted Tenor**” at Clause 1.1 (*Definitions*).

“Rate Switch CAS”

Following the Rate Switch Date, interest on loans in the Rate Switch Currency will be the sum of the Compounded Reference Rate plus the Margin, where the Compounded Reference Rate is the sum of the compounded RFR plus a Rate Switch CAS. The CAS is added to the compounded RFR to account for the economic difference between the relevant IBOR and RFR following a switch.

How the Rate Switch CAS is to be calculated is left blank to be agreed. The possibilities are discussed in section 5 (Transition Issues) of Part II (*Risk-Free Rates in the Loan Market*). As noted in that section, the Borrower will need to consider whether to specify the Rate Switch CAS as a fixed amount in the Agreement, or whether to specify a calculation methodology such that the CAS is calculated when the Rate Switch Date occurs. If the anticipated Rate Switch Date is at an unspecified point in the future, a methodology could be the preferred approach. Some Agents have expressed a reluctance to apply a methodology, preferring to be provided with a fixed number.

CLAUSE 9 INTEREST

Clause 9 (*Interest*) makes separate provision for the calculation of interest on Term Rate Loans and on Compounded Rate Loans:

- The rate of interest on a Term Rate Loan for an Interest Period is the percentage per annum that is the sum of the “Term Reference Rate” and the Margin. The “**Term Reference Rate**” is defined as the Primary Term Rate (e.g. for euro, EURIBOR) or if there is no Primary Term Rate, the specified fallbacks. Fallbacks are discussed at Clause 11 (*Changes to the Calculation of Interest*) below.
- The rate of interest on a Compounded Rate Loan for any day during an Interest Period is the percentage per annum that is the sum of the “**Compounded Reference Rate**” and the Margin. The “**Compounded Reference Rate**” (in summary) is the sum of the “**Daily Non-Cumulative Compounded RFR Rate**” for that day and the “**Baseline CAS**”, if applicable.

The key point of difference is that the calculation of interest on Term Rate Loans (because they reference a forward-looking term rate) is over the Interest Period. The calculation of interest on Compounded Rate Loans is daily, on each day during an Interest Period. This is a function of the compounding methodology recommended in the Sterling Loan Conventions and reflected in the RFR Agreements. The background to this is explained in section 4 (Conventions for referencing RFRs) of Part II (*Risk-Free Rates in the Loan Market*).

Clause 9.1: Calculation of interest – Term Rate Loans

The rate of interest on each Term Rate Loan for each Interest Period, is the percentage rate per annum which is the aggregate of the following:

- the “**Margin**”: a percentage rate per annum to be specified in the definitions clause; and
- the applicable floating rate component (“**Term Reference Rate**”), for example, EURIBOR for Term Rate Loans in euro. The Term Reference Rate will be found in the Reference Rate Terms applicable to the relevant currency.

See comments in relation to the definitions of “**Margin**”, “**Term Reference Rate**” and “**Primary Term Rate**” in Clause 1.1 (*Definitions*) and Schedule 13 (*Reference Rate Terms*).

Clause 9.2: Calculation of Interest – Compounded Rate Loans

The rate of interest on each Compounded Loan, for each day during an Interest Period, is the percentage rate per annum which is the aggregate of the following:

- the “**Margin**”: a percentage rate per annum to be specified in the definitions clause; and
- the applicable floating rate component (“**Compounded Reference Rate**”). The Compounded Reference Rate will be found in the Reference Rate Terms applicable to the relevant currency.

See comments in relation to the definitions of “**Margin**” and “**Compounded Reference Rate**” in Clause 1.1 (*Definitions*) and Schedule 13 (*Reference Rate Terms*).

Clause 9.3: Payment of interest

Interest is payable on the last day of each Interest Period.

The LIBOR Agreements contain an additional provision, to the effect that if the Interest Period is more than 6 Months (a defined term in those Agreements), it must also be paid at 6 Monthly intervals, in line with market practice. This is omitted in the Compounded/Term MTR due to Interest Periods of greater than 6 months having fallen into disuse in relation to Compounded Rate Loans.

For more on Interest Periods, please see comments on Clause 10.1 (*Selection of Interest Periods*).

Clause 9.4: 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.

For Term Rate Loans that become due on a day other than the last day of the Interest Period (for example, as a result of an acceleration or mandatory prepayment requirement), the first Interest Period on the overdue amount is equivalent to the unexpired portion of the then-current Interest Period.

The Agent’s right to set Interest Periods on overdue amounts relating to Term Rate Loans 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.

The same does not apply to Compounded Rate Loans. There, the Agent is free to set the Interest Period, because (as a footnote explains), the provisions relating to Compounded Rate Loans are not predicated on any particular funding practice.

Default interest is compounded with the overdue amount at the end of each Interest Period.

Comment

The default interest rate is often set at 0.5% or 1% above the rate which would otherwise have applied.

Compounding at the end of each Interest Period for the defaulted amount is market practice.

Clause 9.5: Notifications

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

The Agent's notification obligations with regard to Compounded Rate Interest Payments are different. Rates of interest are notifiable when they are determinable. The notification obligation relates to the interest to be paid in respect of an Interest Period, not the Daily Non-Cumulative Compounded RFR for a particular day.

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.

The length of the Interest Periods the Borrower is pre-authorized to select are left to be specified for each currency in Schedule 13 (*Reference Rate Terms*). Periods other than those specified in the Agreement require the approval of all the Lenders.

Comment

As RFRs can be compounded over any period, the length of the permitted Interest Periods for Compounded Rate Currencies can, in theory, be agreed at whatever length best suits the parties. Unless Borrowers have a specific need for flexibility, emerging practice suggests that Interest Periods for Compounded Rate Loans are largely the same as those that featured in LIBOR-referencing loans i.e. one, two, three or six months, or as otherwise agreed between the parties.

In LIBOR-referencing loans, Interest Periods of twelve months were also permitted. This clause of the Compounded/Term MTR, however, states that no Interest Period shall exceed six months.

The reason for this relates to Compounded Rate Loans. In relation to Interest Periods of longer than six months, customary practice has been to require the Borrower to make interim payments of interest every six months. The NCCR methodology (see section 4 (Conventions for referencing RFRs) of Part II (Risk-Free Rates in the Loan Market)) does not envisage the making of interest payments during an Interest Period. The formula would need to be adjusted to accommodate this (compounding being aimed at compensating Lenders for the time value of money).

While of primary relevance to Compounded Rate Loans, the restriction in the Compounded/Term MTR applies to both Compounded Rate Loans and Term Rate Loans. This is because the application of the NCCR is also relevant to Rate Switch Currencies following a switch and Term Rate Currencies for which a Compounded Reference Rate is to apply as a fallback to the relevant Primary Term Rate. Where neither of these circumstances apply, Borrowers who would prefer more flexibility may wish to consider limiting any restriction on the maximum length of Interest Periods to Compounded Rate Loans only.

Other factors to be taken into account in selecting the length of an Interest Period include the following:

- 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 at Clause 13 (*Tax Gross-up and Indemnities*) and at Clause 24 (*Changes to the Lenders*).
- If a Facility is to be repaid or to reduce in instalments, Borrowers may select Interest Periods shorter than would otherwise be allowed, to ensure that Loans of the necessary size mature on the relevant repayment or reduction dates.
- 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.

If the Borrower does not deliver a Selection Notice, the Agreement determines the length of the Interest Period. Again, this default Interest Period is left blank to be specified for each currency in Schedule 13 (*Reference Rate Terms*). Borrowers may wish to discuss the length of the default Interest Period that applies if none is selected with the Agent. The LIBOR Agreements used one Month as the optional default; longer periods may be chosen.

See also comments on relevant definitions at Schedule 13 (*Reference Rate Terms*).

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

To cater for the possibility that business day conventions may vary by currency, this clause cross-refers to Schedule 13 (*Reference Rate*

Terms), where the business day convention applicable to Loans or Unpaid Sums are specified separately for each currency.

Comment

Schedule 13 (*Reference Rate Terms*), as a starting point, applies the “modified following business day” market convention to all currencies. Pursuant to this convention, 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 “modified following business day” market convention is used for the calculation of EMMI’s EURIBOR and is recommended in the Sterling Loan Conventions.

See further comments on relevant definitions at Schedule 13 (*Reference Rate Terms*).

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 Clause 4.4 (*Maximum number of Loans*) and Clause 5.3 (*Currency and amount*).

CLAUSE 11 CHANGES TO THE CALCULATION OF INTEREST

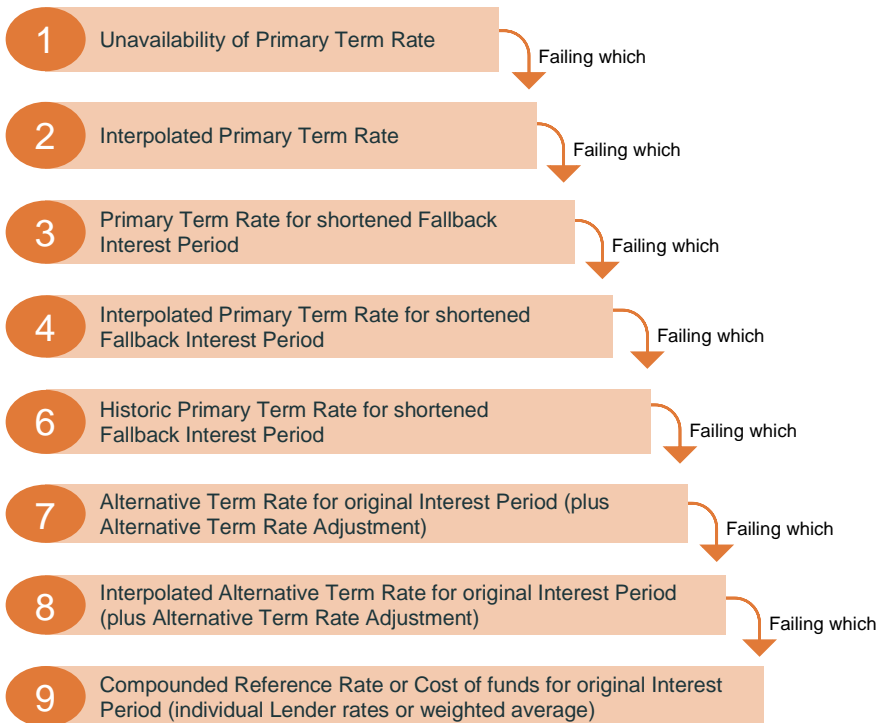
Clause 11.1: Interest Calculation if no Primary Term Rate

Fallbacks are intended to address the temporary unavailability of a reference rate, by specifying how the interest rate will be calculated in the event that the relevant reference rate is unavailable for a period. Different fallback rate options apply to Compounded Rate Loans and Term Rate Loan.

The fallbacks that apply to Term Rate Loans are an updated version of those that applied under the LIBOR Agreements. If the Primary Term Rate (i.e. the relevant IBOR) is not available, two waterfall options are provided.

The fuller waterfall, Option 1 (illustrated in the diagram below) is quite complex. Should the screen rate be unavailable and interpolation impossible, rates for a shortened “**Fallback Interest Period**”, or failing that, “**Historic Primary Term Rates**” will be used. Once those options have been exhausted the next optional set of fallbacks are based on “**Alternative Term Rates**”. The last level of the waterfall provides for the calculation of interest for the relevant Interest Period using either a Compounded Reference Rate or each Lender’s cost of funds, calculated in accordance with Clause 11.4 (*Cost of funds*).

Term Rate Currency Fallback Waterfall (Option 1)



Option 2 is shorter. It provides for the use of Interpolated Primary Term Rates, or if interpolation is not possible, the waterfall moves straight to the option of Alternative Term Rates (level 7 in the Option 1 waterfall).

Comment

Contingency measures put in place by benchmark administrators may decrease the likelihood of contractual fallback options being triggered in relation to a Primary Term Rate. The [Benchmark Determination Methodology for EURIBOR](#), for example, makes provision for the re-publication of rates for the previous day if insufficient inputs are received (or no inputs are received) for example and that rate treated as the EURIBOR rate for that day.

The existence of such contingency plans potentially narrows the circumstances in which contractual fallback provisions 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). Nonetheless, fallback provisions are still considered very important.

While there are a range of approaches to fallbacks (reflected in the number of optional provisions in this clause), parties often decide that the full form of the Option 1 waterfall is unnecessary. The simplicity of a shorter waterfall (the second option) is quite often preferred.

If levels 2-6 of the Option 1 waterfall are included, 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, up to a maximum of one month). Similarly, Historic Primary Term 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.

Historically, both fallback waterfalls would have moved from the Primary Term Rate to a Reference Bank Rate and then ultimately, cost of funds. This changed with the publication of the RFR Agreements.

The use of Reference Bank quotes in fallback provisions had become largely redundant well before 2020. The concept was by then rarely used in new loan documentation, the prospect of LIBOR cessation

having highlighted concerns about the availability of such quotes. In place of Reference Bank Rates, the RFR Agreements offer two new Term Reference Rate fallback options: the option to fallback to an Alternative Term Rate and the option to fallback to a Compounded Reference Rate in place of cost of funds.

The inclusion of an Alternative Term Rate as a fallback contemplates the availability of another forward-looking term rate for the relevant currency. The thought here is that the forward-looking term rates to be derived from certain of the RFRs (discussed at section 3 (Risk-free Rates – the options) of Part II (*Risk-Free Rates in the Loan Market*)) might be appropriate fallbacks. Where the relevant term rate is not yet available, this is not necessarily a barrier to it being included in the waterfall as an interim fallback, although some Borrowers may prefer to have an idea of how the rate behaves and the appropriate CAS to be applied, before agreeing to its inclusion.

The fallback to a Compounded Reference Rate or cost of funds in the final stage of the waterfall envisages the use of a compounded in arrears RFR plus a CAS as a temporary fallback for Term Rate Currencies, or else cost of funds, which was the final fallback in most IBOR-referencing loans.

It is interesting that here, the Compounded Reference Rate is presented as an alternative (rather than in addition) to cost of funds as a fallback rate. In other words, the suggestion is that cost of funds is not required as a fallback if the Compounded Reference Rate applies. This contrasts with the position in relation to fallbacks for Compounded Reference Rates, where cost of funds is presented as an optional fallback (suggesting it may be necessary in some circumstances) – see Clause 11.2 (*Interest calculation if no RFR or Central Bank Rate*).

While this clause requires the parties to select whether to apply Option 1 or Option 2, to determine the fallbacks applicable to a particular currency, it must be read in conjunction with the relevant part of Schedule 13 (*Reference Rate Terms*). There, the parties are asked to specify whether the Alternative Term Rate, the Compounded Reference Rate or cost of funds will apply as a fallback.

The Compounded/Term MTR does not include an Alternative Term Rate or a Compounded Reference Rate as a fallback for EURIBOR.

Instead, the fallbacks for EURIBOR move from the Primary Term Rate options to cost of funds.

Borrowers who rely on interest rate hedging should bear in mind that some of these fallbacks are not mirrored in standard ISDA terms, for example, those based on Historic Primary Term Rates or cost of funds. This is not a new point, the same was true of LIBOR hedging, but where close alignment is desirable, the extent of any basis risk may be a factor to consider.

Clause 11.2: Interest calculation if no RFR or Central Bank Rate

The fallbacks that apply to Compounded Rate Loans under the Compounded/Term MTR are simpler than those that apply to Term Rate Loans and cross-refer to the applicable part of Schedule 13 (*Reference Rate Terms*).

In summary, the RFR used in the calculation of a Compounded Reference Rate is substituted for an adjusted central bank rate, should the RFR be unavailable. This is achieved in the definitions in the parts of Schedule 13 (*Reference Rate Terms*) dealing with Compounded Rate Currencies, which in turn, drive the inputs to the compounding formulae in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*).

The key definition is “**Daily Rate**”. This is the relevant RFR (i.e. SONIA, SOFR or SARON) or, if the RFR is not available, a fallback rate. If the RFR is unavailable on any day, a Central Bank Rate plus an optional spread adjustment (the “**Central Bank Rate Adjustment**”) will apply in place of the RFR in the compounding calculation. If the Central Bank Rate is unavailable on any day, a historic Central Bank Rate (no more than a specified number of days old) plus an optional spread adjustment will apply.

The inclusion of Central Bank Rates in the waterfall obviously means the drafting is different for each currency. See Schedule 13 (*Reference Rate Terms*).

