TRAVERS SMITH

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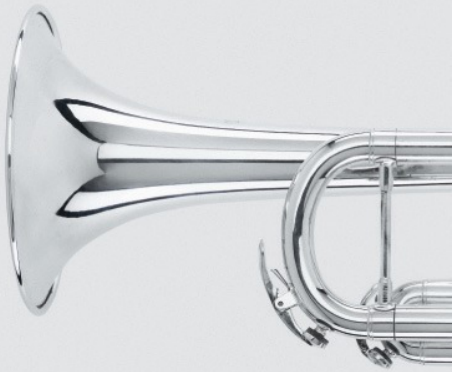

Welcome to the monthly finance bulletin from our banking and corporate recovery department. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on LIBOR and the response of diverse regulatory bodies. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

LMA Documentary Developments

The Loan Market Association (LMA) has been active. On 24 August, revised versions of the Investment Grade; Leveraged; Real Estate Finance and German law governed facility agreements were published, primarily to incorporate currency symbols and definitions (a useful addition in the context of the Eurozone crisis) and the exclusion of "silent administration proceedings" (potentially applicable in the Netherlands and other jurisdictions in the context of distressed lender insolvency proceedings) from the definition of "Insolvency Event".

Further significant changes were introduced to the Leveraged Senior Facility Agreement and related Intercreditor Agreement on 14 September and a new LMA Hedging Letter has also been posted. The changes to the Leveraged Senior Facility Agreement are wide ranging and include optional clauses permitting certain amendments and waivers to be sanctioned other than by unanimous lender consent; financial covenant optional wording excluding from EBITDA accounting gains arising from a buyback of debt by the borrower at less than par; and further changes to the representations, agency, prepayment and ancillary facility provisions. Changes to the LMA Intercreditor Agreement focus on enforcement and refinancing provisions which now address the possibility of receipt of non-cash consideration following asset disposals on enforcement and expand on duties to obtain a fair market price. The changes also encompass variations to hedge counterparties' positions; the introduction of Automatic Early Termination of a swap where consistent with the relevant market; and the payment of restructuring fees to Mezzanine Lenders notwithstanding the subsistence of a mezzanine payment stop.

On 20 September, the LMA also published new term facility agreements for use in (a) developing market jurisdictions; and (b) pre-export finance transactions.

FATCA – More Developments

On 15 August, the International Swaps and Derivatives Association Inc. (ISDA) published the ISDA 2012 FATCA Protocol. This permits the introduction of tax provisions into the ISDA Master Agreement to address the consequences of FATCA withholdings on payments under derivative transactions. The protocol assumes that the recipient determines, by its compliance or otherwise with the FATCA disclosure requirements, whether the withholding tax applies and therefore should assume the risk of withholding.

On 14 September, the US and UK Treasuries signed the first intergovernmental agreement (IGA), which closely follows the model IGA issued in July by the governments of the US, UK, France, Germany, Italy and Spain. Notable features include:

- acknowledging some of the concerns of the pensions industry, pension schemes established in the UK and benefitting from the UK/US double tax treaty are "Exempt Beneficial Owners" and not treated as FFIs. Various pension products are also outside the scope of US Reportable Accounts, including pension schemes registered with HMRC under Article 4 of the Finance Act 2004; pension arrangements normally accessible after the age of 55 where annual contributions are limited to £50,000; and UK registered pension arrangements that are annuities issued to individuals and monetarising a pension or disability benefit;
- inclusion of a commitment to "work together" to develop an alternative approach to achieve the policy adjective of foreign pass-thru payments and gross proceeds withholdings that "minimises burden"; and
- a "most favoured nation" type clause which provides that the UK will benefit from any more favourable terms introduced into Article 4 of the IGA by subsequent IGAs concluded with other countries.

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Spotlight on…LIBOR and the response of diverse regulatory bodies.

The LIBOR fixing scandal has cost Barclays its Chief Executive and attracted £290m in fines from the FSA and US Regulators. Other banks (including RBS, UBS, HSBC and Citigroup) are also likely to be subject to regulatory sanction. The possibility of successful civil litigation has, however, been the subject of debate and others have argued that the English criminal law is simply not equipped to permit the FSO to successfully prosecute the type of conduct disclosed by the recent LIBOR investigations. The current mechanism is supervised by the British Bankers Association (whose position now looks untenable), but is otherwise unregulated. LIBOR is based on the responses of banks to their cost of borrowing in reasonable market size for a given maturity and currency. Whilst the rate is derived from unsubstantiated market data it is, however, moderated by the discounting of the highest and lowest 25% of provided rates and by reference to the mean average of the remaining 50%. Confident assumptions that a measure of objectivity was built into the system were undermined by the pressures on banks, occasioned by the financial crisis, to reassure markets and other banks that their cost of borrowing was at sustainable levels.

