

## The Association of Corporate Treasurers

Comments in response to

### ***Extending eligible collateral in the Discount Window Facility and information transparency for asset-backed securitisations***

**A consultative paper by the Bank of England**

March 2010

April 2010

### **The Association of Corporate Treasurers (ACT)**

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website [www.treasurers.org](http://www.treasurers.org).

Contact details are also at the back of these comments.

### **General**

The ACT welcomes the opportunity to comment on this matter.

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We will restrict our comments to the issues affecting the eligibility of obligations of private non-financial corporations (PNFCs).

It seems to us that PNFCs will be competing for capital over the coming years with governments and local and regional governments, with banks and others. Supply of that capital will be restricted by many proposed changes in regulation and, other financial, economic and societal developments.

Many changes and adaptations will be required in companies' strategies and, eventually, we believe, to many of the regulatory changes currently being considered if they are implemented in the forms currently mooted.

We are, for example, very concerned that proposed bank liquidity requirements coming from the Basel Committee process and the FSA do not sufficiently, or at all, include any liquidity attribution to obligations of PNFCs. We think that this will eventually require to be addressed.

Eligibility of some corporate obligations as collateral or for rediscount with central banks will be an important consideration in inclusion of corporate obligations in banks' portfolios. The current eligibility of portfolios of certain PNFC paper and for securitisations of some PNFC loans and bonds for the Discount Window Facility (DWF) is noted. The Bank of England's activity as market maker of last resort<sup>1</sup> for some PNFC debt is another point.

With that background, we welcome the proposed widening of DWF criteria by inclusion, inter alia, of portfolios of PNFC loans alongside the existing eligibility of securitisations of the same as increasing the flexibility of arrangements.

## **Eligibility criteria**

### **Standby-revolving lines**

PNFCs see bank provided finance as providing, among other benefits, the advantages of stand-by finance or the possibility of "undrawn" periods and of cancellation without penalty of the facility at the end of any interest or drawing period.

We understand that this flexibility makes such loans unsuitable as collateral including potentially for central banks. However, when taking a portfolio of loans, a holder may provide for substitution (cash or alternative loan) in case of permanent or temporary repayment of a loan in a parcel used as collateral and it may not be necessary to exclude them altogether. Similar considerations would apply where a loan in a portfolio falls below the minimum credit rating required.

### **Transferability**

Restrictions on transferability of loans are very important for companies and should not be seen as providing material difficulties for the Bank, although they would limit the buyers of loans to suitable parties which are very widely defined<sup>2</sup>.

Investment grade bank loans usually require the consent, not to be unreasonably withheld, of the borrower to any transfers of the loan. Given the criteria set out in Box C, we do not think that the Bank will have difficulty with such reasonable provisions in most loans regarding provision of information.

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<sup>1</sup> Paul Fisher's paper to the Association of Corporate Treasurers, <http://www.bankofengland.co.uk/publications/news/2010/014.htm>

<sup>2</sup> We should give some explanation of why the matter is of importance.

In considering the covenants which may be provided to the lenders in loans, companies are influenced by the availability of the lenders to keep informed about the company and to be ready to consider changes in covenants at no or low cost – and if such changes are not agreed for the loan to be repaid without penalty as above. If a purchaser of the loan is not able to provide that service, a company will normally wish reasonably to deny the transfer of the obligation to such buyer.

Similarly bank loans normally include a provision that if tax on interest has to be withheld by the borrower and accounted for to the revenue authorities, the company will gross up the interest. Companies will normally reasonably wish to deny the transfer of the obligation to a buyer that is ineligible for a direction from HMRC that withholding tax need not be deducted.

Loan documentation may give lenders access to relevant material not generally available (including inside information) about the borrower. If a lender not bound by a (UK) bankers' common law duty of confidentiality is unable or unwilling to agree to maintain confidentiality of such information received, a company will reasonably need to deny transfer of the obligation to that buyer or to be satisfied that the transferee agrees not to receive such information. It should be easy for the Bank to satisfy this and to impose it on onward transferees.

These restrictions on transfers of loans are very important and loans lacking such features would be much less attractive to investment grade companies. Cost increases due to tax grossing up are unattractive, of course. But an inability to repay at reasonable notice (and without material penalty) can be of vital consideration.

We are concerned about references to changing eligibility criteria over time and we would expect that such changes would be properly consulted on should they be proposed.

#### Use of LMA documentation

Reference is made to the LMA investment Grade documents. Caution is needed here.

Reference is made in the paper to the purchase of BB- or higher loans. Cross-over and sub-investment grade issuers may well be using the Sub Investment Grade LMA documentation – though “fallen angels” will probably not.

Sub Investment Grade documents are different and have different objectives. The Investment Grade LMA documents are endorsed by the British Bankers Association and the Association of Corporate Treasurers and the Sub Investment Grade are not. The ACT publishes borrowers’ guides<sup>3</sup> to each set of documents, each guide running to several hundred pages.

The LMA documents are frameworks and not complete in themselves. Some of the most important matters to be dealt with in an agreement are referred to in the LMA framework with alternatives or, often, only with empty square brackets. This is because of the need for customisation case by case. Some banks will have their own modified and completed agreements which they use as a starting point for discussion with borrowers and which they probably call “LMA compliant” and which they impose on weak borrowers. Higher grade borrowers will have their own versions too. A large company will not want to tolerate differing terms loan by loan as it makes record keeping and compliance over complicated and so it will not consider banks’ drafts as a starting point. Compromise is reached in mid-tier companies. The “LMA standard” provides “boiler plate” for the mechanics of a loan and a framework for the rest of the agreement enabling experienced readers to find their way around the document rather than providing uniform content. It is important to note that the principles of LMA documentation are that of codification of market current best practice and LMA documentation is not a medium for changing practice.

As signatories, the ACT encourages use of the LMA framework.

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<sup>3</sup> Available from the ACT website at <http://www.treasurers.org/loandocumentation> (registration required)

## The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for international treasury, providing the widest scope of benchmark qualifications and continuing development through training, conferences and publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at <http://www.treasurers.org/technical/resources/manifestoMay2007.pdf>.

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