As the primary interim fallback (based on a Central Bank Rate), is incorporated into the definition of Daily Rate, the purpose of this clause is to provide for a fallback from that Central Bank rate, to cost of funds. This is optional. It will apply only if “*Cost of Funds to apply as a fallback*” is indicated in Schedule 13 (*Reference Rate Terms*).

Comment

The inclusion of an ultimate fallback to cost of funds is optional for Compounded Rate Loans. There is some debate as to whether an ultimate fallback to cost of funds is appropriate for Compounded Rate Loans. This is partly conceptual. RFRs are not a proxy for term funding costs in the way that LIBOR is. There is also an argument that an ultimate fallback beyond a central bank rate is unnecessary, given the very remote possibility of it ever being triggered. Pursuant to paragraph (f) of Clause 1.2 (*Construction*), references in the Agreement to a Central Bank Rate shall include references to successor or replacement rates.

Cost of funds is often omitted as a rate fallback for Compounded Rate Loans. If this is agreed, it will be specified in the relevant section of Schedule 13 (*Reference Rate Terms*).

Clause 11.3: Market Disruption

This clause is designed to enable 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. Prior to the RFR Agreements, the LMA's market disruption clause was crafted with LIBOR in mind. Lenders became entitled to substitute their cost of funds for LIBOR (or EURIBOR) if a specified percentage of Lenders notified the Agent that they were unable to fund their participation in the loan at that benchmark. In the Compounded/Term MTR the market disruption provisions apply in the same way to Term Rate Loans as in the LIBOR Agreements (with some changes to the terminology), but are optional in relation to Compounded Rate Loans.

The benchmark against which Lenders are to judge their funding costs is now termed the "**Market Disruption Rate**" and must be specified for each currency in Schedule 13 (*Reference Rate Terms*). If the parties do not specify a Market Disruption Rate in the applicable Reference Rate Terms, this clause will have no effect for loans in that currency. Where a Market Disruption rate is specified, if a Lender's cost of funds exceeds the Market Disruption Rate for that currency, it may notify the Agent. If Lenders representing in excess of a the specified percentage of the relevant Loan notify the Agent to that effect, Clause 11.4 (*Cost of funds*) is engaged and interest will be the sum of the Lenders' cost of funds and the Margin for the relevant Interest Period.

See paragraph (a)(iv) of Clause 1.2 (*Construction*) in relation to the definition of “**cost of funds**” that is applicable for this purpose.

The Market Disruption Rate is a rate over a period, rather than a Daily Rate. Applied to Compounded Rate Loans, it must therefore reference a Cumulative Compounded RFR Rate. The cumulative compounding formula in Schedule 15 (*Cumulative Compounded RFR Rate*) is included to enable the compounded RFR to be calculated over the Interest Period for the purposes of calculating any Market Disruption Rate.

Comment

Continuing relevance

The LIBOR manipulation scandal prompted renewed focus on the operation of this clause, and in particular, whether it was aligned with modern bank funding arrangements. It had long been apparent that some banks are unable to fund themselves at LIBOR, at least in the inter-bank market. Further, non-bank Lenders who could fund themselves at LIBOR in any circumstances were participating regularly 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, in theory at least, would be capable of operation regardless of any disruption in any market. This prompted questions as to whether the then-current version of the LMA’s clause was appropriate from the Borrower’s point of view. The heading of the clause, “market disruption”, suggests provisions catering for the consequences of an adverse change in funding conditions. That, arguably, was not the case.

The market disruption provisions also seemed 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. The market disruption clause contained no such threshold to mitigate its potentially adverse effect on the Borrower.

As a result, Borrower-side lawyers argued during the LIBOR transition process that while the interest rate provisions of the Investment Grade

Agreements were being comprehensively updated to accommodate RFRs, this clause should be dispensed with. In addition to the points above, the clause has rarely been invoked, in part because Lenders struggled to calculate their cost of funds for this purpose. Lenders were reluctant to delete a protective clause, so Clause 11.3 was ultimately retained as an optional provision in the RFR Agreements in a slightly updated form.

Market Disruption and Compounded Rate Loans

While a significant number of investment grade borrowers have agreed that market disruption provisions should not apply to Compounded Rate Loans, there remain a range of views. Where market disruption provisions apply, Borrowers should pay close attention to the specified percentage of Lenders required to trigger the provisions, to safeguard themselves as far as possible (see further below). The applicable Market Disruption Rate also requires attention.

The Market Disruption Rate for Term Rate Currencies will be the relevant IBOR (which has discussed above, is assumed to be an inter-bank rate that contains an element which can operate as a proxy (however accurate) for lenders' funding costs). If this principle is to be applied to Compounded Rate Loans, the Market Disruption Rate if included, should be the aggregate of the compounded RFR and a CAS, rather than being based solely on the RFR calculation. Otherwise, the basis for the trigger of the market disruption clause is fundamentally altered from that applicable in LIBOR days.

If no CAS features in the Market Disruption Rate, cost of funds may not be an accurate substitute for the Compounded Reference Rate – and more importantly, the provision may be easier to trigger (RFRs not being a reflection of funding costs in distressed markets). Borrowers may argue, therefore, that market disruption provisions are redundant in the context of Compounded Rate Loans.

Negotiating points if this clause applies

Borrowers might argue that where applicable, Clause 11.3 should 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 if Lenders' funding costs have increased materially beyond

the applicable Market Disruption Rate 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. They may point out that the clause as drafted requires Lenders representing a material proportion of the Loan to notify the Agent that they are unable to fund at the Market Disruption Rate, which should protect the Borrower from the clause being invoked by a minority of Lenders. Although historically the agreed threshold here was often Lenders whose participations represent 50% of the Loan, the percentage may be lower. In many deals the threshold is set at 35%. In light of the comments above, it would seem important for Borrowers to negotiate as high a threshold as possible.

Borrowers should also consider the suggestions in the footnotes to Clause 11 (*Changes to the Calculation of Interest*), added at the request of the ACT some years ago, reminding 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 is to be priced on a cost of funds basis.

If any right to revoke a Utilisation Request is to be meaningful, it must be capable of exercise before the Loan is funded. For Term Rate Loans, this may be the case. For Term Rate Loans, the cut off is close of business on the Quotation Day (so for euro, two Target Days prior to funding). For Compounded Rate Loans, the notification time (as drafted) falls at the end of the Interest Period, another reason why Clause 11.3 is problematic as applied to Compounded Rate Loans.

This point is explained further in the comments on the definitions of “**Reporting Day**” and “**Reporting Times**” at Schedule 13 (*Reference Rate Terms*).

Clause 11.4: Cost of funds

This clause provides the basis on which Lenders’ cost of funds shall be charged and paid for Interest Periods where it applies as a fallback rate, or pursuant to Clause 11.3 (*Market Disruption*).

The parties are given two options. The cost of funds payable to each Lender can be the cost of funds rate that Lender notified to the Agent (termed as that Lender’s “**Funding Rate**”). Alternatively, the cost of

funds payable to each Lender can be the weighted average of the Funding Rates notified to the Agent by each Lender.

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

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

Note that “**cost of funds**” is defined in Clause 1.2 (*Construction*).

Comment

It is understood that the option to use a weighted average rate was introduced 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 rate it is designed to replace (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 original rate in those circumstances.

The LMA's optional drafting also provides that any Lender who notifies the Agent of a Funding Rate which is less than the Market Disruption Rate, should continue to receive the original rate. Borrowers may question why a Lender would notify a Funding Rate which is less than the Market Disruption Rate.

Clause 11.5: Break Costs

The application of “**Break Costs**” is specified by currency in Schedule 13 (*Reference Rate Terms*). This clause contains the Borrower’s obligation to pay Break Costs, where applicable. 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.

Comment

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*). As noted, Break Costs do not typically apply to Compounded Rate Loans.

The main point that Borrowers quite often take on this clause (as applicable to Term Rate Loans) 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.

Clause 12.2 (*Arrangement fee*) makes provision for the payment of arrangement fees to the Arrangers as set forth in a separate Fee Letter, as is customary.

Clause 12.3 (*Agency fee*) makes provision for the payment of agency fees to the Agent as set forth in a separate Fee Letter, as is customary.

Comment

Commitment fees (payable on undrawn and uncanceled commitments) are typically set out in this clause as a percentage of the Margin (often between 30% and 40%). Where the transition from LIBOR to RFRs results in an adjustment to applicable Margins,

Borrowers should consider whether any adjustment to the commitment fees is appropriate (see section 5 (Transition Issues) of Part II (*Risk-Free Rates in the Loan Market*)).

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).

Comment

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 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).

Comment

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.

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 outstanding for a year or more, but generally also revolving facilities where. Although revolving facility advances may be made for periods of less than a year, they may be rolled over, so 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 tax.

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.

Comment

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 DTTP Scheme mitigates the burden of procedural formalities in many cases. Any potential 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 Lenders: 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.

Comment

The existence of the third, blank, condition in the definition of “**Treaty Lender**” is unsatisfactory. The ACT has made representations to the

LMA that instead of the blank, it would be preferable to include some optional drafting. The blank means that the third condition is sometimes omitted entirely. This give rise to the risk that a Treaty Lender may be entitled to grossed-up payments even though Treaty relief allowing the Borrower to pay without withholding will 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 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: 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.

Comment

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 Date¹⁶.

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

The DTTP Scheme

The DTTP Scheme became operative on 1 September 2010. Provisions catering for the operation of this scheme were added to the Investment Grade Agreements shortly thereafter. 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 holders¹⁷. 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 1 (*The Original Parties*) where their names appear. Lenders who acquire their participation on the secondary market or pursuant to Clause 2.2 (*Increase*) are asked to make the relevant confirmation in the Transfer Certificate, Assignment Agreement or Increase Confirmation (see Schedule 4 (*Form of Transfer Certificate*), Schedule 5 (*Form of Assignment Agreement*) and Schedule 12 (*Form of Increase Confirmation*)).

¹⁶ Though see the discussion at *Clauses 24.2: (Company consent) and 24.3 (Other conditions of assignment or transfer)* below.

¹⁷ www.hmrc.gov.uk/cnr/dtpp-register.pdf.

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.

Comment

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 such 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 relevant 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 was hoped that it might 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. A Borrower paying gross in these circumstances would, however, still be taking the risk of learning after the event that it should in fact have withheld.

The scope of the DTTP Scheme was extended after its introduction 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 therefore 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.

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*).

Comment

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 now customary, though stronger and more determined Borrowers may be 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 the LMA's form of tax indemnity 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 (i) have 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.

Comment

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.

Comment

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 *Clauses 24.2: (Company consent) and 24.3 (Other conditions of assignment or transfer)*); 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.

Comment

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

Clauses 13.8 and 13.9: FATCA

What is FATCA?

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. The scope of the rules on foreign passthru payments have still not been finalised. However, 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 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 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 reduced very substantially the number of FFIs that would need to make – or would ever suffer – the withholding imposed by FATCA.

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

After FATCA came into force, 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, 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).
- The possibility of claims relating to any FATCA withholding being pursued against the Borrower via Clause 13.3 (*Tax indemnity*) or Clause 14 (*Increased Costs*) is also excluded.
- Each party is required to confirm its FATCA status to the others to facilitate compliance. There is a mechanism for replacing the Agent if its involvement risks triggering FATCA withholding Clause 26.12 (*Resignation of the Agent*).

Comment

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 in transactions involving lenders in non-IGA jurisdictions. 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 of the LMA’s 2014 “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 used on a widespread basis, but may be relevant in some instances.

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.

Comment

Negotiating points

The scope of the increased costs clause is quite often discussed, although typically fairly easily settled, as the adjustments sought are reasonably well known among regular market participants. Borrowers are quite often able to weaken this provision in some respects, although what is achieved and the nature of any limitations vary. Points commonly addressed include the following:

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 incurrence 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 (see further below) is still quite commonly included although, as explained below, the risk of Increased Costs claims arising out of Basel II is very limited.

Borrowers often consider that any Increased Costs arising out of “Basel III” should be excluded from the scope of this clause, now that the main components of the package originally known as Basel III have been implemented in the UK and the EU.

The treatment of Basel III costs (also discussed further below) is often the particular focal point of negotiations on the scope of the increased costs clause. Amendments may be instigated by Lenders: Lenders often seek to adjust the LMA clause to provide that “Basel III” costs (widely defined to encompass any future guidance or standards relating to Basel III) are recoverable. This is regardless of whether they constitute a change in law, given that Basel III is now virtually fully implemented in the UK and the EU.

Other exceptions may apply or be negotiated in certain agreements. For example, while it is not clear that such costs have prompted increased costs claims in practice (similarly to Basel III costs), some Lenders and Borrowers seek to allocate specifically costs arising out of the US Dodd-Frank Act which, among other things, imposes more stringent capital requirements on US financial institutions.

Basel II and Increased Costs

The first Basel Capital Accord was adopted in 1988 (**Basel I**). Basel II refers largely to the International Convergence of Capital Measurements and Capital Standards published by the Basel Committee on Banking Supervision (**BCBS**) in June 2004.

Under Basel II (as under its predecessor Basel I), banks were required to meet a capital ratio of a minimum of 8% of risk weighted assets, with Total Tier 1 capital of not less than 4%. Basel II also required that banking supervisors should have the power to compel banks to hold capital in excess of the 8% minimum ratio where this was justified.

Overall, Basel II was considerably more risk sensitive than Basel I and marked a shift in favour of greater reliance on banks' internal models and methodologies, and external credit ratings. Both of these developments would come under considerable scrutiny in the aftermath of the financial crisis leading to Basel III. Under Basel II, assessments of a borrower's creditworthiness may vary from bank to bank, depending on whether the internal ratings based approach 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.

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 many years.

Basel II has been fully implemented in the EU (and the UK), 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). However, it had not been fully implemented in other countries when

the 2007-9 financial crisis hit, notably the US, a point acknowledged in the LMA's footnote to Clause 14. Moreover, 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 considered unlikely, but cannot be entirely ruled out. Against this background, some Borrowers consider it appropriate to continue 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

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".

Although Basel III did not change the minimum capital ratio or general approach to capital regulation in Basel II, it altered the composition of

capital and minimum requirements for common equity Tier 1, additional Tier 1 and Tier 2 capital, as well as the calculation of risk-weighted assets. In addition, banks are required to build up capital buffers in good times that can be drawn down in periods of stress.

The Basel III package also introduced liquidity standards 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.

The Basel III reforms were implemented in the EU primarily through the fourth Capital Requirements Directive (2013/36/EU) (**CRD IV**) and the Capital Requirements Regulation (575/2013) (**CRR**) as well as a package of amendments made by the CRR II Regulation (2019/876) and the CRD V Directive (2019/878/EU). In the UK, Basel III standards are reflected in a patchwork of onshored EU legislation, the PRA Rulebook and other legislative and regulatory material.

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, Basel III (in its original iteration) has been in force for some time in the EU and UK, indicating that costs relating to Basel III and CRD IV should fall outside the scope of the increased costs indemnity as drafted in the Investment Grade Agreements. In light of the phased implementation of the various elements of Basel III, it became 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/CRD V costs (and their UK equivalent) are intended to be within, or outside, its scope.

Borrowers may argue that by now they 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 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 fairly rare in syndicated facilities to date.

In the face of general resistance from Lenders to the concept of excluding Basel III 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, is to permit the Finance Parties to claim costs relating to Basel III 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 is to provide that Lenders may claim Increased Costs arising out of Basel III/CRD IV/V 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.

To complicate matters further, references to Basel III may also be understood to cover the finalised Basel III post-crisis reforms published by the Basel Committee in December 2017 primarily in “Basel III: Finalising post-crisis reforms” (BCBS424) (also sometimes referred to as “Basel IV”). Among other things, these provisions

restrict the use of banks' internal models across several dimensions and impose an output floor (that is the requirement that risk-weighted assets resulting from internal models cannot be less than 72.5% of the risk-weighted assets deriving from the standardised approach). The reforms also improve the granularity of several standardised approaches and reduce their reliance on external ratings.

This final package of Basel III reforms were originally expected to be implemented in full by 1 January 2022, although this was put back to 1 January 2023 due to the economic dislocations caused by the coronavirus pandemic. The UK and the EU have announced that implementation of these final elements will be delayed until 2025.

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.

Comment

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.

Comment

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 2007-9 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 (*The Role of the Agent and the Arranger*).

It is worth noting here that the equivalent provision in other of the LMA's templates was also altered in the wake of the 2007-9 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.

Comment

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.

Comment

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.

