

Loan Documentation

Changes in our changing world

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1. Introduction

- 1.1 Thus far, 2013 has been an interesting year in the debt markets in New Zealand. The market has been characterised with refinancings and bolt-on acquisitions, with a relative paucity of new syndicated loans written. Internationally, the US is fighting to come out of recession whilst growth in Europe and the UK has been tepid. The spectre of the dissolution of the Euro appears to have receded, for the moment at least. The US Term Loan B market has, however, proved very strong and that has impacted the transaction flow in both Australia and New Zealand. Borrowers who would have historically tapped local markets have instead opted for covenant-lite 7-year US money. Over recent years a number of innovations in loan documentation have been driven by the Global Financial Crisis (**GFC**) and international regulatory change.

2. Response to GFC

The GFC was characterised by bank failures, debt buybacks and the threat of the Eurozone break up. In the London banking market this resulted in loan documentation refinements for both leveraged and investment grade credits. New Zealand has not experienced directly many of these issues. Hence although some of the refinements have been adopted, there has not been a wholesale adoption of the LMA concepts in New Zealand.

Issues addressed in Europe include:

2.1 Insolvent Lenders/Agent

- (a) *Defaulting Lender/Non-Acceptable L/C Lender – how to fund a working capital line?*
- (i) What happens when a lender (particularly of a revolving credit facility) or a syndicate fronting lender for letter of credit/bank guarantee issuance becomes insolvent? Although an insolvent bank would not be able to fund, loan agreements traditionally did not address this situation.

Under the post-2009 changes to the London LMA form of leveraged loan agreement (**LMA Leveraged Facilities Agreement**) a number of specific rights were activated once a lender became a "Defaulting Lender". The defaulting lender definition means any lender (other than a lender that is a sponsor affiliate) that:

- (aa) has failed to make its participation in a loan available or notifies the agent that it will fail to make its participation available;
- (bb) has failed to provide cash collateral or has notified the agent that it will not provide cash collateral;
- (cc) has rescinded or repudiated a finance document;
- (dd) is a fronting bank that either fails to issue or pay a claim in respect of a letter of credit or has notified the agent that it will not issue or pay a claim in respect of a letter of credit; or
- (ee) is subject to an insolvency event.

The defaulting lender definition is therefore wider than pure insolvency-related events. However, from a practical perspective insolvency is likely to be the most

significant issue. It does not include a cross-default concept (so a default under another facility by a lender does not mean it is a defaulting lender). It also does not include affiliates.

A borrower's rights include cancellation of any available facility. A borrower can also effect a total or partial replacement of the defaulting lender at or below par through the increase of commitments by new or existing lenders or an option for any revolving facility loans made by a defaulting lender to term out.

In more recent amendments to the form of LMA Leveraged Facilities Agreement, if a lender believes that any entity is or may be a lender and that entity has (i) ceased to have an investment grade rating or (ii) an insolvency event has occurred in relation to that entity, the agent is obliged (if requested) to indicate to the relevant lender the extent to which the entity has a commitment. This recognises the impact on other syndicate members of a defaulting lender.

Provision is also made for an issuing bank that has issued letters of credit or bank guarantees to take action where it is indemnified by a non-acceptable L/C lender. This concept is wider than the definition of defaulting lender. The issuing bank may request that a non-acceptable L/C lender cash collateralises its portion of the outstanding amount of a letter of credit issued by that issuing bank.

Should the non-acceptable L/C lender fail to provide the cash collateral, the borrower may opt to provide cash cover or the issuing bank can instead require it from the borrower which can fund it out of a revolving facility loan. If no cash cover is provided, the issuing bank may reduce the amount of any letter of credit requested on the utilisation date.