Regulatory bodies and governmental institutions have been lining up to initiate consultations and present their proposals for an overhaul of the existing rate setting mechanism, which is demonstrably flawed. The Wheatley Review in the UK has generated a discussion paper which was subject to a very short consultation process and which focuses on increased regulatory oversight and a wider panel of banks with rates set on the basis of average rather than mean submissions and a narrow range of currencies and maturities. Recent announcements suggest that Wheatley's Review is segueing into a wider taskforce set up by the International Organisation of Securities Commissions and co-chaired by Wheatley and Gary Gensler, the Chairman of the US Commodity Futures Trading Commission. On a separate front, a group of senior officials under the auspices of the Bank of International Settlements is participating in an enquiry by the Financial Stability Board, whilst the European Commission has published its own consultation paper on the wider issue of regulation of benchmarks which appears to favour governmental supervision of indices.

Regulators will, it is hoped, be aware of the need for co-ordinated and measured action, given the number of existing financial contacts potentially affected by any change to the LIBOR mechanism, many of which currently refer to the BBA Interest Settlement Rate.

Audit exemptions

On 11 September 2012, BIS published the Companies and Limited Liability Partnerships (Accounts and Audit exemptions and change of Accounting Framework) Regulations 2012. These come into force on 1 October and will apply to financial years ending after this date. The new regulations, amongst other things, (a) exempt subsidiaries from the mandatory yearly audit if the shareholders so elect, subject to the Parent company giving a statutory guarantee of its subsidiaries' total existing liabilities; and (b) excuse dormant companies from the obligation to prepare and file accounts and be audited, subject to certain conditions.

Most facility agreements impose an obligation on each Group member to provide annual audited accounts, but if any agreement relies on the statutory obligation to do so, that obligation may be affected by the new Regulations. In any event, many facility agreements might be expected to limit the provision by the Parent of an unlimited guarantee, statutory or otherwise.

In the courts

Assenagon Asset Management SA v Irish Bank Resolution Corporation Ltd [2012] EWHC 2090 (Ch)

This case arises from the nationalisation of Anglo Irish Banking Corporation in January 2009 and the terms of the distressed exchange offer put to Anglo Irish noteholders by the Irish government. In this case, the offer to noteholders was to exchange their existing notes for an inferior note with a face value of 20% of the existing notes, albeit with an improved interest rate and the benefit of a guarantee from the Irish government. Those accepting the exchange offer were required to vote at a subsequent noteholders' meeting in favour of a resolution authorising the issuer to redeem notes not so exchanged at 0.001% of their face value – an effective expropriation. Cognisant that they might be left with worthless bonds, 92% of noteholders accepted the offer and the resolution was passed, thus disenfranchising the dissident noteholders. Assenagon was one of the dissidents and argued:

(i) that the terms of the trust deed regulating the notes did not permit the majority to pass such a resolution;

(ii) that those noteholders who had accepted the exchange offer were, at the time of the vote, no longer entitled to vote on the subsequent resolutions. Their original notes had been transferred to the Issuer by way of the exchange process and the terms of the notes prohibited the exercise of voting powers when notes were held beneficially by the Issuer; and

(iii) the extraordinary resolution constituted an abuse of majority voting powers and was unfairly oppressive of the minority.

Briggs J rejected the argument in (i) above, whilst accepting that such clauses in trust deeds required a restrictive interpretation. He agreed however with the argument in (ii) above, holding that the Issuer had acquired a beneficial interest in the notes on the date that it had accepted the noteholders' offer to exchange. Even if the arguments in paragraph (ii) were to fail and the noteholders passing the resolution disenfranchising the minority were entitled to do so, Briggs J held that the resolution was invalid because it did involve an abuse of power by the majority.

Whilst reported at the end of July, the case warrants special attention because (a) the Issuer has leave to appeal and there is a real possibility of consideration by the Court of Appeal; (b) the decision, whilst capable of distinction as a matter of degree from earlier decisions of the English courts upholding comparable, though perhaps less egregious exit consent schemes, is inconsistent with US authority (*Katz v Oak Industries Inc.* (1986)) which rejected any imputation that an "exit consent" arrangement constituted a bad faith abuse of power; (c) the decision may trigger similar claims by dissenting bondholders; (d) issuers may now be more disposed to elect in favour of New York law to regulate high yield bond issues; and (e) the case has implications for other European countries seeking to restructure subordinated bondholders positions in the context of distressed banks.

Recent transactions

We have recently advised:

- The Royal Bank of Scotland plc as agent on the amendment and restatement of the revolving facility (with term out) made available to Central Trust to finance the provision of mortgages in respect of residential property in the UK
- CLS Holdings plc, a multi-national property investment company, on the issue of its £65m 5.5 per cent. Retail Bond due 2019

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