Clause 17.4 (*Reference rate transition costs*) is an optional placeholder, to be completed if the parties to specify how any costs associated with amendments or waivers contemplated by Clause 35.4 (*Changes to reference rates*) will be allocated between them.

Comment

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.

This allocation of reference rate transition costs was the subject of some debate in the context of amendments to LIBOR facilities. In the early stages, Lenders quite often assumed that, as is customary in relation to amendments requested by the Borrower or necessitated by its own circumstances, the Borrower would meet the Lenders' costs as well as its own. Amendments to accommodate replacement reference rates can, however, be distinguished from that situation, being driven by a market-wide change on a timetable driven by financial sector regulators rather than Borrowers. In the US, the LSTA recommended that Lenders should not be passing the costs of LIBOR transition amendments on to Borrowers. In the London-based loan market in the context of LIBOR, it the more common position was for the parties to agree that each would bear its own costs.

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.

Comment

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 investment grade, 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 might, for example 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 introduction to Section 8 (*Representations, Undertakings and Events of Default*).

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

OVERVIEW – APPROACH TO COMMERCIAL TERMS

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: 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 each relevant member 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, 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 frequently put forward are discussed in the commentary on individual clauses.

It is emphasised 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 investment grade and beyond. The application and stringency of any financial covenant tests will also be credit-driven.
- **Jurisdiction-driven:** The Investment Grade Agreements are designed for English Obligors. Supplemental provisions are often prompted by the nationality of the Obligors (for example, if there is a US Obligor, provisions relating to compliance with a range of US regulations is customary).
- **Sector/business-driven:** Additional provisions may be driven by the nature of the business. Examples of quite widespread application here include representations and undertakings relating to environmental matters and insurance coverage which are often applicable to businesses with real estate assets. Financial covenants also tend to be quite sector-specific.
- **Policy-driven:** Some representations and undertakings are put forward because a Lender has adopted a policy of doing so across its loan book, possibly in response to its perceptions of current risk levels. 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 further below).

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.

TECHNIQUES FOR LIMITING THE COMMERCIAL TERMS

Application to Group, Obligors or individual entities

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 Obligor's 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 definition provides greater certainty of meaning. In appropriate cases, monetary thresholds can be a measure of materiality (for example, where it is necessary to identify "material" litigation or an amount of permitted Financial Indebtedness).

Qualifications by reference to knowledge are likely to be most relevant to the representations and also, more wide-ranging undertakings such as those relating to sanctions (see further below). 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.

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 as an exception to Clause 22.3 (*Negative pledge*), Clause 22.4 (*Disposals*) and Clause 23.5 (*Cross-default*). 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.

As noted in section 1 (Navigating Challenging Conditions) of Part III (Hot Topics), significant geopolitical events can affect exchange rates. Material movements in exchange rate (or past adverse experiences) might prompt Groups with foreign currency exposures to consider whether this could have any implications under their loan documentation.

Baskets are a good example of provisions that may be so affected. They 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.

Comment

Where the impact of exchange rate movements on baskets or other monetary limits is of concern, Borrowers sometimes try to negotiate contractual protection against an inadvertent breach. Such provisions must be crafted to fit the circumstances, but may be along the lines that no Event of Default or breach of any representation or undertaking shall arise as a result of fluctuations in exchange rates.

Possible Supplementary Provisions - Sanctions

The background to sanctions provisions in loan documentation is discussed in section 1 (Navigating Challenging Conditions) of Part III (*Hot Topics*). As noted in that section, sanctions provisions are not a feature of the Investment Grade Agreements, so provisions need to be settled on a case by case basis.

The LMA has not incorporated any specific clauses relating to sanctions into its English law templates, most likely 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 circumstances¹⁸. However, it has produced a number of helpful guidance notes on sanctions and 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, a point certain Lenders are quite focussed on.

¹⁸ Note that the LMA's templates for Borrowers in developing markets jurisdictions incorporate framework definitions that might be used sanctions provisions, although no representations and undertakings, as this is an area where market practice diverges. These also appear in certain of its African law templates, alongside undertakings regarding the use of proceeds of the facility in breach of US sanctions (alongside a footnote inviting users to consider whether other regimes are relevant).

Comment

Requests for sanctions provisions from Lenders often include assurances in relation to some or all of the following:

- **Sanctions targets and sanctioned countries:** the 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 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 may be required to give assurances on a more extensive range of issues. However, in the investment grade market, it is not typical to cover all of the above topics. 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 generally required.

In practice, 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. Many such Borrowers will resist requests to represent and/or undertake that the Group complies with "Sanctions", for example. Such provisions tend to expose the Group to a wider set of compliance obligations than those to which its business is subject. Borrowers may instead direct Lenders to rely on the undertaking regarding the Group's compliance with laws generally, which is typically framed in a more proportionate manner (see Clause 22.2 (*Compliance with laws*)).

A more typical set of protections in an investment grade agreement might focus on assurances regarding the absence of sanctions

targets/activities in sanctioned countries, the use of the proceeds of the facilities and the existence of compliance policies and procedures.

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. Examples of 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 laws applicable to any party to the Agreement. Borrowers may seek to limit their scope to capture only sanctions regimes in key jurisdictions applicable to the Borrower’s group, 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 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 Group undertakes activities or has relationships with counterparties in countries that are subject to sanctions (for example, under licence), appropriate carve outs from the sanctions provisions will need to be agreed.

Another 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 individually 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 above is intended simply give a flavour of what Lenders may seek to cover, and prompt thoughts on the most appropriate strategy for a particular Borrower. 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, and possibly think about putting forward their own proposal on sanctions language, with a view to achieving a more balanced outcome.

The contents of a Borrower draft will depend on the geographic spread of the business, its sector and the Borrower's own compliance processes and (as with all lending terms) its credit standing. Another factor to take into account, if Borrowers have multiple debt facilities, is that the sanctions framework is consistent across those facilities.

Possible Supplementary Provisions – Anti-Corruption Laws

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. Representations and undertakings relating to compliance with anti-corruption laws have started to appear with increasing frequency in corporate loan documentation in recent years, often alongside provisions relating to sanctions.

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 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 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 facility are not applied in breach of sanctions.

Comment

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 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 facility in breach of sanctions, where included, knowledge qualifications (in particular with regard to the “indirect” use of proceeds) are negotiated reasonably often.

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.

Comment

This representation is usually a Repeating Representation.

Clause 19.2: Binding obligations

This representation 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.

Comment

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.

Comment

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.

Comment

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.

Comment

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.

Comment

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.

Comment

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.

Comment

As the LMA User Guide comments, this is not needed from English corporate Obligor. In addition, all Obligor 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.

Comment

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.

Comment

These representations may be omitted in clubbed deals or in refinancing transactions which do not involve the preparation of an Information Memorandum (alongside the definition of "**Information Memorandum**" in Clause 1.1 (*Definitions*)). 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 introduction to Section 8 (*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 the 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.

Comment

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 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.

Comment

This representation is usually a Repeating Representation.

Clause 19.13: No proceedings

This 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 as a new limb (b) to the representation. This 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.

Comment

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.

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 (*Representations*).

Comment

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 above), 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.

Comment

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.

Comment

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.

Comment

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, which made significant changes to accounting for leases has given rise to similar concerns (see comments on the definition of "**Financial Indebtedness**" at Clause 1.1 (*Definitions*) above).

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. 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.

Comment

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*)).

Also, on the topic of litigation, Borrowers should note that 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 noted above.

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).

Comment

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: Direct Electronic Delivery by Company

This provision means that, if the Agent and the relevant Lender(s) agree, the Borrower can deliver information required to be delivered under the Agreement electronically.

Comment

The Lenders are not obliged to agree to the use of electronic communications, although in practice, in general, processes are such that this does not generally present a problem.

See also comments at Clause 31 (*Notices*).

Clause 20.7: “Know Your Customer” checks

These provisions require the Obligor 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 Obligor 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 2017 (as amended)

*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. The 2017 Regulations have been further amended, most significantly through the transposition of the EU Fifth Anti-Money Laundering Directive (2018/843/EU) in January 2020. The 2017 Regulations, as subsequently amended, remain in*

place following Brexit. For the time being the UK money laundering regime remains broadly in line with the EU regime.

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.

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.

Part II of the Guidance includes sector-specific guidance on syndicated lending. 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.

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.

Comment

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 (for now) should be similar given the EU origins of the UK regime.

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.

Financial covenants have been a key area of focus for treasurers navigating challenging conditions in recent times, as noted in Part III (*Hot Topics*). From the treasurer's perspective, it is crucial to ensure the financial covenants are both set at a level which can be realistically complied with and drafted carefully to reflect the nature of the Group's operations and accounting policies.

The Investment Grade Agreements provide no guidance on the typical shape of the financial covenants 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?

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, over the 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

The nature of the financial covenants depends 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 (**ICRs**) 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 and certain key concepts and definitions are explained below.

Leverage (Debt Cover)

A leverage ratio compares the 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 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.

The concept of "Borrowings" for this purpose typically captures a narrower category of debt than the LMA definition of "Financial Indebtedness" that is used, for example, in any covenant restricting the Group from incurring Financial Indebtedness and the cross-default Event of Default (see comments at Clause 1.1 (*Definitions*) above). The differences between "Borrowings" for financial covenant purposes and the LMA definition of "Financial Indebtedness" include the following:

- "Borrowings" is typically limited to the aggregate outstanding principal, capital or nominal amount of indebtedness of any member of the Group which falls into any of the listed categories of debt. Financial Indebtedness is broader, extending to any indebtedness for the items listed in its sub-paragraphs.
- Financial Indebtedness includes the marked to market value (or actual amount due if terminated) of the Group's hedging transactions. The fair value of any derivatives is not included in "Borrowings" as it is not "debt", at least until the transaction in question is closed out and also due to the potential for year-on-year fluctuation if derivatives were included in the calculation.

The debt side of a leverage ratio is often calculated on a "Net Debt" basis, meaning net of cash and "Cash Equivalent Investments". The

latter term may require some attention from the Borrower's perspective to ensure that all the assets the treasury would treat as cash equivalent are adequately captured.

EBITDA, in broad terms, is operating profit before interest and tax, adding back charges in respect of amortisation, depreciation and impairment. Although used by many companies, treasurers will be aware that EBITDA is not a required income statement item under IFRS. As EBITDA is not a concept defined by accounting standards, for financial covenant purposes, it is typically further defined.

Lenders will wish to ensure that the definition produces an accurate calculation of the profits of the borrowing group based on the same elements used in their credit analysis to set the target ratios and such that it illustrates the Group's profits in the ordinary course (to enable accurate period on period comparison). For financial covenant purposes, EBITDA is thus a constructed figure that excludes non-ordinary course items: one-off items which, if included, might mask the underlying ongoing profitability of the business and profits representing gains and losses that fluctuate from year to year and/or which the business is unable to realise. Examples of items that are typically added back or reversed out of contractual EBITDA definitions include exceptional items and unrealised gains and losses on derivatives items. The EBITDA definition is usually subject to some level of negotiation.

EBITDA may be further adjusted as used in a leverage ratio to accommodate mid-period acquisitions and disposals – see comments under "Adjusted Leverage" below.

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 investment grade 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*).

"Adjusted Leverage" (acquisitions and disposals)

In the context of a leverage ratio, an important point for Borrowers is whether, and if so, how EBITDA should be adjusted to take into account any acquisitions and disposals made during the testing period. Such adjustments are most often discussed in leveraged transactions where private equity sponsors may plan to re-shape the business following the acquisition. It is not universal practice to address acquisitions and disposals in definitions of EBITDA used in leverage ratios in corporate loans. However, the widespread application of this practice in the leveraged market has prompted the point to be considered in lending transactions more generally. For corporates with a programme of acquisitions (or disposals) in mind, it may be worth considering. The reasons for and key features of an "Adjusted Leverage" ratio (which compares the Group's debt to an EBITDA number adjusted for acquisitions and disposals) are explained briefly below.

The starting point here is the assumption that if the Group acquires a business or assets during a testing period, it will be advantageous to the Borrower to include the EBITDA of the acquired business for whole of that period, rather than just from the date upon which the business or asset was acquired. Conversely, if any business or asset is disposed of during the relevant period, it may be advantageous to the Borrower to exclude from EBITDA any profits or losses attributable to the disposed items for the whole of the period. This adjustment rests on the assumption that unprofitable, or less profitable businesses or assets are likely to be sold; this, of course may not be true. However, such adjustments for disposals are typically included alongside adjustments for acquisitions.

In leveraged transactions, some Borrowers seek adjustments to EBITDA that take into account not only the EBITDA attributable to the acquired business, but also the effect of any cost savings and synergies that are projected to result from such acquisition. This is sometimes referred to as “aspirational EBITDA”. Similar “aspirational EBITDA” adjustments may also be made for cost savings relating to disposals during the period. In some cases, such adjustments may extend even further. In certain transactions, adjustments extending to cost savings and synergies arising out of “restructurings or any other transaction” entered into during the period, in addition to acquisitions and disposals, have been sought.

Where agreed, Lenders are likely to impose some parameters around the scope of “aspirational EBITDA” adjustments. Such cost savings and synergies may be restricted to those which are realised during the testing period, although sometimes the benefit of such add-backs applies also to subsequent periods. Lenders may also require that such savings are supportable and specifically identifiable and, in some cases, verified by an external accountant and/or subject to an overall cap (either a monetary figure or, more commonly, a percentage of EBITDA).

It is worth noting that although an EBITDA metric is also used in other financial covenant ratios (for example, an ICR), “Adjusted” EBITDA along the lines outlined above, is normally relevant only for the purpose of calculating leverage. This is because the leverage ratio typically compares a balance sheet figure as at a particular date, against EBITDA during the testing period, an income statement measure. Acquisitions are likely to involve the reduction of cash balances and/or the incurrence of additional debt to fund the purchase price. Conversely, disposals may involve cash realisations or a debt reduction. If the full impact of any debt incurred or repaid (and any cash movements) as a result of acquisitions and disposals is taken into account on the balance sheet or “debt” side of the ratio, the rationale is that the income statement or “profit” measure should be similarly adjusted to take into account the full impact of the transaction on profits. The adjustment makes sense in terms of comparing like with like.

This issue does not arise in the same way in relation to ratios such as an ICR, which derive solely from income statement figures.

Leverage ratios and exchange rate movements

As noted in section 1 (Navigating Challenging Conditions) of Part III (*Hot Topics*), external events can have a significant impact on exchange rates, 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.

Interest cover (ICR)

An 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 (again, often a defined concept of EBITDA) to its interest obligations or "Finance Charges" on its "Borrowings" 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.

As noted above, ICRs do not require adjustment for acquisitions and disposals in the same way as a leverage ratio. For the purposes of an ICR, the EBITDA of any business acquired during the relevant period will generally be included just from date of acquisition (which, it is understood follows the IFRS accounting treatment), in the same way as any finance charges on any additional debt incurred as a result of the acquisition will only be included on the other side of the ratio from the date of the acquisition.

It is, however possible to incorporate adjustments for acquisitions and disposals (and related cost savings) to income statement ratios, by adjusting both sides of the ratio. For example, for the purposes of an ICR, "Finance Charges" would be calculated on the assumption that any debt incurred/prepaid during the period (possibly including any "costs savings and synergies" relating to the debt adjustment) was incurred or prepaid on Day 1 of the relevant testing period.

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, 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.

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 financial covenants

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 such an 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, and perhaps without realising, many Borrowers, even in the investment grade market, will have become familiar with covenant terms and definitions which are based on those originating in the Leveraged Agreement.

Treasurers tasked with understanding and monitoring LMA-based 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 (in particular, key building blocks such as "EBITDA" and "Borrowings") 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 digest, 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 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

"Covenant-lite" loans have been the subject of many headlines. They are quite different from investment grade corporate loans, in particular in terms of the applicable financial covenants. The covenant-lite product is designed primarily to meet the needs of sub-investment grade or leveraged borrowers and the non-bank investors who buy leveraged debt participations. The key point here is that such investors do not have the same interest as relationship banks in regular covenant tests and wish to analyse and trade their loan investments in the same way as their bond investments.

While the covenant-lite trend began in the sponsor-led leveraged loan market, it is now sufficiently established that the technology has been adopted by sub-investment grade corporate issuers in their secured term

facilities. This may be because the corporate has also issued high yield bonds and wishes to align its obligations across its loan and bond documentation. Accordingly, it is potentially useful for treasurers operating in all sectors of the market to have a general awareness of the key features of a covenant-lite loan.