- (ii) The 16 April 2013 revision of the APLMA Secured Term and Multicurrency revolving Syndicated Facility Agreements (**APLMA Facilities Agreement**) does not explicitly adopt the defaulting lender/non-acceptable L/C lender concepts. It does, however, include a concept of impossibility resulting from a change in law or regulation in the illegality prepayment event. This falls well short of the LMA concept. The APLMA Facilities Agreement does include a voluntary cancellation right for any available facility; however, this must reduce the commitments of lenders rateably under the facility and the right of repayment and cancellation of a single lender provision only applies in the traditional circumstances where a payment has been required under the gross-up, tax indemnity or increased costs provision. The APLMA documentation committee are, however, currently considering a revised draft of the APLMA investment grade multicurrency term and revolving facilities agreement (**Proposed APLMA Facilities Agreement**) that includes a defaulting finance party concept covering any finance party (so would include agents and fronting banks as well as lenders) and is broadly similar to the LMA Facilities Agreement approach and includes non-payment under the loan document, recession or repudiation or actual insolvency.
- (iii) APLMA has not released a proposed New Zealand form of syndicated facilities agreement. As a result, the market operates differently with each law firm maintaining its own precedents and each lender also developing its own precedent provisions. An informal survey of syndicated loan agreements drafted by the leading New Zealand law firms over the last year and discussions with market participants (**NZ Syndicated Loan Facilities**) does not reveal explicit provisions that address the defaulting lender/non-acceptable L/C lender issue.

A number of market participants however include very broad impossibility provisions that exonerate the relevant lender from any liability for any circumstance outside of their control. In all of these agreements, everything

turns on the precise drafting of the clause; however, in an insolvency this type of provision would arguably not afford the relevant lender protection (particularly if the relevant Lender put itself into an insolvency procedure).

(b) *Impaired Agent – administration, payments and communication*

Administration

- (i) Similar issues arise when an agent defaults on payment or becomes insolvent. The LMA has therefore adopted an “Impaired Agent” concept and refined the mechanics for addressing a change of agent. Given the role of the agent is so pivotal in the mechanics of a syndicated facilities agreement, and particularly in relation to administration of drawings and payments, the spectre of insolvent agents gave rise to concern and amendment to the LMA Leveraged Facilities Agreement.

Historically, loan agreements catered for the resignation of an agent. The LMA Leveraged Facilities Agreement also provides that following consultation and on 30 days notice, the majority lenders may replace the existing agent and appoint a new agent.

Where the agent is an impaired agent, that 30 day time period can be reduced. This empowers the majority lenders to replace the agent quickly if it becomes an impaired agent.

- (ii) Under clause 27.11 of the APLMA Facilities Agreement, the agent has a right to resign, but there is no mechanic to address the position where the Lenders wish to change the agent (for any reason whatsoever). In the proposed APLMA Facilities Agreement, clause 27.11 is more consistent with the LMA position.
- (iii) In contrast, although the New Zealand market does not appear to have embraced the impaired agent concept, all major firms typically include both a right of resignation for the incumbent agent and a right for the majority lenders to replace the incumbent agent on approximately 30 days notice. Therefore, although the New Zealand documents do not enable the majority lenders to move more quickly without obtaining all party consent, there is generally a mechanism to enable the lenders to remove an impaired agent.

Payments

- (i) During the period prior to replacement of an impaired agent, payment mechanics will be effected. The traditional payments provision generally set the default position for payments under a loan agreement as being directed through the agent – so both obligors and lenders make virtually all payments through the agent. The LMA included a provision enabling both obligors and lenders to make payments direct (or in certain circumstances place amounts on deposit in order to facilitate payments under the loan agreement when the agent is insolvent).

More recent changes to the LMA Leveraged Facilities Agreement have addressed the practicalities on the borrower side of making those payments by requiring the agent to provide the parent with a list of lenders and their commitments, either monthly or on demand (but not more frequently than monthly). Market participants in the UK acknowledged that it was undesirable for payments under a loan agreement to be inadvertently impacted by the insolvency of an agent.

- (ii) Under the APLMA Facilities Agreement, fee payments are made in accordance with the fee letter and all other payments are made to the agent (save where

security has become enforceable and the security trustee requires payment to be made to them).

