YOUR LENDERS: DO YOU CARE?

MARK DALEY OF BERWIN LEIGHTON PAISNER EXPLORES SOME OF THE ARGUMENTS CONCERNING FREE ASSIGNABILITY IN THE SYNDICATED LOAN MARKET.

The Loan Market Association (LMA) published a paper in June 2001 on loan transferability. As one might expect from an organisation representing banks, it favours banks having a high degree of freedom to transfer their loans with the borrower having only limited ability to veto a transfer.

The advantages for banks of having free assignability do not need to be spelt out. The LMA's view is that maximising liquidity is in the interests of borrowers, because liquidity makes for a larger pool of credit and it would follow that raising loan capital without freedom to transfer could be more difficult or more costly. All of which may be unarguable at the macro level, but may not be persuasive when applied to an individual borrower. Some treasurers who choose to raise money in the syndicated loan market (the paper is aimed principally at syndicated loans) rather than the bond markets may regard controls on assignability as outweighing possible disadvantages in terms of cost or availability. This article sets out to explore some of the arguments concerning free assignability.

THE LMA'S VIEW. The LMA's position is that a borrower's consent should not be unreasonably withheld, and that it should not be needed at all for loan assignments where:

- the borrower is in default;
- the facility is fully drawn;
- the transfer is to an affiliate of the transferring bank; or
- the facility is a large syndicated loan for a specific purpose, for example, acquisition finance (referred to in the LMA paper as 'event-driven situational financings').

The LMA recognises borrowers' concerns that transfers to non-banks might have withholding tax and therefore grossing up consequences, and that borrowers may legitimately protect themselves by restricting grossing up – rather than assignments – to 'qualifying lenders' or 'recognised banks'.

This begs several questions, but this article concentrates only on two: what does 'not to be unreasonably withheld' mean in this context; and why might treasurers be concerned about the make up of a banking syndicate once the loan is full drawn? A borrower might be concerned about the identity of a transferee because of unease that if, in the future, the borrower needs to request an amendment or waiver, it could be faced with a syndicate made up of lenders which it does not know and which have no predisposition to be accommodating. The concerns may be based on past experience of a particular bank, or a view that non-banks, or banks which have not been with you from the start, might be less accommodating or will need more persuasion of the merits of that entirely reasonable waiver request you think might be necessary if things do not go as well as hoped. Can you rely on 'not to be unreasonably withheld', or should you insist on an absolute power of veto?

WITHHOLDING CONSENT. 'Not to be unreasonably withheld' is one of those imprecise phrases often used as a compromise in negotiations. As lawyers are fond of saying, it depends on all the circumstances, and it is a question of fact. One can imagine cases where a refusal might clearly be reasonable or unreasonable, but that leaves a large grey area where the only certain outcome is that you will probably get into an argument about what it means. There are some reported cases about this, usually in the context of landlords wishing to refuse consent to a tenant assigning a lease, and a useful (but unreported) Court of Appeal decision concerning the demerger of British Gas in 1986, from which limited guidance can probably be drawn – up to a point.

If your facility is not fully drawn and you have reasonable grounds for concern that a potential transferee might not be able to honour a drawdown request, your refusal would almost certainly be reasonable. Having said that, the nature of bank collapses is that, like an old table leg which looks solid but has been hollowed out by woodworm, you may well not be able to have reasonable grounds in advance of the collapse itself; after which the transfer is not going to happen anyway.

If your concern is simply unease about the possible behaviour in the future of a transferee in relation to a request for a waiver which might never be made concerning a state of affairs which does not yet exist, then the prospect of your being able to refuse with confidence that a court would vindicate your actions as reasonable is remote. If you regard this as a serious issue, then you cannot rely

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on the words 'not to be unreasonably withheld', and the only safe course is to insist on an outright veto. As a broad proposition, the law, such as it is, probably takes the view that if a transferee cannot reasonably be expected to perform its contractual obligations, an objection would be reasonable; otherwise, it probably would not.

RELATIONSHIPS. This begs the question: how important is this in the overall context? The context being the negotiation of a loan document where this is unlikely to be the only issue on your list. After all, relationships tend to be good when a borrower is in good shape, and deteriorate if it ceases to be. Even that good personal relationship you have with your relationship officer will mean little once your credit score with the banks drops below a certain level; then the limits of the relationship officer's authority will become more apparent, and credit committees and even 'special situations' officers will have a more active and obvious role. So even if the lender of record remains the same, if things get sticky, the behaviour of that lender will not.

There is, of course, the argument that a bank coming in at a time when there are problems, and which has bought the debt at a discount, might be more accommodating. Tying in the original banks probably makes it somewhat easier to explain a situation – you do not have to start from scratch – but in reality does this have more than marginal significance? A reluctant syndicate member which is tied in because you refuse consent to a transfer could be a thorn in your side. And, of course, the market in silent sub-participations has been active in London for at least 20 years, and if you refuse consent to a bank assigning, it can achieve the commercial effect of an assignment (including for bank regulatory purposes) through a silent sub-participation or credit derivative. The sub-participant may remain behind the scenes, but if the original bank has become a front for a sub-participant and has no remaining commercial interest of its own, are you better or worse off than if you have the sub-participant up-front as an assignee?

In the recession of the early 1990s the issue of trading distressed companies' debt became a hot topic, particularly in the context of the Bank of England's London Approach rules to dealing with companies in difficulty. My experience was that debt trading occurred (often by silent sub-participation) on a large scale, and I could not say that borrowers would clearly have been in a better position, or treated more leniently, if it had not occurred; it would be interesting to know if any readers had different experiences (readers can email the editor of *The Treasurer* at mhenigan@treasurers.co.uk or fax 020 7248 2591).

In many cases one can question how valuable it is to maintain control of the identity of a syndicate once the loan is fully drawn. I suspect it is unlikely to top many lists of 'must-have' points, and the identity of the agent bank probably counts for a lot more in most cases. If it is an issue for you, however, then the time to raise the point is when the mandate letter and draft term sheet are being discussed, because if the term sheet addresses the issue in detail, you would only be able to negotiate it later on by going back on the signed term sheet.

The trading of bilateral loans is unlikely, and the most likely cases where a transfer would occur would be a transfer to an affiliate as part of a bank reorganisation, perhaps after a merger, or the securitisation of the bank's commercial loans, in which case the bank would continue to administer the loan in any event. In both these cases, the relationship issue is unlikely to arise.

CONFIDENTIALITY. Hand in hand with debt trading and post-signing syndication is the issue of confidentiality. The LMA recognises that borrowers will at least want the potential buyer to sign a confidentiality letter addressed to the seller and the borrower, and such a letter will provide a degree of comfort, although a well-drafted letter will contain a number of exceptions which will permit disclosure, and of course tracing a leak (if someone breaches the terms of the letter) may often be impossible in any event.

TRUST. The LMA suggests that "in an environment where there are many methods of transferring risk, relationships should be based on mutual trust rather than on specific documentary provisions". Most treasurers probably adopt this attitude as a practical matter in any event, although one might wonder whether, with ever-lengthening loan agreements, this is sauce for the goose but not for the gander.

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