Covenant-lite term loans have become widely referred to as “term loan B” or “TLB”, reflecting the terminology used in the US loan market. In Europe, the term **TLB** is generally used to describe an English law secured 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, these loans use financial ratios as incurrence tests, of the type typically used in high yield bonds.

The covenants in such loans 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 TLB/covenant-lite loan market differ from those used in the fully covenanted loan market. This is in part due to the desire to mirror in the loans, the New York law terms that are typical in high yield bonds.

Revolving credit facilities extended to Borrowers with covenant-lite TLB term facilities typically share the same security package (most likely on a priority or “super-senior” basis) as the TLB lenders. To provide the RCF Lenders with some warning signal of financial difficulty, the RCF will typically contain a “springing” leverage covenant. This is in the more traditional maintenance covenant style, but is tested only when the RCF is drawn by a specified amount.

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.

Comment

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.

Comment

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.

Comment

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 introduction to Section 8 (*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 9 (*Existing Security*), 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 9 (*Existing Security*).
- ***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.

Borrowers should consider whether these exceptions are sufficient to cover all of its ordinary course hedging and whether there are specific categories (perhaps as a result of changing circumstances) that might benefit from express reference. Rising energy prices during 2022 have prompted more corporates to enter into energy derivatives, for example.

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, due to the impact of 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. Borrowers quite often seek to delete the time period for discharge here as the fixed period can be problematic.

Borrowers should note that 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. There are many possibilities. Some 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.
- Security arrangement relating to workers' compensation or social security arrangements (which can be particularly relevant in certain EU jurisdictions).

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 introduction to Section 8 (*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*".

Comment

Scope of restriction

Strong credits are generally able to loosen this covenant quite significantly. That can be achieved in a number of ways. For example, the covenant may apply only to disposals of material assets, or to disposals of all or a material part of their assets (or even to disposals of "all or substantially all of their assets"). The defined term

“Material Adverse Effect” may be employed; for example, such that disposals are permitted unless they have or are reasonably likely to have a Material Adverse Effect. Another option for listed Borrowers, which in effect imposes a reasonably substantial materiality threshold, is to restrict only 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 capped at 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 introduction to Section 8 (*Representations, Undertakings and Events of Default*).

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 distributions in a manner that is not otherwise restricted under the Agreement. Opinions differ as to whether an exception for disposals of cash and distributions such as 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*).

Comment

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 Obligor 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 (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.

Comment

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.

As noted in section 1 (Navigating Challenging Conditions) in Part III (Hot Topics), treasurers should consider carefully whether any exceptions to this clause are required in light of the potential direction of the business over the course of the facilities.

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.

Comment

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 UK 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.

Comment

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.

Comment

Borrowers can usually negotiate reasonable grace periods (such as between 15 and 30 days or Business 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.

Comment

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.

Comment

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 introduction to Section 8 (*Representations, Undertakings and Events of Default*)).

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 introduction to Section 8 (*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.

Overview: 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

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.”

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.

Comment

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. The wording here 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. However, that is arguable, given that the statute is not specifically referenced. Some consider the wording here to be quite uncertain and therefore seek 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. Further, for some Groups, it may be the case that a balance sheet test is inappropriate for all/certain members of the Group, which for various legitimate reasons, may be balance sheet insolvent on this basis.

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 (*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.”

Comment

Negotiating points

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 scheme of arrangement that does not involve distress could arguably fall outside 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.

UK Corporate Governance and Insolvency Act 2020 (CIGA)

CIGA, which implemented a number of now-expired temporary measures to support companies during the COVID period, also introduced some permanent changes to the UK regime. These include a new moratorium procedure to give eligible companies in

financial difficulty time to put together a rescue plan as well as a new restructuring procedure, the restructuring plan.

CIGA prompted Lenders to review the insolvency Events of Default (and other insolvency-related provisions in loan documentation) to determine whether the existing language was sufficient to capture the new processes (to the extent considered appropriate to do so).

The LMA concluded that it was not necessary to change the Investment Grade Agreements to reflect these new tools and other changes made by CIGA. In the context of the above Events of Default, the drafting already refers expressly to moratoria and to “*any composition, compromise, assignment or arrangement*” which may be viewed as sufficient to capture the new restructuring plan.

From the Borrower’s point of view, there is a potential question as to whether the CIGA moratorium should be captured within the scope of this Event of Default. A key feature of the moratorium is that debts arising under many financial services contracts are exempt from the payment holiday, which covers lending, securitisation, derivatives and most types of debt capital markets transactions. The moratorium is designed principally to protect corporates against outstanding trade creditor liabilities and landlords. Accordingly, Lenders can continue to receive payments. Further, the moratorium is aimed at a rescue scenario; for the moratorium to be in place, the monitor needs to be of the view that a rescue is (and remains) likely. In these circumstances, should the insolvency proceedings Event of Default be triggered if a CIGA moratorium applies?

Lenders may argue that the moratorium is an insolvency process and that its use is nonetheless indicative of financial distress (it is only available where the directors are of the view that the company is or is likely to become unable to pay its debts) and therefore it should entitle them to “come to the table” to negotiate in reliance on an Event of Default. In practice, where the moratorium becomes relevant, other defaults (for example under financial covenants) may have occurred, potentially meaning the exclusion of the CIGA moratorium from the insolvency Events of Default is of limited utility.

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.

Comment

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.

Comment

Inclusion of this Event of Default (the **MAC**) is now fairly common in the investment grade market, but some stronger Borrowers 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.

The leading English case on MAC clauses along LMA lines¹⁹ indicates that a MAC clause cannot be triggered in reliance on an event of default which the parties were aware of 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 clause 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. It is also common 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, in paragraph (c) of (Clause 19.11 (*Financial statements*)) (see the comments on that clause).

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 Available Commitments.

¹⁹ Grupo Hotelero Urvasco SA v Carey Value Added SL & Anor [2013] EWHC 1039 Comm.

Comment

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.

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.

Comment

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 *Clauses 24.2: (Company consent) and 24.3 (Other conditions of assignment or transfer)*.

In general, in this context, it is worth bearing in mind the relationship between the class of permitted Lenders and the requirement for the

²⁰ *Essar Steel Limited v The Argo Fund Limited* [2006] EWCA Civ 241.

Borrower's consent to transfers (see *Clauses 24.2: (Company consent) and 24.3 (Other conditions of assignment or transfer)*). A very broad class of permitted Lenders 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 2007-9 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 most 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 investment grade 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). However, this will not often be the case and such provisions are not a feature of many investment grade loans.

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 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).

These clauses also include important protection for Borrowers from tax gross-up or indemnity obligations and increased costs claims following an assignment or transfer.

Comment

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).

Note that the equivalent provision in the Leveraged Agreement contemplates the Borrower having less control over transfers, which is designed to facilitate (and encourage) secondary trading in that market. This is reflective of the relatively higher capital cost to Lenders of holding leveraged loans on their balance sheet. The Leveraged Agreement contains two options here, both of which fall short of a consent right for the Borrower. Option 1 requires the Lenders 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. Option 2 involves the Borrower agreeing 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. In practice, a range of approaches and exceptions are agreed. These options, however are not reflective of what is currently being achieved in practice. In

the sub-investment grade and leveraged market, the extent of the Borrower's control over transfers and assignments is typically closely negotiated. The imposition of transfer restrictions has been a key area of focus for many private equity sponsors active in the European leveraged loan market in recent years.

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.

²¹ [2012] EWHC 3655 Comm; [2014] EWCA Civ 302.

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*)). 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 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.

The Investment Grade Agreements were amended back in April 2009 to disapply this protection for Borrowers 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.

Possible Supplementary Provisions: Designated Entity Clause

In some jurisdictions, Lenders must be licensed to participate in lending activities. To cater for any licensing restrictions that may arise in multi-jurisdictional transactions, Lenders sometimes request the addition of what has become known as a “Designated Entity” clause. This enables the Lender to nominate an Affiliate licensed locally in the relevant jurisdiction to participate in a particular Utilisation (for example, to a borrower in a jurisdiction where licensing requirements apply). The Affiliate does not assume the Lender’s commitments under the Facility, nor does it have any voting rights as a Lender. The Borrower continues to communicate with the Lender in the normal way. The role of the Affiliate 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.

Designated Entity clauses were highlighted 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 left the EU.

In April 2017 the LMA therefore published a form of Designated Entity clause, intended as slot-in drafting, for use in appropriate circumstances. The clause, which has been updated in minor respects since publication,

has been drafted to slot into the Leveraged Agreement but can easily be adapted to fit other LMA templates.

Comment

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.

Brexit prompted broad questions with regard to the volume of lending and other types of financial sector activity that would be based in the UK post-Brexit. One area of focus was on the options a lender has under LMA terms to relocate its participation to an office or subsidiary in another jurisdiction should it turn out, post-Brexit, that the participating Lender was legally unable to continue.

The terms of the Investment Grade Agreements provide Lenders with significant flexibility to restructure how their participations are held and/or to exit the facility, should they need to do so for regulatory reasons:

- Lenders are permitted to transfer their participations to Affiliates without the need for the consent of, or to consult with, the Borrower Clauses 24.2: (*Company consent*) and 24.3 (*Other conditions of assignment or transfer*)).
- Lenders are permitted to transfer their participations to another Facility Office. 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*)).
- 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 the affected Lender 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 facility by selling their participation to a third party. Pursuant to the Investment Grade Agreements, this requires 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).
- A Designated Entity clause, however, provides a Lender with a more efficient alternative to transferring or assigning its commitments to an Affiliate pursuant to the above provisions at short notice. "Lending Affiliates" can be made party to the Agreement at any time, so they are ready to act if required. 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 in investment grade loans 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.

The Borrower should not be financially prejudiced as a result of the operation of any Designated Entity clause. 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 at Clauses 24.2: (*Company consent*) and 24.3 (*Other conditions of assignment or transfer*)). However, 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.

Clause 24.6: and Clause 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.

Comment

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.

Comment

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 can be important to Lenders for the purposes of accessing central bank funding. 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.

Comment

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. However, given that pro rata interest settlement has been recommended in SONIA-referencing facilities by the UK RFRWG, going forward, the pro rata approach will be the market standard in most cases.

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.

Clause 25.2 and Clause 25.3 provide a mechanism for the accession and resignation of Borrowers.

Clauses 25.4 to 25.6 provide a mechanism for the accession and resignation of Guarantors.

Comment

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

Clause 26 sets out the role of the administrative parties, the Agent and the Arranger(s). 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.

Comment

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 2007-9 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 appeared significantly different. However, in general terms, it is simply longer and more detailed than the pre-existing provisions. Much of the 2014

²² See, for example, *Torre Asset Funding Ltd & Anor v The Royal Bank of Scotland plc* [2013] EWHC 2670 (Ch).

review resulted in the language spelling out more clearly matters which were probably within the scope of the previous provisions.

For example, the clauses specify 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 replaced.

However, in some areas, the revised LMA language constituted 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 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.

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 any 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.

Comment

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 generally 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.

Comment

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...*”.

Comment

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 an 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.

Comment

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.

Possible Supplementary Provisions: Clause 26.18 (amounts paid in error)

In June 2021, the LMA published an optional clause to be added to this section as Clause 26.18 (*Amounts paid in error*). The purpose of the clause is to establish for the Agent a contractual claim for a debt against any Party to the Agreement who receives an “Erroneous Payment”. The objective is to ensure that if amounts are paid by the Agent to another Party in error, there is a clear process for claiming back the funds erroneously paid.

The text of the clause is set out below:

Clause 26.18: (Amounts paid in error)

- (a) *If the Agent pays an amount to another Party and [within [] Business Days of the date of payment] the Agent notifies that Party that such payment was an Erroneous Payment then the Party to whom that amount was paid by the Agent shall on demand refund the same to the Agent [together with interest on that amount from the date of payment to the date of receipt by the Agent, calculated by the Agent to reflect its cost of funds].*
- (b) *Neither:*
- (i) *the obligations of any Party to the Agent; nor*
 - (ii) *the remedies of the Agent,*
- (whether arising under this Clause 26.18 or otherwise) which relate to an Erroneous Payment will be affected by any act, omission, matter or thing which, but for this paragraph (b), would reduce, release or prejudice any such obligation or remedy (whether or not known by the Agent or any other Party).*
- (c) *All payments to be made by a Party to the Agent (whether made pursuant to this Clause 26.18 or otherwise) which relate to an Erroneous Payment shall be calculated and be*

made without (and free and clear of any deduction for) set-off or counterclaim.

(d) *In this Agreement, “Erroneous Payment” means a payment of an amount by the Agent to another Party which the Agent determines (in its sole discretion) was made in error.*

Comment

The background to this provision, is a 2021 dispute between Citibank N.A. and Revlon Inc. (the **Revlon case**) heard initially in the Southern District of New York²³. The case involved an unusual situation, whereby a large amount of money was sent to Revlon’s lenders in error, which happened to equal precisely the amounts of principal and interest Revlon owed on the loan to its lenders. The question was whether the lenders were entitled to keep the money; or were required to pay it back to Citi. While New York law generally treats failure to return money that is paid in error as unjust enrichment or conversion and requires the money to be returned, there is an exception to that rule. This applies, in summary if the funds discharge a valid debt and the recipient has no knowledge of the error (the “discharge for value” defence). Due to the fact that the amount wrongly transferred happened to match exactly the amount Revlon owed to the lenders, the court ruled that Citi was unable to recover it.

The Revlon case happened in New York and was an unusual situation. Nonetheless, it prompted Agents to look at customary loan terms under New York and English law, to determine what their rights would be in a similar situation.

Clause 29.4 (*Clawback and pre-funding*) establishes an obligation on parties in receipt of a payment to refund the Agent on demand, but (despite its title) is limited in substance to a pre-funding scenario, i.e. “where a sum is to be paid to the Agent under the Finance Documents for another Party”. The Investment Grade Agreements do not otherwise deal specifically with erroneous payments. This prompted demand for express contractual protections to supplement any rights the Agent might have under applicable law to reclaim an erroneous

²³ A transcript of the initial decision is available [here](#).

payment, and the development of the LMA's slot-in clause, quoted above.

The clause supplements any rights the Agent may have at law. It includes a waiver of any defences or set-off rights which the recipient Party might otherwise be able to assert which might inhibit the Agent's right to reclaim the erroneously paid amounts.

The optional time limit for the notification of claims by the Agent was added following representations from the ACT. Borrowers may choose to provide, in the interests of certainty that notification must be made by the Agent where practicable, within (say) three Business Days of the date of payment. Borrowers may also take the view that if the Agent makes a payment in error, it should not be entitled to interest on that payment, in particular, where such interest is based on its own costs.

Borrowers will note that what constitutes an "**Erroneous Payment**" is a matter for the Agent's "sole discretion" (with no contractual parameters on how this discretion is to be exercised), rather than an objective assessment of, for example, whether an amount in excess of what is then due under the Finance Documents has been paid. This is in contrast to the approach in Clause 29.4 (*Clawback and pre-funding*) and in Clause 28 (*Sharing Among the Finance Parties*), where the amount subject to clawback or re-distribution is objectively calculable (as, respectively, (i) the difference between the amount the Agent has received and the amount it has paid in anticipation of receiving that sum and (ii) the amount a Finance Party has received and applied towards a payment due under the Finance Documents in excess of its pro rata entitlement).

The wider scope here is potentially significant from the perspective of both Lenders and the Borrower. It may not be in either's interests that the Agent could (at its own discretion) claw back a payment which is in fact (or is at least arguably) due. The most obvious way to limit the LMA clause to address this concern would be to reshape it to refer to amounts paid in excess of what is then due under the Finance Documents. This would give scope (in the case of a disputed payment from the Agent) for a Party faced with a demand for reimbursement of an amount which it regards as having been properly paid to resist that repayment. It would also have the advantage of more closely tracking the formulation of the two clauses of the Investment Grade Agreement noted above. However, Agents may

view this amendment as potentially limiting the utility of the Erroneous Payments clause as an immediate recourse tool. A compromise may be to provide that a demand (and repayment) under the Erroneous Payments clause is without prejudice to the Agent's obligation to perform its underlying payment obligations under the Finance Documents, for example:

"This Clause 26.18 is without prejudice to the payment obligations of the Agent under the Finance Documents. Any amount refunded by a Party to the Agent pursuant to paragraph (a) above shall, for the purposes of such payment obligations, be treated as if it had not been received by such Party."