The sharing provisions of the APLMA Facilities Agreement further provide that any payment not made in accordance with the payments provisions must be assessed by the agent and, if necessary, payment must be made through the agent. Hence, there was a specific regime for specified matters (such as fees), but the default position is for payment via the agent. If the agent is unable to perform its usual functions, this mechanic would be unworkable.

The APLMA documentation committee are considering adopting the LMA approach to payments under the Proposed APLMA Facilities Agreement. Where the agent becomes a defaulting finance party, the LMA approach has been broadly adopted. As the payments provision would cater for the impaired agent scenario, the sharing provisions are less of an issue. However, it is notable that the partial payments provisions only relate to the agent and do not extend to any by-passing payments.

- (iii) In the NZ Syndicated Loan Facilities, three approaches were taken:
- (aa) Payments are made through the agent with exclusions for specific matters such as fees or hedging (very similar to the APLMA position);
 - (bb) Payments are paid to or to the order of the security trustee but with consent to payments being made to the agent with other specific exclusions for direct payments until the security became enforceable; or
 - (cc) Payments are to be made to the account of a lender which that lender has specified from time to time (or sometimes to the agent where applicable)

Of those three approaches, the second is legally the most protective of the finance parties' position as all amounts go into the security trust. Legally therefore, any amounts paid to the agent are still trust property, although there may be logistical issues clawing back any amounts paid to the agent after the onset of insolvency and prior to the security trustee providing a different direction. Also, to the extent the security trustee and agent are the same legal entity, significant practical issues may arise in the event of an insolvency notwithstanding the legal construct.

The last approach affords flexibility to avoid payments to the agent if necessary. It may well be that as a practical matter those transactions operate on a day-to-day basis so all payments are made through the agent. However, there is a clear ability to route the payments directly and avoid the practical issues raised by an agent insolvency without having to amend the relevant loan agreement.

None of the NZ Syndicated Loan Facilities contained information provisions akin to those adopted by the LMA regarding identity of lenders; however, given that the banking syndicates are generally much more closely held this is likely to cause an issue only on the very largest transactions.

It is notable that the sharing provisions of the NZ Syndicated Loan Facilities often operate to limit an individual lender's recoveries. For example, some market participants permit a lender to receive repayments of principal or amounts distributed by the agent, whilst other market participants adopt a proportional approach (i.e. a lender should not receive more than its proportionate share of any amount paid) and yet others require all payments to go through the agent unless expressly permitted. The interaction of these

provisions with the payments provisions may benefit from some adjustment to ensure they operate harmoniously together.

None of the NZ Syndicated Facilities provide for direct communication between borrower and lenders where there is an impaired agent, as the LMA does. However, query whether this is really necessary, particularly given that the New Zealand market is much more relationship-driven characterised by a take-and-hold model for lending rather than a distribution model.

2.2 Disruption to payment systems

- (a) Another issue that first arose as a consequence of 9/11, but was also brought into focus in the context of the GFC and the Eurozone Crisis, was what would happen if there was a material disruption to the payment or communications systems or the financial markets required to operate in order for payments to be made in connection with the facilities or the transactions contemplated by the loan documents. The LMA therefore included an optional provision to allow the agent and the borrower to consult and agree changes to the operation and administration of the facilities as the agent deems necessary in the circumstances. Those changes would be binding on all the parties to the loan agreement.
- (b) There is no corresponding provision contained in the ALPMA Facilities Agreement. The illegality mandatory prepayment event has been expanded to include impossibility as a result of a change in law or regulation. This may, but does not necessarily, cover disruption to payment systems or financial markets. Under the Proposed APLMA Facilities Agreement, a very similar provision to the LMA Facilities Agreement clause has been included as an optional provision.
- (c) The NZ Syndicated Loan Facilities do not contain equivalent provisions. There are, however, provisions contained in many New Zealand loan agreements that are worth considering. For example, some market participants include an impossibility provision that protects the agents and lenders if they fail to comply with any obligations – some restrict this protection to “circumstances affecting any relevant interbank market generally”, whilst others refer to governmental/local authority action, a change of law or “other circumstances affecting the relevant funding markets generally or the availability of finance to lending institutions in those markets generally” or “any other cause which is beyond its control”.

