

New approach to loan documentation

Caroline Bradley of the Association looks at a new form of documentation that could save time and money in syndicated loan agreements.

During 1998, in response to demand from lenders in the syndicated loan market, the Loan Market Association (LMA) launched a project to produce a form of syndicated loan agreement that would help to introduce some harmonisation into the format of loan documents and into the wording of clauses covering the more mechanical areas. The British Bankers Association and The Association of Corporate Treasurers were invited to appoint representatives to participate in the working group commenting on the drafting of the document. The drafting was undertaken jointly by Allen and Overy and Clifford Chance; the remaining members of the working group were lawyers from other city law firms and bankers.

Until now, the form of a syndicated loan document often followed the standard form of the law firm instructed to draft the agreement. The creation of a new common form of documentation is designed to provide uncontentious boiler-plate provisions that save on time and money and allow the parties to concentrate on the more business-specific provisions of each transaction.

According to Peter Vipond of the BBA: "Credit markets are undergoing major changes driven by a number of factors including the euro, regulatory reform and credit product innovation: all of these require a response from the syndicated loan market. Our objective in contributing to this initiative has been to promote the UK as an efficient market for the syndication and management of loans."

Although the main objective of the LMA in this project has been to encourage a harmonised approach to primary syndicated loan documentation, it is also likely to have an impact on secondary loan trading if the new common format is widely adopted. Some members of the Association may well find

Some treasurers see a harmonised approach as a welcome development that will save time and expense and facilitate syndication of their loans

themselves reluctant to see it co-operate in such an initiative but there are potential advantages to treasurers in the availability of a more harmonised format which could save time and expense. Of equal importance was the opportunity for the Association to ensure that the concerns of borrowers would be aired. The invitation to be represented on the working group was therefore accepted, with a view to achieving a format that would be more balanced between the interests of borrowers and lenders. Andrew Balfour, a member of the Association's technical committee and a partner at Slaughter and May, was appointed as our representative.

Clearly, a balance would be hard to achieve considering the range of possible borrowers, in terms of credit rating, size and borrowing requirements. However, general agreement has been reached on a format which provides a reasonably balanced starting point. Some clauses may not require further negotiation, although others will do. Indeed, the most contentious areas, such as financial covenants and related definitions, have deliberately been left blank. The LMA document aims to reflect current market practice for a

syndicated facility to a corporate with an investment grade rating. Borrowers and lenders using this format will still need to enter into negotiations to produce a loan document that is tailored to their particular situation and transaction requirements.

The primary documents

There will be three forms of the documentation (the 'primary documents'):

- a multicurrency term and revolving facilities agreement;
- a multicurrency term facility agreement; and
- a multicurrency revolving facility agreement.

The primary documents are structured so that, in each, sections 2 to 6 cover operational mechanics of a loan, section 7 the guarantee (if any) and so on. Accompanying them will be a users guide prepared by the LMA which explains the structure of the primary documents and goes through each definition and clause, explaining its purpose and context. In addition, it sets out the assumptions underlying the document. In brief these are:

- the agent is based in London and syndication takes place primarily in the London market and Euromarkets;
- each lender is a bank or financial institution;
- the obligors are companies, incorporated in England and Wales;
- all facilities are unsecured and the obligors are of an investment grade rating;
- each lender participates in each facility proportionally; and
- each transaction is governed by English law.

As far as possible the primary documents are written in 'plain English', with

clauses broken down into shorter sub-paragraphs, with exceptions listed as sub-paragraphs rather than provisos.

How to use primary documents

It is envisaged that lenders would introduce the potential use of the primary documents as an option in the term sheet they present to borrowers at the start of negotiation of a syndicated loan.

At each stage of the negotiation and documentation process it is intended that drafts will show clearly what insertions and amendments have been made. It is envisaged that the drafting law firm will provide copies of the negotiated document marked to show variations from the primary document at each reiteration. It is also an LMA recommendation that conformed copies of the final agreement should be marked to show changes from the relevant primary document. This will facilitate administration of the loan and any possible secondary loan trading.

Christopher Elliott of the LMA believes that both lenders and borrowers will benefit from "a more efficient documentation process to a transaction, savings in the time-related costs of that process and confidence in the practical operation of the facility throughout its term."

The primary documents will be available to treasurers directly from the LMA in hard copy at a cost of £50 and will also be available at no cost from relationship banks and legal firms who are LMA members.

Should treasurers use them?

Borrowers should not feel under any pressure to adopt this format and will, in any event, need to undergo the negotiation process necessary to ensure that it is tailored to meet their requirements. Like the ISDA swaps documentation, the devil is in the detail. Specific tailoring of an individual facility agreement based on a primary document will require as

much attention as does the schedule of the ISDA. It should, however, assist borrowers and lenders in their review of documentation and may reduce legal costs for borrowers.

The Association believes that borrowers should:

- always take independent legal advice when negotiating the loan documentation;
- consider the option of continuing to use their existing documentation or some other format; and
- if they decide to use a primary document, they should critically consider what changes to it they will require. Some lenders may be unwilling to consider significant variations from the template but borrowers should consider the terms of the primary documents very carefully and should certainly not regard them as a standard.

Transferability clauses

Borrowers need to consider their policies and controls over loan trading carefully. The primary documents include provisions for transferability that are consistent with many loan agreements that have been used in the syndicated market for the past decade. However, the gradual but widespread adoption of a clearly recognisable form of loan document, with clauses in familiar places and marked to show changes from the primary document, would ultimately assist liquidity in the syndicated loan market.

The primary documents will be of value as a reference source for borrowers seeking a reasonably balanced starting point for entering into loan negotiations and to companies looking to update standard in-house loan documentation for current developments. Also, as David Creed notes: "reducing the cost and time required to turn a loan offer into a loan drawdown is an important element in funding a company. The LMA's syndicated loan format should offer efficiency and savings in the loan negotiation process for many borrowers, once the loan term sheet has been agreed. Treasurers should explore the benefits they can achieve by using the format in their negotiations."

Although some treasurers may be concerned at the development of a more harmonised approach to loan documentation, others will see it as a welcome development that will save time and expense and facilitate syndication of their loans.

Borrowers should ensure that they take the necessary advice to benefit from the positive aspects of using the primary documents without sacrificing the ability to tailor the documents to their particular circumstances. To this end, the Association intends to publish a commentary on the primary documents providing a clause-by-clause analysis, concentrating on the more important issues, and pointing out some of the areas where borrowers might wish to focus their attention.

Borrowers who are willing to include loan transferability in their documentation might expect to gain increasing benefit in lower margins relative to non-transferable loans, ease of syndication and possibly fewer covenants. Borrowers unwilling to contemplate their debt being traded must ensure that they take advice on that section of the document that deals with transferability and make their position clear to their advisers and lenders before starting syndication. ■

Caroline Bradley is the technical officer of the Association.

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