Borrowers may take the view that Agents are paid a fee for their services and generally held to a very low standard of responsibility (see the discussion in the introduction to this Clause 26 above). That being the case, some may argue that if the Agent makes an error, it must manage the consequences of that error itself, in accordance with the general law, without the benefit of language that mitigates any loss or damage to it.

This clause has not been adopted universally in practice and is not currently "market standard". The LMA's note that accompanies the clause notes that there is a "*broad spectrum of views...as to the extent to which such protection is appropriate*" and the LMA makes "*no recommendation as to its inclusion or otherwise in facility documentation*".

While in situations where express contractual provision for erroneous payments is proposed, the parties adopt a clause modelled on the LMA language, treasurers should be aware that the LSTA and some Agents have prepared their own versions of this provision, which are more wide-ranging and tend to prompt more detailed negotiation. These may contain, for example, language creating a trust over the mistaken payment in favour of the Agent, a wide ranging right for the Agent to set-off any amounts owing by it, in any context, to the recipient of the mistaken payment against that recipient's obligation to return that mistaken payment, contractual acknowledgement that receipt of a payment in a different amount to an accompanying payment notice may be mistaken and/or express provision for the Agent to step into the shoes of the recipient's lending position to the

extent of the mistaken payment, in the event that the mistaken payment is not returned.

The LMA considered, but did not include these features in its clause, sensibly determining to concentrate on the core protection for the Agent, a clear right to enforce a claim for the return of the mistaken payment. Such additional provisions (in light of the reasons for this clause) are likely to be resisted by English law Borrowers.

Since the development of the LMA clause and various Agent's own iterations, the Revlon case has been appealed²⁴. In September, it was announced that Citi's appeal had been allowed. The US Court of Appeals determined (in essence) that the creditors in this instance had constructive knowledge of the mistake, which meant they could not rely on the discharge for value defence. It is not clear whether this will dampen the view of certain Agents on the need for such provisions. While the situation that gave rise to the litigation, as already noted, was quite unusual, some may take the view that a clear contractual route to restitution remains preferable.

CLAUSE 27 CONDUCT OF BUSINESS BY THE FINANCE PARTIES

This clause is most often discussed in the context of Clause 13.4 (*Tax Credit*) and Clause 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.

Comment

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

²⁴ A transcript of the appeal decision is available [here](#).

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 originally 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.

Comment

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**” along the lines provided in the Lehman provisions. See Part V (*Commentary on the Lehman Provisions*). 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*), comments on definition of “**Business Days**” at Clause 1.1 (*Definitions*) and on Business Day conventions at Schedule 13 (*Reference Rate Terms*).

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.

Comment

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.

Note that this is one of two clauses entitled “Change of currency” in the Compounded/Term MTR, and is not to be confused with Clause 6.3 (*Change of currency*) which sets out a currency-switching mechanism for Term Facility Loans

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.

Comment

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.

Comment

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

The starting point for this clause is that 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.

However, Clause 31.5 (*Electronic communication*) allows any two parties to agree to communicate using electronic means (such as email or posting to a secure website). Electronic communications between an Obligor and a Finance Party are permitted only to the extent agreed between the Obligor and that Finance Party and where the relevant

parties provide each other with their email addresses and any other necessary information.

Comment

Borrowers should be aware, for the purposes of compliance with any delivery deadlines, that any communication or document 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 DAY COUNT CONVENTION AND INTEREST CALCULATION

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 32.3 reflects this position. It applies the day count convention of ACT/360 or, where practice in a relevant market differs, that market practice, to the calculation of any interest, commission or fee accruing under the agreement. This market practice override operates to apply a day count convention of ACT/365 (fixed) for sterling calculations.

Clause 32.2 therefore states that any interest, commission or fee accruing under a Finance Document will be calculated without rounding. However, the total amount of any accrued interest, commission or fee which is, or becomes, payable shall be rounded to two decimal places. Note the distinction here between the calculation of the rate (no rounding) and amounts of interest etc. that become payable (rounded to two decimal places).

While the rounding provisions in Clause 32.3 have been drafted to accommodate the Sterling Loan Conventions and compounded RFRs, they apply to all rate calculations and interest payments under the Agreement to avoid unnecessary complication. This should not result in changes to amounts of interest payable in respect of Term Rate Loans. Term rates (for example, EURIBOR) appear on screen, rounded in accordance with market convention, so that the specified calculation rounding convention does not apply. Further, general market practice is

to round all amounts of interest payable to two decimal places for practical reasons.

Comment

Clause 32.3 also addresses the rounding convention to be applied. This has been tailored to reflect the UK RFRWG's [Best Practice Guide for GBP Loans](#) and accompanying [worked examples](#) of the Sterling Loan Conventions. The UK RFRWG's recommendation is that when using a Non-Cumulative Compounded RFR Rate (as is the case in the RFR Agreements), interest should be rounded two decimal place only at the end of the Interest Period. This is necessary to ensure that daily interest amounts calculated using a Non-Cumulative Compounded RFR Rate equal exactly amounts calculated using the Cumulative Compounded RFR rate.

Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and its footnotes provide that in applying the formula to calculate the daily rate, the "no rounding" convention is subject to the limits of systems capabilities. This is to ensure that rounding-related systems constraints do not prevent a Finance Party from performing the necessary calculations.

Treasurers may wonder whether, if such systems limitations result in the use of rounded amounts that is inconsistent with the recommendations of the UK RFRWG noted above and as reflected in Clause 32 (*Day Count Convention and Interest Calculation*)

A systems "work around", known as the "crumbs" approach, enables the daily amounts of interest which result from the application of the NCCR to the principal amount to be carried forward on an unrounded basis. However, it seems that the "crumbs" approach cannot be used in the calculation of the daily NCCR itself as some systems have a maximum number of decimal places, e.g. 16. This is the reason for the wording addressing the limits of systems capabilities in this Schedule. Appendix 3 of the UK RFRWG's [Best Practice Guide for GBP Loans](#), "Technical and Systems Capability Guidance", contains further information on this topic.

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 case²⁵, 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, of the 2009 case, 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.

²⁵ *Tele2 International Card Company SA v Post Office Limited* [2009] EWCA Civ 9. This decision has recently been considered and followed. In a 2022 High Court case, *Lombard North Central plc v European Skyjets Ltd* [2022] EWCA 728, it was held that positive steps taken by the parties can have the effect of overriding a contractual remedies and waivers provision.

CLAUSE 35 AMENDMENTS AND WAIVERS

Clause 35.1: Required consents

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.

Clause 35.2: All Lender matters

Clause 35.2: All Lender matters (Investment Grade Agreements)

"[Subject to Clause 35.4 ([Changes to reference rates) 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;*
- (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), [0 (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 40 (Governing law) or Clause 41.1 (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."*

Comment

Matters requiring unanimous Lender consent

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 arguably more 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 Clause 40 (*Governing Law*) and Clause 41.1 (*Jurisdiction*). These were added in the wake of the round of loan restructurings that followed the 2007-9 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 the introduction to Section 8 (*Representations, Undertakings and Events of Default*)), 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.

Possible supplementary provisions: “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.

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 or the Arranger as the case may be).

Clause 35.4: Changes to reference rates

This optional clause provides a mechanism for amending the agreement to facilitate the replacement of a reference rate should that be required or desirable after the date of the Agreement, subject to the consent of the specified majority of Lenders and the Borrower. It is an updated and expanded version of the “Replacement of Screen Rate” clause introduced a number of years ago to facilitate LIBOR transition. Prior to the widespread adoption of such provisions, adjustments to interest rate provisions (of whatever nature) required all Lenders to consent.

Either party can initiate the replacement of a benchmark under this clause. The parties have the option to restrict the application of the clause so that it is only triggered upon the occurrence of specified events (“**Published Rate Replacement Events**”), such as the relevant reference rate being discontinued or no longer being representative of the underlying market it is intended to measure.

Comment

The LIBOR transition process highlighted the importance of including provisions in all loan documentation that facilitate the future replacement or adjustment of reference rate terms as efficiently as possible. The Compounded/Term MTR does this quite comprehensively.

The Reference Rate Supplement route (see comments on that definition at Clause 1.1 (*Definitions*)) enables adjustments to be made to existing Reference Rate Terms. The Compounding Methodology Supplement route is available if changes to the compounding methodologies applicable to Compounded Rate Loans are necessary. The Supplements are documents agreed between the Borrower and the Agent (acting on the instructions of the specified majority of Lenders), which (pursuant to Clause 1.2(g)) override any pre-existing terms relating to the relevant Compounded Rate Currency. These provisions are intended to cater for changes to conventions or market practice on the more detailed aspects of using RFRs. While Clause 35.4 could, in theory, also be used to adjust Reference Rate Terms in certain circumstances, it is aimed at situations where (as was the case for legacy LIBOR transactions), a reference rate needs to be replaced after the date of the Agreement, necessitating brand new Reference Rate Terms and most likely broader changes to related provisions.

Clause 35.4 is an optional clause, but it is useful to both Lenders and Borrowers should any transition to a new rate be required during the course of the Facilities. It is routinely included in syndicated facilities.

The definition of Published Rate Replacement Event includes the relevant reference rate being calculated in accordance with the rate administrator’s contingency or fallback policies in circumstances which are not temporary or for a period no less than the “**Published Rate Contingency Period**”. The minimum period applicable to each currency must be specified in the Reference Rate Terms applicable to

that currency. Contingency methodologies are typically intended only to be used for relatively short-term contingency events. The Published Rate Contingency Period should therefore be relatively short, to reflect that the parties are likely to wish to move on from e.g. historic rates (if that is the contingency methodology) to an alternative solution. Published Rate Contingency Periods of 30 days/one month have been agreed in a number of more recent facility agreements. This applicable period for each currency must be inserted in Schedule 13 (*Reference Rate Terms*).

It is worth noting that pursuant to Clause 35.4, the occurrence of a Published Rate Replacement Event (e.g. cessation) that applies to one tenor of a reference rate will facilitate the replacement of the reference rate for that tenor only and not for all tenors for which the relevant reference rate is published. In this respect, this trigger for an amendment process as a means of addressing the replacement of reference rates differs from the rate switch provisions in Clause 9A (*Rate Switch*). Under the rate switch provisions, where the trigger occurs in relation to one tenor only, the rate switch occurs for the relevant currency generally i.e. for all tenors. See comments at Clause 9A (*Rate Switch*) above.

The list of amendments to the agreement which can be made with Majority Lender consent pursuant to Clause 35.4 has also been expanded from that in the LIBOR Agreements to include amendments that relate to, or have the effect of, aligning the means of calculating interest on a Compounded Rate Loan to any subsequent recommendations issued by a relevant body. This is a potentially helpful provision, which has been included on an optional basis to give parties some degree of flexibility in the event that thinking and official recommendations around compounding develop after the Agreement has been signed. Note however that the Compounded/Term MTR makes separate provision, through the use of a “Compounding Methodology Supplement”, for the mathematical formulae specified in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*) to be amended without a formal amendment process and subject to fewer parameters than set out in Clause 35.4.

The clause is subject to an optional “you snooze you lose” provision (see “Possible supplementary provisions: “yank the bank” and “you snooze you lose” above). 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 the requisite (Majority Lender) consent has been obtained.

CLAUSE 36 CONFIDENTIALITY

Clause 36.1: Confidentiality

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. 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.

Clause 36.2: Disclosure of 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.*** This includes 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 24.9 (*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).

Comment

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 Schedule 10 (*LMA Form of Confidentiality Undertaking*) for use under the terms of Clause 36 is in a form acceptable to them.

Clause 36.3: Disclosure to numbering service providers

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.

Comment

Although investment grade loans, in many cases, are not traded, this optional provision is generally treated as boilerplate. The LMA is keen to promote settlement efficiency in the loan market and has strongly encouraged banks to include it in loan agreements. 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

These clauses require the Agent to keep “**Funding Rates**” (each Lender’s cost of funds, if cost of funds is applicable, see Clause 11.4 (*Cost of funds*)), confidential. The obligation to keep Funding Rates confidential extends also to 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.

The background to these confidentiality obligations relates to LIBOR. LIBOR contributors (to the extent they still exist, for USD rates only) are subject to obligations under the LIBOR Code of Conduct for Contributing Banks (the **Code**) to keep their funding rates confidential, an obligation designed to implement the LIBOR administrator’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. When the Code was introduced, this was applied in the Investment Grade Agreements and other LMA templates by extension, to Funding Rates.

CLAUSE 38 BAIL-IN

This clause requires all parties to the Agreement to acknowledge that liabilities under the Agreement are subject to “bail-in” powers under applicable bank resolution and recovery regimes. The purpose of the clause is to ensure that if regulators or resolution authorities seek to exercise statutory powers to write down and/or convert the liabilities of a failing financial institution into equity (as they are entitled to do, for example, across the EU and in the UK), they can do so effectively.

Comment

This clause responds to a regulatory obligation of financial institutions within the scope of EU or UK bank resolution and recovery legislation. As a result, whether or not to include such provisions is not generally a topic for negotiation, as the provision stems from a statutory requirement. An outline of the legal background is set out below.

There are no material points for Borrowers on the text of the clause to the extent it covers the UK and EU regimes. Resistance may have limited effect should any statutory resolution powers be exercised in respect of the relevant Lender in any event. However, the prospect of a counterparty's liabilities being disrupted as a result of regulatory or government intervention is generally unappealing. The existence of bail-in powers and any other legal and regulatory powers to disrupt lending relationships in the event a financial institution gets into financial difficulty, are an important counterparty risk factor for treasurers to consider.

For an investment grade Borrower, a key part of risk management in this area lies in maintaining close relationships with a variety of banks. It is also 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 comments at Clause 24 (*Changes to the Lenders*)). The Lehman provisions, which provide for the management of defaulting and insolvent Lenders and administrative parties (see Part V (*Commentary on the Lehman Provisions*)) may assist in ensuring that a single Lender or Agent in financial difficulties does not disrupt the entire facility.

Borrowers should note that as drafted (and in contrast to the equivalent clause produced by the LSTA for the New York law market), the LMA clause offers an option to anticipate future bail-in legislation regimes applicable in other countries (in other words, it takes account of any recovery and resolution regimes that may come into effect at any point anywhere around the world). Unless it is clear that there are particular regimes in existence that need to be taken into account, investment grade Borrowers may prefer that this option is deleted.

In loan facilities involving US lenders, Borrowers may be asked to include a further provision, usually in the form published by LSTA, which addresses a US resolution regime affecting “US global systemically important financial institutions”. The US “QFC stay rules”, in summary, require these institutions, both in the US and overseas, to include “QFC stay” language in their loan agreements if the loan documents also support the Borrower’s obligations under swaps or other “qualified financial contracts” or “QFCs”. The QFC stay language, where included, in essence inhibits the Agreement and related contracts from being terminated.

The QFC stay provisions do not need to go into all loan agreements. They are primarily relevant to loans that incorporate guarantee and security obligations that secure both the loan and related hedging (swaps). However, some affected Lenders take the view that they are not prepared to analyse each agreement they sign to determine whether it is in-scope and will therefore seek to include the QFC language in all loan agreements as a default position. Borrowers may take exception to this position. While such language, where irrelevant may be of no effect, its inclusion introduces unnecessary complexity and potentially, uncertainty into the Agreement.

Bail-in clauses – summary of legal background

“Bail-in” clauses began to appear in loan documentation following the implementation of the EU Recovery and Resolution Directive (2014/59/EU) (BRRD). 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 enables the relevant regulator to write down and/or convert the liabilities of a failing institution into equity.

The BRRD has been implemented across the EEA. Accordingly, the bail-in powers of EEA regulators should be effective in relation to liabilities governed by the laws of an EEA country. However, that would not necessarily be 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, by requiring EEA financial institutions

to replicate the statutory bail-in power contractually 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 can be construed quite broadly. The concern is that in some countries, this may include 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, when the BRRD was introduced (pre-Brexit), it was generally concluded necessary to include a contractual bail-in clause in loan documentation entered into by an EEA financial institution subject to the BRRD and governed by the law of a non-EEA country (for example, a New York law loan agreement).

Neither the EU nor national regulators specified the form a bail-in clause should take. The LMA therefore 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 this 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 LMA bail-in clause was initially made available as a slot-in optional clause as while the UK remained part of the EU, it was engaged only in LMA-based loan documentation governed by the law of a non-EEA country (and therefore was not relevant to English law documentation)

Post-Brexit, the UK became a “third country” for the purposes of the BRRD. Accordingly, it became necessary for EEA-regulated financial institutions to include a bail-in clause in English law governed contracts. Further, there was the question of whether UK-regulated firms should include bail-in clauses in Agreements governed by the law of any country other than the UK. The UK’s post-Brexit resolution regime, which is largely contained in the Banking Act 2009 (as amended), broadly mirrors the BRRD regime. The LMA updated the bail-in clause to reflect both the UK’s withdrawal from the EU and to

refer to the UK resolution regime. It was also updated (in light of the implementation of other bail-in regimes around the world), to refer to such other bail-in regimes as may be relevant.

The current, broader form of bail-in clause was eventually incorporated into the Investment Grade Agreements during 2021. Note that as the BRRD is implemented in each EEA state under local law, the clause incorporates those laws by reference to the LMA's EU bail-in schedule, in an attempt to avoid making the clause too unwieldy. This document is published on the LMA website and summarises the relevant laws. It is updated from time to time as required.

CLAUSE 39 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 40 GOVERNING LAW

The Investment Grade Agreements are expressed to be governed by English law.

Clause 40 (*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.

Comment

While this clause was crafted during the UK's membership of the EU, no changes were required as a result of Brexit and a choice of governing law (before the English courts or before the courts of an EU member state) continues to function as previously. The legal background is described briefly below.

Governing law post-Brexit – summary of legal background

Before the courts of an EU member state, the validity of the parties' choice of governing law is governed by Regulation (EC) No. 593/2008 (Rome I), the EU regulation on choice of law. Pursuant to Rome I, 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 continue to respect that choice notwithstanding Brexit.

The law governing non-contractual obligations is determined in the EU27 in accordance with Regulation (EC) No. 864/2007 (Rome II),

which functions in much the same way as Rome I. 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. Again, English law, if selected by the parties, continues to be upheld²⁶.

Rome I and Rome II became part of domestic UK law by operation of section 3 of the EU (Withdrawal) Act 2018 at the end of the Brexit implementation period on 31 December 2020. As a result, the Rome I and Rome II regimes continue to function as previously, in the EU and in the UK because they do not depend on reciprocity.

English governing law clauses continue to be upheld post-Brexit in the UK and EU²⁷ irrespective of when the contract was entered into. Accordingly, Brexit provided no reason to choose a governing law other than English law where English law would otherwise be the preferred choice.

CLAUSE 41 ENFORCEMENT

Clause 41.1: Jurisdiction

This clause designates the parties' choice of jurisdiction. It is presented in two alternatives.

The first alternative confers exclusive jurisdiction on the courts of England but does not prevent the Finance Parties from taking proceedings in the courts 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 (the **asymmetric** option).

The second alternative is an exclusive submission by both parties to the courts of England (the **exclusive** option).

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.

Comment

An asymmetric jurisdiction clause is customary in loan documentation and is not often altered. The second alternative, the exclusive jurisdiction clause, was added to the Investment Grade Agreements in light of Brexit.

The main practical implication of Brexit (and the UK falling outside the EU-wide rules on jurisdiction and judgments) is that it is necessary for the lawyers to consider more closely:

- whether disputes arising out of the Agreement might be litigated in an EU member state; and
- where the parties submit to the jurisdiction of the English courts, whether any material assets against which any resulting judgment might be enforced are located in an EU member state.

The exclusive clause is adopted only in transactions where there is a legal concern about either the validity of the asymmetric clause or, the applicable enforcement of judgments regime, as a result of the jurisdictions involved. Although a handful of decisions of the courts of certain EU countries (notably, France) have cast doubt on the legal validity of asymmetric clauses, in practice, the situations where such concerns prompt Lenders to give up the flexibility of the asymmetric clause are relatively few²⁷.

The legal background to circumstances where an exclusive jurisdiction option might be selected as a result of Brexit is described in more detail below.

In general, the selection of the LMA's exclusive jurisdiction option is not likely to be of material concern from the Borrower's point of view. The effect of the exclusive option is to narrow the Finance Parties' enforcement options, to proceedings before the English courts.

Should Lenders wish to adopt the exclusive option, or indeed an alternative dispute resolution mechanism such as arbitration,

²⁷ Following Brexit, the validity of asymmetric jurisdiction clauses in the UK is no longer in doubt, the English courts having upheld the validity of such provisions as a matter of English law – see e.g. *Commerzbank AG v Liquimar Tankers Management Inc* [2017] EWHC 161 (Comm).

Borrowers should discuss the implications of the proposed changes with their legal adviser.

Jurisdiction clauses post-Brexit: summary of legal background

The Brussels Recast Regulation²⁸ is the principal EU instrument relating to jurisdiction and the enforcement of judgments. The Brussels Recast Regulation provides that jurisdiction clauses which designate the court of a member state as the exclusive choice, 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.

Where a contractual submission to the jurisdiction of the English courts is contemplated (as in the Investment Grade Agreements), the legal analysis no longer relies on the Brussels Recast Regulation. The Brussels regime is not relevant to the question of the validity of a choice of English law before the courts of an EU member state. Nor is it applicable to the enforceability of a judgment of an English court before the courts of the EU.

This does not mean that the designation of the English courts in a transaction involving EU27 Obligors or assets is automatically the wrong choice. It simply means that whether the relevant courts would uphold the parties' jurisdiction agreement and the process under the local regime for enforcing an English judgment needs to be explored with local lawyers in the relevant EU member state(s). In other words,

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).

it is necessary to go through the same process as has always been necessary in the context of transactions involving parties, assets or the courts of non-EU states such as the US. This topic will be addressed in the legal opinions delivered to the Lenders as conditions precedent to the transaction (see comments at Schedule 2 (Conditions Precedent)).

If the Obligors or the location of any security assets provide a nexus with one or more EU member states – and there is a legal concern about whether the jurisdiction clause will be upheld or an English court's judgment enforced, before the courts of that member state, the Finance Parties may seek to adopt an exclusive jurisdiction clause, which falls within the scope of another international convention, the 2015 Hague Convention on Choice of Court Agreements.

The Hague Convention will, for most purposes, fill the gap left by Brussels Recast and ensure the validity of in-scope jurisdiction agreements and the enforcement of judgements arising out of those agreements in the UK and across the EU. However, its scope is more limited than the EU framework it supersedes. The key point here is that it applies to exclusive jurisdiction agreements only.

In summary, the Hague Convention requires the contracting states (from 1 January 2021, the UK, the EU, Mexico, Singapore and Montenegro) to give effect to exclusive jurisdiction agreements made in favour of a contracting state's courts. It also facilitates the enforcement of judgments of the courts designated by in-scope exclusive jurisdiction agreements in the other contracting states.

Clause 41.2: 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.

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*).

Comment

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.

The conditions precedent, as is customary include the delivery of legal opinions. These opinions are typically addressed to the Agent, the Arranger and the Lenders forming part of the primary syndicate. The subject matter is primarily the capacity and authority of the Obligors to enter into the Agreement and specified related documents and the validity and enforceability of such documents.

Opinions on English law loan agreements are typically provided by the legal advisers to the lenders. If the Obligor Group includes entities incorporated in other jurisdictions (or there are Finance Documents, for example, security documents governed by the laws of other jurisdictions), the lenders will also typically seek legal opinions from lawyers qualified in the relevant jurisdictions.

The list of conditions precedent includes (at item 3(b)) the following:

“A copy of any other Authorisation or other document, opinion or assurance which the Agent considers necessary or desirable (if it has notified the Company accordingly) in connection with the entry into

and performance of the transactions contemplated by any Finance Document or for the validity or enforceability of any Finance Document.”

Stronger borrowers may seek to delete this “sweeper” provision, on the basis that the Agent should give thought to and list the items required as conditions precedent prior to signing the Agreement, rather than leaving the Borrower with the risk of delay or uncertainty at the point of initial utilisation.

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 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 5 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 6 FORM OF ACCESSION LETTER

A form of letter to be used by acceding Borrowers or Guarantors. See Clause 25 (*Changes to the Obligors*).

SCHEDULE 7 FORM OF RESIGNATION LETTER

A form of letter to be used by resigning Borrowers or Guarantors. See Clause 25 (*Changes to the Obligors*).

SCHEDULE 8 FORM OF COMPLIANCE CERTIFICATE

This certificate confirms compliance with any financial covenants. See Clause 20.2 (*Compliance Certificate*).

SCHEDULE 9 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 10 LMA FORM OF CONFIDENTIALITY UNDERTAKING

This is the form of Confidentiality Undertaking to be entered into as required for the purposes of Clause 36 (*Confidentiality*). See also comments on definition of “**Confidentiality Undertaking**” at Clause 1.1 (*Definitions*).

SCHEDULE 11 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*).

Comment

Suggested timings are set out in this Schedule; Borrowers should review the deadlines (which are typically proposed by Lenders) carefully.

SCHEDULE 12 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 13 REFERENCE RATE TERMS

Schedule 13 is divided into four Parts:

- Part I, Part II and Part III contain Reference Rate Terms for Compounded Rate Loans in USD loans, sterling and CHF respectively.
- Part IVA contains Reference Rate Terms for Term Rate Loans in euro loans and Part IVB, Reference Rate Terms for Compounded Rate Loans in euro.

The Reference Rate Terms for Compounded Rate Loans in Part I, Part II, Part III and Part IVB are structured identically, and pre-populated with a common framework. Optional aspects and aspects which may vary by currency are in square brackets. Each term in these Parts is discussed below in the order in which they appear in Schedule 13.

Part IVB, which contains Reference Rate Terms for euro loans referencing EURIBOR (euro being the only Term Rate Currency) is discussed separately below.

SCHEDULE 13 PARTS I, II, III AND IVB – REFERENCE RATE TERMS FOR COMPOUNDED RATE CURRENCIES

Comments on Reference Rate Terms – Compounded Rate Currencies

Cost of funds as a fallback

The primary interim fallback rate (a rate based on a Central Bank Rate) is incorporated into the definition of Daily Rate. Whether to provide a further fallback to cost of funds is optional in relation to Compounded Rate Loans. It will apply only if “Cost of funds to apply as a fallback” is indicated here. In many cases, parties are concluding that cost of funds is not necessary as an ultimate fallback.

See discussion at Clause 11.2 (*Interest calculation if no RFR or Central Bank Rate*) and in relation to the definitions of “**Central Bank Rate**” and “**Central Bank Rate Adjustment**” in Clause 1.1 (*Definitions*).

“**Additional Business Day**”

This is required to ensure that for actions which require a rate fixing, the relevant RFR is available. It is therefore defined in the Reference Rate Terms applicable to Compounded Rate Loans as an “**RFR Banking Day**” (see below).

See comments at Clause 1.1 (*Definitions*) in relation to “**Business day**” for further background.

“**Baseline CAS**”

A “**Baseline CAS**” optional, but if used, should be agreed and inserted here. As discussed in section 5 (Transition Issues) of Part II (Risk-Free Rates in the Loan Market), the CAS concept was devised as a means of monitoring the economic impact of transition in loans that

Comments on Reference Rate Terms – Compounded Rate Currencies

are moving from LIBOR to RFRs via either an amendment process or pursuant to rate switch provisions. It is less obvious why a separate Baseline CAS is required in a new RFR-referencing facility. Some RFR-linked loans use a Baseline CAS, but, most RFR-linked lending now appears to be proceeding without it. The pricing will, of course, be agreed between the parties in the normal way, taking into account market conditions, relationships and other factors.

Even if no Baseline CAS is included, treasurers may find it useful to be familiar with the options for calculating the CAS to enable them to compare Lenders' offers on Margins to previous LIBOR facilities. This may need to be considered currency by currency (see further "**Margin**" below).

If a Baseline CAS is to be included, the parties will need to specify the methodology to be used to calculate it, or insert the agreed fixed amount. If a methodology rather than a fixed CAS is specified, a footnote in the Compounded/Term MTR highlights the possibility that the Baseline CAS could be a negative number and suggests the parties consider applying a zero floor.

A fixed Baseline CAS, either a number of basis points or by reference to the **BISL CAS** appears the more common approach, where a separate CAS is included.

There may also be a question as to whether the Baseline CAS should vary according to the length of the Interest Period applicable to the relevant Compounded Rate Loan. Again, the

Comments on Reference Rate Terms – Compounded Rate Currencies

	<p>BISL CAS illustrates that spreads can be different across Interest Periods. Some Borrowers may prefer a single or blended CAS that applies across all tenors.</p>
<p>“Break Costs”</p>	<p>The parties must specify here whether Break Costs will or will not apply to Compounded Rate Loans. It has become generally accepted that Break Costs should not apply to mid-period prepayments of Compounded Rate Loans.</p> <p>See comments at Clause 1.1 (<i>Definitions</i>) in relation to “Break Costs” for further background.</p>
<p>Business Day Conventions – definition of “Month” and Clause 10.3 (Non-Business Days)</p>	<p>Business Day conventions for the payment of interest are specified by currency in the Reference Rate Terms. The Compounded/Term MTR applies the “Modified Following Business Day Convention” to both Term Rate Loans and Compounded Rate Loans, such that payments of interest that would fall to be made on a day that is a Non-Business Day are adjusted to the next succeeding Business Day, unless that Business Day falls in the next calendar month, in which case the interest payment date is the preceding Business Day. This is in line with the UK RFRWG’s recommendation for sterling RFR loans.</p> <p>See comments at Clause 1.1 (<i>Definitions</i>) in relation to “Business Day” and at Clause 10.3 (<i>Non-Business Days</i>) for further background.</p>
<p>“Central Bank Rate” and</p>	<p>If the RFR is unavailable on any day, a “Central Bank Rate” plus an optional spread</p>

Comments on Reference Rate Terms – Compounded Rate Currencies

“Central Bank Rate Adjustment”

adjustment (the “**Central Bank Rate Adjustment**”) will apply in place of the RFR in the compounding calculation. If the Central Bank Rate is unavailable on any day, a historic Central Bank Rate (no more than a specified number of days old) plus an optional spread adjustment will apply.

The “**Central Bank Rate**” and “**Central Bank Rate Adjustment**” are different for each currency. The optional definitions of “Central Bank Rate” provided for USD, sterling and CHF are typically used without adjustment. The optional definition of “Central Bank Rate” for Compounded Rate Loans in euro provides three alternative options. The Compounded Reference Rate Terms for euro have not yet been used in sufficient numbers to determine which is preferred.

The definition of Central Bank Rate Adjustment is left blank for the parties to agree. The methodology for calculating the adjustment (other than for euro where there are insufficient examples) is consistent in practice and reflects the relevant RFR authority’s contingency policies. The definition typically used for sterling (and also for USD), matches the Bank of England’s [short term contingency methodology for determining SONIA](#) on the basis of the Bank of England Bank Rate as follows:

“In relation to the Central Bank Rate prevailing at close of business on any RFR Banking Day, the 20 per cent trimmed arithmetic mean (calculated by the Agent or by any other Finance Party which agrees to do so in place of the Agent) of the Central Bank Rate Spreads

Comments on Reference Rate Terms – Compounded Rate Currencies

for the five most immediately preceding RFR Banking Days for which the RFR is available.”

“Central Bank Rate Spread” is defined as *“The difference (expressed as a percentage rate per annum) calculated by the Agent (or by any other Finance Party which agrees to do so in place of the Agent) between:*

- (a) *the RFR for any RFR Banking Day;*
and
- (b) *the Central Bank Rate prevailing at close of business on that RFR Banking Day.”*

See also comments at Clause 1.1 (*Definitions*) in relation to the relevant definitions. Fallbacks are discussed further at Clause 11.2 (*Interest calculation if no RFR or Central Bank Rate*).

“Daily Rate”

The Daily Rate is the benchmark for the relevant RFR Banking Day (i.e. the relevant RFR or the fallback adjusted Central Bank Rate) to be used in the compounding formulae in Schedule 14 (*Daily Non-Cumulative Compounded RFR Rate*) and Schedule 15 (*Cumulative Compounded RFR Rate*).

The LMA formulation is typically used without adjustment. Where the adjusted Central Bank Rate is engaged as a fallback, the definition provides for the use of the an adjusted Central Bank Rate to be calculated based on the last published rate, provided that rate is not more than a certain number of days’ old. The number of days is left blank for the parties to complete. The limit is typically set at 5 RFR Banking Days.

Comments on Reference Rate Terms – Compounded Rate Currencies

The definition of Daily Rate also incorporates an optional zero floor – see comments below.

“Daily Rate” – the zero floor

For Term Rate Loans, it is common to set a contractual floor of zero on the benchmark rate, such that the Lenders’ Margin yield is protected should the benchmark become negative. See comments on the definition of “**Term Reference Rate**” at Clause 1.1 (*Definitions*).

The option to apply a zero floor to interest on a Compounded Rate Currency, however, is presented differently. The Sterling Loan Conventions recommend the daily application of any agreed interest rate floor (rather than the floor being applied at the end of the interest period as in the case of Term Rate Loans) because Compounded Rate Loans accrue interest daily. Accordingly, the zero floor applicable to a Compounded Rate Currency appears in the definition of “**Daily Rate**” (which is either the relevant RFR for a given RFR Banking Day, or, if unavailable, the applicable fallback). The definition of Daily Rate provides, optionally, that if the Daily Rate is less than zero, it shall be deemed to be zero.

There is a commercial point here for Borrowers regarding the interest rate floor, if included.

During the LIBOR transition process, in facilities that for transition purposes included a separate CAS as part of the pricing, it was typically the case that any interest rate floor was applied to the sum of the compounded RFR and CAS, rather than the compounded RFR alone. In other words, the floor applies to all components of the pricing that reflect

Comments on Reference Rate Terms – Compounded Rate Currencies

amounts that would have previously been reflected in LIBOR. The aim was to align the application of the floor in the RFR-linked facility with how a floor applies in a loan referencing LIBOR. This is consistent with the principle that the transition from LIBOR to RFRs should not involve a transfer of value between Lender and Borrower.

The Compounded/Term MTR applies the zero floor in this manner in relation to Rate Switch Currencies, which switch to a Compounded Reference Rate that includes a Rate Switch CAS (see comments at Clause 9A (*Rate Switch*)). This approach also applies in relation to Term Rate Currencies, where a Compounded Reference Rate plus a Fallback CAS is specified as a fallback (see Clause 11 (*Changes to the Calculation of Interest*)). However, the same does not apply to Compounded Rate Loans which reference compounded RFRs from the date of the agreement (i.e. loans in sterling, USD and CHF). In other words, the optional zero floor drafting in the RFR Agreements does not take account of the Baseline CAS. A footnote records the reason for this: to avoid an economic difference between transactions that include a separate CAS as part of the Compounded Reference Rate and those which do not.

In the Compounded/Term MTR, whether to include a Baseline CAS as part of the Compounded Reference Rate for sterling, USD and CHF is optional. If a Baseline CAS is included, the definition of Daily Rate can be adjusted easily to provide that if the aggregate

Comments on Reference Rate Terms – Compounded Rate Currencies

of that rate and the applicable CAS is less than zero, the Daily Rate shall be deemed to be such a rate that the aggregate of the Daily Rate and the applicable CAS is zero. Borrowers may wish to make this adjustment.

If the pricing does not include a Baseline CAS (i.e. the Compounded Reference Rate is the Daily Non-Cumulative Compounded RFR Rate), Borrowers may wish to consider the potential impact of any zero floor. Some might argue that the zero floor should not apply (certainly if that was the case in relation to their LIBOR facilities). Other options might include building in a CAS-equivalent adjustment, simply for the purposes of applying the floor. For example, the definition of Daily Rate could be adjusted to provide that if the aggregate of that rate and (for example) a specified “floor adjustment” (a number of bps) is less than zero, the Daily Rate shall be deemed to be such a rate that the aggregate of the Daily Rate and the applicable floor adjustment is zero. This could also potentially be achieved by applying a Margin ratchet mechanism that adjusts the Margin by reference to a negative Daily Rate.

“Lookback Period”

The compounding formulae in Schedule 14 and Schedule 15 incorporate a “Lookback Period”. The reasons for the lookback are discussed in section 4 (Conventions for referencing RFRs) of Part II (*Risk-Free Rates in the Loan Market*). The five RFR Banking Day lookback recommended in the Sterling Loan Conventions is included as the optional default position for all Compounded Rate

Comments on Reference Rate Terms – Compounded Rate Currencies

Currencies in Schedule 13 (*Reference Rate Terms*).

Five RFR Banking Days appears to have been adopted in most transactions completed to date. There are, however, situations where a different Lookback Period might be more appropriate, for example, a shorter lookback if drawings are likely to be for very short periods. Conversely, a longer lookback might be appropriate if borrowers or certain borrowers are situated in jurisdictions where it takes more time to mobilise payments. The UK RFRWG has acknowledged possible variations in the length of the Lookback Period depending on borrower/lender need, for example in the context of transactions in developing markets.

The length of the Lookback Period will also affect the required notice period for voluntary prepayments of Compounded Rate Loans. See comments on Clauses 8.4 and 8.5 (*Voluntary prepayments*).

“Margin”

In contrast to the LIBOR Agreements, which envisage a single Margin for all currencies, the Compounded/Term MTR provides for a Margin to be specified in the Reference Rate Terms for each currency separately.

There is some logic to this: during the transition period where three-part pricing applied to most loans, the CAS element of the pricing varied by currency. The [BISL CAS rates](#), as fixed on 5 March 2021, provide an illustration. As the market moves to two-part pricing, in theory, absorbing the CAS element into the Margin, should result in the Margin

Comments on Reference Rate Terms – Compounded Rate Currencies

increasing by an equivalent amount, which will be different for each currency.

In practice, of course, calculations may not be quite so logical, in particular in the relationship-driven investment grade loan market. Some investment grade borrowers have simply retained their pre-RFR Margins, dispensing with the CAS. However, if, when treasurers come to amend or refinancing facilities, applicable Margins are increased, consideration should be given to the impact of any increased Margin on other metrics in the facility agreement that reference the Margin. For example, whether Margin ratchet amounts need to be re-set. If commitment or other fees are set at a proportion of the Margin, that proportion may need to change from the levels customary in LIBOR facilities.

“Market Disruption Rate”

The Market Disruption Rate is an agreed proxy for Lenders’ funding costs. Pursuant to Clause 11.3 (*Market Disruption*), if the agreed percentage of Lenders notify the Agent, they cannot fund themselves at the Market Disruption Rate, they can instead charge the Borrower their cost of funds for that Interest Period.

Clause 11.3 may not apply to Compounded Rate Loans, in which case the “*None specified*” option should be selected here. If Clause 11.3 is agreed to apply, the LMA’s drafting reflects that the Market Disruption Rate (for parity with LIBOR deals), should be set at the sum of the Cumulative Compounded RFR Rate for the Interest Period and the Baseline CAS.

Comments on Reference Rate Terms – Compounded Rate Currencies

See comments at Clause 11.3 (*Market Disruption*).

“Relevant Market”

This concept is left to be defined by currency in the relevant Reference Rate Terms. It is designed to refer to the market where the loan is assumed to be funded. This will vary according to the reference rate against which pricing has been determined (e.g. the sterling wholesale market for sterling, the market for overnight cash borrowing collateralised by US government securities for dollars).

The term is used as a reference point for conventions and market practice, where they might differ from those specified in the Agreement. For example, in Clause 32 (*Day Count Convention and Interest Calculation*) interest accrues on the basis of a 360 day year unless practice in the “Relevant Market”, differs – which in the sterling wholesale market, which uses a 365 day year, it does.

“Reporting Day” and “Reporting Times”

These definitions are required only if Market Disruption Rate is specified and/or Cost of Funds is specified to apply as a fallback in the Reference Rate Terms (see above).

Lenders wishing to invoke Clause 11.3 (*Market Disruption*) must notify the Agent by close of business at the Reporting Time. The Reporting Time optionally specified here is close of Business on the Reporting Day for the relevant loan.

The Reporting Day is defined as the Business Day which follows the day which is the Lookback Period prior to the last day of the

Comments on Reference Rate Terms – Compounded Rate Currencies

Interest Period. The Reporting Day therefore falls within the Lookback Period for the Compounded Rate Loan for the relevant Interest Period. In other words, it falls at the end of an Interest Period.

If cost of funds is payable for an interest period, as a fallback pursuant to Clause 11.2 (*Interest calculation if no RFR or Central Bank Rate*), or because the trigger threshold for the operation of Clause 11.3 (*Market Disruption*) has been reached, each Lender must notify the Agent of its cost of funds by the Reporting Time. The optional Reporting Time provided for this purpose is close of business on the date falling a specified number of Business Days after the Reporting Day, or if earlier, the day on which interest is due for that Interest Period.

The point for Borrowers to be alert to here, is that if the market disruption clause or the rate fallback provisions are triggered, the Lenders will be obliged to notify the Agent very late in the Interest Period – or even, on the date interest is due to be paid – of the amount of interest payable on a Cost of Funds basis. Borrowers are likely to consider this somewhat unfair. A solution might be to adjust the notification requirements such that they apply earlier in the period (as is the case in relation to Term Rate Loans). If that is not acceptable to Lenders, this is another factor that supports the Borrower's argument that market disruption and cost of funds provisions are not suitable for Compounded Rate Loans.

Comments on Reference Rate Terms – Compounded Rate Currencies

	<p>See also comments at Clause 11.3 (<i>Market Disruption</i>) and Clause 11.4 (<i>Cost of funds</i>).</p>
“RFR”	<p>The RFR Agreements contain standard definitions of SONIA, SOFR, €STR and SARON. A definition of TONAR can be found in the LMA’s TONAR Schedule, published separately.</p> <p>Treasurers may be aware that the 2021 ISDA definitions contain definitions of a wide range of RFRs for non-LIBOR currencies. Those definitions (and related provisions) may provide a useful reference point for those seeking to reference RFRs other than those provided for the Investment Grade Agreements, subject to the note of caution in section 5 (Transition Issues) of Part II (<i>Risk-Free Rates in the Loan Market</i>) above regarding conventions.</p>
“RFR Banking Day”	<p>This is a day on which the daily RFR is published. It is different for each Compounded Rate Currency. The definitions provided for Sterling, USD and CHF are not typically adjusted.</p> <p>See comments at Clause 1.1 (<i>Definitions</i>) in relation to “Business day” for further background.</p>
“Published Rate Contingency Period”	<p>The optional trigger for the replacement of benchmark process set out in optional Clause 35.4 (<i>Changes to reference rates</i>) is a “Published Rate Replacement Event”. This includes a reference rate being calculated in accordance with the rate administrator’s contingency or fallback policies in circumstances which are not temporary, or for</p>

Comments on Reference Rate Terms – Compounded Rate Currencies

a period of no less than the “**Published Rate Contingency Period**”, which is blank for the parties to agree.

Contingency methodologies are typically intended only to be used for relatively short-term contingency events. The Published Rate Contingency Period is therefore typically quite short, to reflect that the parties are likely to wish to move on from e.g. historic rates (if that is the contingency methodology) to an alternative solution.

Published Rate Contingency Periods of 30 days/one month are reasonably common for all currencies, although there are variations.

“**Interest Periods**”

Pre-agreed Interest Periods are largely the same that those featured in LIBOR-referencing loans i.e. one, two, three or six months.

12 month Interest Periods are not used in relation to Compounded Rate Loans. See discussion at Clause 10 (*Interest Periods*).

SCHEDULE 13 PART IVA – REFERENCE RATE TERMS FOR TERM RATE CURRENCIES

Comments on Reference Rate Terms – Term Rate Currencies

CURRENCY [AND CATEGORY OF

The currency is the Term Rate Currency (as drafted here, euro).

The optional specification of a “category of loan/unpaid sum/accrual” is only required for

Comments on Reference Rate Terms – Term Rate Currencies

LOAN/UNPAID SUM/ACCRUAL]	<p>Term Rate Currencies for which Compounded Reference Rate Terms are also included in the Agreement i.e. Rate Switch Currencies.</p> <p>Its purpose is to allow the parties to specify which Reference Rate Terms apply (Term Rate or Compounded Rate) to accruals prior to the Rate Switch Date.</p>
Rate Switch Currency	<p>The parties must specify whether each Term Rate Currency is a Rate Switch Currency (in which case, Clause 9A (<i>Rate Switch</i>) applies and Reference Rate Terms for Compounded Rate Loans in that currency must be included).</p> <p>At the time of writing, it remains unusual for euro to be designated as a Rate Switch Currency.</p>
Compounded Reference Rate as a fallback	<p>This is specified not to apply to Term Rate Loans in euro, where €STR-based fallbacks are not yet widely adopted.</p> <p>If applicable, Compounded Rate Terms are likely to be required.</p> <p>See comments at section 3 (Risk-free Rates - the options) of Part II (<i>Risk-Free Rates in the Loan Market</i>) and comments at Clause 11.1 (<i>Interest Calculation if no Primary Term Rate</i>).</p>
Cost of funds as a fallback	<p>This is specified to apply to Term Rate Loans in euro.</p> <p>As discussed at Clause 11.1 (<i>Interest Calculation if no Primary Term Rate</i>), cost of funds is still in use as fallback for EURIBOR loans.</p>
“Additional Business Day”	<p>This concept applies only to the fixing of the interest rate on Term Rate Loans. EURIBOR,</p>

Comments on Reference Rate Terms – Term Rate Currencies

	<p>being quoted on every day that TARGET2 is open, so an Additional Business Day is defined as a TARGET Day.</p> <p>See comments at Clause 1.1 (<i>Definitions</i>) in relation to “Business Day” for further background.</p>
<p>“Alternative Term Rate” and “Alternative Term Rate Adjustment”</p>	<p>The optional default position here for euro is “none specified”, which reflects current market practice.</p> <p>These concepts are included in case the parties wish to adopt an adjusted forward-looking RFR term rate as part of the fallback waterfall for the Primary Term Rate.</p> <p>As discussed at Clause 11.1 (<i>Interest Calculation if no Primary Term Rate</i>), no such rate is yet available for euro.</p>
<p>[“Backstop Rate Switch Date”]</p>	<p>This must be specified if the Term Rate Currency is a Rate Switch Currency. It is the date on which (if other trigger events have not occurred earlier), the currency will become a Compounded Rate Currency.</p> <p>See comments at Clause 9A (<i>Rate Switch</i>).</p> <p>As already noted, at the time of writing, it remains unusual for euro to be designated as a Rate Switch Currency.</p>
<p>“Break Costs”</p>	<p>Since the transition to RFRs, it has quickly become accepted that Break Costs should not apply to loans in Compounded Rate Currencies (see comments on Reference Rate Terms applicable to Compounded Rate Currencies above). The concept (and a definition) of Break Costs may, however, still be required for Term</p>

Comments on Reference Rate Terms – Term Rate Currencies

Rate Loans. The definition provided here and applicable to Term Rate Loans in euro reflects the long-standing LMA formulation of Break Costs in the LIBOR Agreements (see comments on “**Break Costs**” at Clause 1.1 (*Definitions*)).

The main commercial point that Borrowers have historically taken 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 Clause 8.1 (*Illegality*), Clause 11.3 (*Market Disruption*), Clause 13 (*Tax Gross-up and Indemnities*) and Clause 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

Comments on Reference Rate Terms – Term Rate Currencies

	<p>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 handful of (often longer running) agreements.</p>
<p>Business Day Conventions – definition of “Month” and Clause 10.3 (Non-Business Days)</p>	<p>The Compounded/Term MTR applies the “Modified Following Business Day Convention” to both Term Rate Loans and Compounded Rate Loans, such that payments of interest that would fall to be made on a day that is a Non-Business Day are adjusted to the next succeeding Business Day, unless that Business Day falls in the next calendar month, in which case the interest payment date is the preceding Business Day. This is customary.</p> <p>See comments at Clause 1.1 (<i>Definitions</i>) in relation to “Business Day” and at Clause 10.3 (<i>Non-Business Days</i>) for further background.</p>
<p>[“Fallback Interest Period”]</p>	<p>This optional definition is relevant to the fallback options for Term Rate Currencies provided in Clause 11.1 (<i>Interest Calculation if no Primary Term Rate</i>). The length of the Fallback Interest Period is left blank to be agreed. The use of rates for Fallback Interest Periods is intended to be temporary. The agreed period is therefore typically fairly short. The agreed period might range from around one week to one month.</p> <p>Fallbacks are discussed at Clause 11 (<i>Changes to the Calculation of Interest</i>).</p>
<p>“Margin”</p>	<p>The Compounded/Term MTR provides for a Margin to be specified in the Reference Rate Terms for each currency separately.</p>

Comments on Reference Rate Terms – Term Rate Currencies

	<p>See comments on the definition of “Margin” in relation to the Reference Rate Terms for Compounded Rate Currencies above.</p>
“Market Disruption Rate”	<p>The Market Disruption Rate for Term Rate Currencies is typically the Primary Term Rate, so for euro, it is EURIBOR.</p> <p>See comments at Clause 11.3 (<i>Market Disruption</i>).</p>
“Primary Term Rate”	<p>For euro, this is EURIBOR.</p> <p>EURIBOR is administered by EMMI and is the domestic interbank rate for the euro area. EMMI’s EURIBOR measures the rate at which wholesale funds in euro could be obtained by credit institutions in current and former EU and EFTA countries in the unsecured money market. Following relatively recent reforms, it is calculated using a hybrid methodology that is based on contributions from a range of panel banks. Further information is available on EMMI’s EURIBOR website.</p>
“Quotation Day” and “Quotation Time”	<p>The Quotation Day is the day on which the chosen benchmark rate is fixed, and the Quotation Time, the time at which it is fixed. These definitions reflect the market convention that EURIBOR rates are fixed two TARGET Days beforehand as of 11 a.m. CET.</p> <p>See comments at Clause 1.1 (<i>Definitions</i>) in relation to “Quotation Day” for further background.</p>
“Relevant Market”	<p>This concept is left to be defined by currency in the relevant Reference Rate Terms. It is designed to refer to the market where the loan is</p>

Comments on Reference Rate Terms – Term Rate Currencies

	<p>assumed to be funded. This will vary according to the reference rate against which pricing has been determined. For Term Rate Loans in euro, it is the European interbank market.</p> <p>As discussed above in relation to the Reference Rate Terms for Compounded Rate Currencies, the term is used as a reference point for conventions and market practice, where they might differ from those specified in the Agreement.</p>
“Reporting Day” and “Reporting Times”	<p>The definitions of Reporting Times are the same as for Compounded Rate Loans. The definition of Reporting Day is different for Term Rate Currencies. It is defined as the “Quotation Day”.</p> <p>The difference means (in summary) that where Clause 11.3 (<i>Market Disruption</i>) or Clause 11.4 (<i>Cost of funds</i>) applies in relation to a Term Rate Loan, the Lenders will be obliged to make the required notifications to the Agent at the beginning of the Interest Period, rather than (as noted in relation to Compounded Rate Loans), at the end.</p> <p>See also comments at Clause 11.3 (<i>Market Disruption</i>) and Clause 11.4 (<i>Cost of funds</i>).</p>
“Published Rate Contingency Period”	<p>See comments in relation to the Reference Rate Terms for Compounded Rate Currencies above.</p>
“Interest Periods”	<p>Pre-agreed Interest Periods typically reflect the available quoted tenors of the Primary Term Rate from one month (or those the Borrower requires). EURIBOR is currently available for one, two, three, six and twelve month tenors.</p>

See discussion Clause 10 (*Interest Periods*).

POSSIBLE SUPPLEMENTARY PROVISIONS: REFERENCE RATE TERMS FOR ADDITIONAL CURRENCIES

As noted in section 6 (Documentation) of Part II (*Risk-Free Rates in the Loan Market*), the LMA has produced a slot-in TONAR Schedule, containing skeleton Reference Rate Terms for JPY loans referencing compounded in arrears TONAR. It may be, as other major IBORs cede to RFRs, there is demand for standardised drafting for loans in additional Compounded Rate Currencies that are not ex-LIBOR currencies. However, currently, if it is agreed that additional currencies are to be Compounded Rate Currencies, treasurers will be reliant on the Lenders and their advisers to produce appropriate terms.

If Reference Rate Terms for a Term Rate Currency other than EURIBOR are required, there is some historic LMA drafting that may provide a starting point for certain rates. The LMA produced the “Domestic Interest Rate Benchmark Slot-In Schedules”, which contain provisions for the domestic benchmarks applicable to a number of currencies, in 2013, following the announcement that LIBOR rates for certain currencies were to be discontinued. The LMA’s “Domestic Interest Rate Benchmark Slot-in Schedules” contain drafting for rates applicable to Australian dollars, New Zealand dollars, Canadian dollars, Danish Kroner and Swedish Kronor. At the time of writing, all of the rates covered continue to exist.

The 2013 drafting must be used with caution in conjunction with the RFR Agreements. Firstly, the Domestic Benchmark Slot-In Schedules were drafted to slot into the LIBOR Agreements; so will need to be adapted to the terminology and numbering used in the RFR Agreements. Secondly, and more importantly, changes have been made to the methodologies of some of these rates and the available maturities as part of the broader initiative to transition major IBORs to RFRs (see section 8 (Beyond LIBOR) of Part II (*Risk-Free Rates in the Loan Market*)). Accordingly, it will be necessary to discuss with the Lenders the current conventions for

using the relevant rate and whether the relevant rate (in all required maturities) is expected to remain available for the life of the facility.

LMA 2013 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)

SCHEDULE 14 DAILY NON-CUMULATIVE COMPOUNDED RFR RATE

Schedule 14 specifies the calculations to be performed for the purposes of calculating the “**Compounded Reference Rate**”, which is the rate at which interest is payable on Compounded Rate Loans, (in summary) is the sum of the “**Daily Non-Cumulative Compounded RFR Rate**” for that day and the CAS, if applicable. The Daily Non-Cumulative Compounded RFR Rate is calculated for each RFR Banking Day by reference to the mathematical formula specified in Schedule 14.

The Daily Non-Cumulative Compounded RFR Rate is essentially the “**Cumulative Compounded RFR Rate**” for that day minus the Cumulative Compounded RFR Rate for the previous day. It is therefore necessary to calculate a Cumulative Compounded RFR Rate in order to arrive at the Daily Non-Cumulative Compounded RFR Rate. The Cumulative Compounded RFR Rate calculation required for the purposes of the Daily Non-Cumulative Compounded RFR Rate is also included in the formula in Schedule 14.

The Schedule provides that in applying the formula to calculate the daily rate, the “no rounding” convention is subject to the limits of systems

capabilities. This is to ensure that rounding-related systems constraints do not prevent a Finance Party from performing the necessary calculations. See further comments at Clause 32 (*Day Count Convention and Interest Calculation*).

Comment

As the Daily Non-Cumulative Compounded RFR Rate is derived from a Cumulative Compounded RFR Rate, it adds a further level of complexity to rate determinations. As noted in section 4 (Conventions for referencing RFRs) of Part II (*Risk-Free Rates in the Loan Market*), the NCCR approach has been recommended for loans because it better supports intra-period events such as prepayments and trading. The Daily Non-Cumulative Compounded RFR Rate formula generates a daily compounded rate which allows the calculation of a daily interest amount, enabling accurate calculation of accrued interest at any point in time. This is not needed or typically used in capital markets products, nor is an NCCR reflected in the ISDA IBOR fallbacks.

While an NCCR might “better support” intra-period prepayments (by making prepayment amounts more straightforward for lenders to calculate), the UK RFRWG’s Best Practice Guide for GPB Loans notes that an NCCR is not essential for the purpose of calculating prepayment amounts. The NCCR is therefore of primary importance for the purposes of trading and efficient prepayments in syndicated deals. If the RFR Agreements are being adapted for bilaterals or even certain clubbed loans, the parties may agree to dispense with the Daily Non-Cumulative Compounded RFR Rate and calculate the Compounded Reference Rate by reference to a CCR formula only, which generates a single compounded rate of interest for the whole period. The use of a CCR in appropriate cases will not only simplify the drafting of the loan agreement but may also better reflect the basis on which interest is recorded in most treasury management systems.

SCHEDULE 15 CUMULATIVE COMPOUNDED RFR RATE

Schedule 15 contains a standalone Cumulative Compounded RFR Rate formula, for the calculation of the Compounded Reference Rate over a period.

Comment

The formula in this Schedule 15 is relevant to the Compounded/Term MTR as drafted, solely for the purposes of Clause 11.3 (*Market Disruption*). If the Reference Rate Terms for all Compounded Rate Currencies specify that no Market Disruption Rate applies, it will be superfluous.

NOTE: COMPOUNDED/TERM MTR WITH/WITHOUT OBSERVATION SHIFT

The only differences between the Compounded/Term MTR with observation shift, and the version without observation shift are in the formulae in Schedule 14 and Schedule 15. In the version with observation shift, the weighting elements of the formulae refer to the days in the observation period rather than the days in the interest period.

Comment

General market practice is to adopt the lookback without observation shift approach in line with the recommendation of the UK RFRWG. There may, however, be instances where a lookback with observation shift is the preferred approach, for example, where alignment with associated hedging is important.

For further background on the observation shift option, see section 4.4 (Observation shift) of Part II (*Risk-Free Rates in the Loan Market*).

**PAR V
COMMENTARY ON THE
LEHMAN PROVISIONS**

PART V / 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 (*Repayment*) in Part IV). The remainder (which have been updated a number of times since publication) are still presented as optional clauses. Accordingly, they are addressed separately in this Part V.

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 Possible supplementary provisions: “yank the bank” and “you snooze you lose” in Part IV).
- The identity of a Defaulting Lender may be disclosed by the Agent to the Borrower.

These provisions are also available in a version suitable for use in swingline facilities.

Comment

These provisions are widely used, including the optional aspects.

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.

Comment

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.



**GLOSSARY
AND
CONTACT DETAILS**

GLOSSARY

Key terms defined for the purposes of this guide are listed below.

ACT	The Association of Corporate Treasurers.
APLMA	The Asia Pacific Loan Market Association.
ARRC	The Alternative Reference Rates Committee (the US Working Group).
BISL	Bloomberg Index Services Limited, appointed by ISDA to publish the fallback rates and CAS for use in derivatives on the cessation/pre-cessation of LIBOR.
CAS	Credit adjustment spread, a separate amount which may (optionally) be added to the compounded RFR to account for the economic difference between LIBOR and the relevant RFR.
CCR	Cumulative compounded rate, being the compounded RFR rate applicable over a given period.
CHF	Swiss Francs.
CME Term SOFR	The Term SOFR rates published by the CME Group.
Compounded/Term MTR	The LMA recommended form of multi-currency term and revolving facilities agreement referencing compounded/term rates (May 2021 version).

CRTPA	The UK Contracts (Rights of Third Parties) Act 1999.
ECA 2022	The UK Economic Crime (Transparency and Enforcement) Act 2022.
ECB	European Central Bank.
EMMI	The European Money Markets Institute, the current administrator of EURIBOR.
ESG	Environmental, social and governance.
€STR	The Euro Short-Term Rate (the RFR for euro).
EU27	The 27 member states of the European Union.
Euro Working Group	The Working Group on Euro Risk-Free Rates.
EURIBOR	The Euro Interbank Offered Rate.
FCA	The UK Financial Conduct Authority.
FSB	The Financial Stability Board.
GLP	The LMA's Green Loan Principles (February 2021 version).
HMRC	Her Majesty's Revenue and Customs.
IASB	The International Accounting Standards Board.
ICE Term SOFR	The term SOFR rates produced by ICE Benchmark Administration Limited.

ICMA	The International Capital Markets Association.
Investment Grade Agreements	The LMA's recommended forms of facility agreement for investment grade borrowers (comprising the LIBOR Agreements and the RFR Agreements).
IRS	Internal Revenue Service.
ISDA IBOR Fallbacks	The ISDA Supplement and ISDA Protocol (each as separately defined).
ISDA Protocol	ISDA's IBOR Fallbacks Protocol, published in October 2020 and effective from 25 January 2021.
ISDA Supplement	ISDA's IBOR Fallbacks Supplement, published in October 2020 and effective from 25 January 2021.
JPY	Japanese Yen.
KPI	Key performance indicator.
Lehman provisions	The LMA's Users' Guide to LMA Finance Party Default and Market Disruption clauses in conjunction with the recommended form of primary documents (May 2021 version).
Leveraged Agreement	The LMA's senior multi-currency term and revolving facilities agreement for leveraged acquisition finance transactions (December 2021 Compounded Rate/Term Rate version).
LIBOR Agreements	The LMA's recommended forms of facility agreement for

	investment grade borrowers referencing LIBOR (February 2020 versions).
LMA	The Loan Market Association.
LMA User Guide	The LMA's Users' Guide to the Investment Grade Primary Documentation (February 2020 version).
LSTA	The Loan Syndications and Trading Association.
MAC	Material adverse change.
MFN	Most favoured nation.
NCCR	A non-cumulative compounded rate, as recommended by the UK RFRWG in the Sterling Loan Conventions, calculated by taking the CCR for a given day and deducting the CCR for the previous day, giving a daily compounded rate that allows the calculation of a daily interest amount.
NSIA	The UK National Security and Investments Act 2021.
OFAC	The Office of Foreign Assets Control, the primary sanctions authority in the US.
OFSI	The Office of Financial Sanctions, responsible for the enforcement of financial sanctions in the UK.
PA 2004	The UK Pensions Act 2004.
Pre-cessation	In the context of a reference rate, refers, in summary to the date on which a relevant supervisor

	declares that the rate is no longer representative of the underlying market or economic reality it is intended to represent.
PSA 2021	The UK Pension Schemes Act 2021.
RFR	Risk-free rate.
RFR Agreements	The LMA's recommended forms of facility agreement for investment grade borrowers referencing RFRs (May 2021 versions).
RFR User Guide	LMA User Guide to the RFR Agreements (May 2021 version).
SARON	The Swiss Average Rate Overnight (the RFR for CHF).
SLL	Sustainability-linked loan.
SLLP	The LMA's Sustainability-Linked Loan Principles (March 2022 version).
SLP	The LMA's Social Loan Principles (April 2021 version).
SOFR	The Secured Overnight Financing Rate (the RFR for USD).
SONIA	The Sterling Overnight Index Average (the RFR for sterling).
SPT	Sustainability performance target.
Sterling Loan Conventions	The UK RFRWG's Recommendations for SONIA Loan Market Conventions (September 2020).

Swiss Working Group	The National Working Group on Swiss Franc Reference Rates.
Term SOFR	A forward-looking term reference rate derived from SOFR, for example CME Term SOFR and ICE Term SOFR.
Term SOFR DM Exposure Draft	The LMA's exposure draft single currency term and revolving facilities agreement for use in Developing Markets jurisdictions incorporating Term SOFR (October 2021 version).
Term SOFR Exposure Drafts	The Term SOFR DM Exposure Draft and the Term SOFR MTR Exposure Draft, each as separately defined.
Term SOFR MTR Exposure Draft	The LMA's exposure draft multi-currency term and revolving facilities agreement incorporating Term SOFR (October 2022 version).
Term SOFR User Guide	The LMA's Commentary to the Term SOFR DM Exposure Draft (October 2021 version).
Term SONIA	Term SONIA reference rate, a forward-looking term rate derived from SONIA.
TIBOR	The Tokyo Interbank Offered Rate.
TONAR	The Tokyo Overnight Average Rate (the RFR for JPY).
TONAR Schedule	The LMA's skeleton Reference Rate Terms for Compounded Rate Loans in JPY.

TORF	Tokyo Term Risk Free Rate, a forward-looking term rate derived from SOFR.
UK RFRWG	The Working Group on Sterling Risk-Free Reference Rates.
USD	United States dollars.
Working Group	The national working groups convened in each LIBOR currency jurisdiction to catalyse market-led transition from LIBOR to alternative rates.

ABOUT THE ASSOCIATION OF CORPORATE TREASURERS

The Association of Corporate Treasurers (**ACT**) is the only professional treasury body with a Royal Charter.

We set the global benchmark for treasury excellence and lead the profession through our internationally recognised qualifications, by defining standards and by championing continuing professional development. We are the authentic voice of the treasury profession, representing the interests of the real economy and educating, supporting and leading the treasurers of today and tomorrow.

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.

Risk-free rates

The ACT continues to work closely with regulators, the LMA and other fellow trade associations and benchmark providers to ensure that the needs of the corporate sector and the real economy are not overlooked in the transition from LIBOR.

We welcome input from members on all aspects of lending practice including LIBOR transition by email to technical@treasurers.org.

Further information about the ACT is available at <https://www.treasurers.org/>.

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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 ground-breaking transactions, with a varied client list ranging from major corporations and financial institutions to governments.

Our loan finance practice represents investment grade and sub-investment grade borrowers in all industry sectors, giving 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 advised the ACT on the first versions of the Investment Grade Agreements and provides ongoing advice to the ACT in relation to the LMA's investment grade loan documentation and related issues.

The Slaughter and May team has been actively involved in a number of the London-based regulatory and industry-led working groups looking at aspects of LIBOR transition and advised the ACT on the development of the LMA's RFR Agreements.

Further information about Slaughter and May is available at <https://www.slaughterandmay.com/>.

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