In some transactions these provisions are carved back so that the relevant agent/lender is obliged to take reasonable steps to continue to perform its obligations under the finance documents once the relevant event has ceased and also to clarify that, for example, a lender cannot decline to perform its obligations by reason of the imposition of increased costs. Furthermore, whilst these provisions afford lenders varying degrees of protection, they do not provide a mechanism within the loan agreement to practically address this kind of issue. In New Zealand, banking syndicates tend to be more relationship driven than some of those seen in the European or US market, so reaching agreement or varying terms may be less of a logistical issue.

Another approach has been to expand the illegality prepayment event to include impossibility as a result of (i) a change in law or regulation or (ii) circumstances affecting the availability of finance (including, in particular, New Zealand Dollars) to lending institutions generally. An agreed period is provided for the agent and borrower to negotiate to determine whether there is a basis upon which another lender will assume the affected lender’s suspended rights. This approach has the virtue of enabling the borrower to attempt to replace the affected lender and continue with the facilities on foot. Although there is not an express mechanism to address the assumption of a commitment by a new lender, so long as the agent is still able to process transfers, the mechanic would work.

2.3 Eurozone crisis

In response to the threatened partial or total break-up of the euro, lawyers around the world looked more closely at the way their loan mechanics worked. An analysis of the issues demonstrated that documentary shortcomings may increase the redenomination risk.

- (a) The LMA Leveraged Facilities Agreement now defines euro as the currency of the participating member states (being any member state of the European Union that has euro as its lawful currency in accordance with relevant European legislation). In addition, there were adjustments to the payments provisions to enable the agent to specify the currency of payment. In addition, as the place of payment is considered to be a relevant factor in assessing the likelihood of redenomination, payments are due for payment at the time and in such funds specified by the agent as being customary at the time for settlement of transactions in the relevant currency in the place of payment. The place of payment for euro is a principal financial centre of the relevant participating member state or London. There has also been an expansion of the jurisdiction clauses with a view to increasing protection for lenders.
- (b) In Australia, although the APLMA Facilities Agreement does not make much specific provision for redenomination risk, the Proposed APLMA Facilities Agreement includes a definition euro as the currency of the member states of the European Union that continue to adopt the single currency in accordance with the EC Treaty. In addition, a very similar payments provision has been adopted to the LMA in relation to the currency of payments. However, the rules regarding place of payment allow a little more flexibility for euro than the LMA as it provides for a principal financial centre in a participating member state or London. The participating member state definition includes a continuity concept – that is, any member state that has adopted and continues to adopt euro as its lawful currency. Both formulations should be sufficient to move the place of payment from a departing member state. The Proposed APLMA Facilities Agreement, however, goes further than the LMA and includes an optional provision that enables the agent, following consultation with the borrower and the lenders, to notify the borrower of amendments which are required or reasonably desirable in the opinion of the agent by reason of the actual or threatened cessation of the issue of the euro, to effect a redenomination of any outstanding advance or commitment from euro into another (pre-agreed) currency.
- (c) In New Zealand, the spectre of the break-up of the euro does not appear to have concerned market participants too significantly. Although euro is often defined as a currency, the other innovations are not necessarily included. It appears that euro exposures are not sufficiently significant that market participants have been concerned to seek the Proposed APLMA Facilities Agreement across the board at this stage.

2.4 Floating rate benchmarks – where to next?

- (a) Interest rates in Europe and the US plummeted as central banks cut interest rates in the face of the GFC. In response many banks introduced a “LIBOR floor” for leveraged credits - it provides that if the relevant interest rate is less than zero, LIBOR shall be deemed to be zero. The concept was introduced to avoid negative interest rates.

Given interest rates in New Zealand have consistently remained at higher levels than those reached in Europe and the US, the “LIBOR floor” concept does not appear to have achieved much traction in New Zealand.

- (b) Whilst the historically low interest rates persisted, the LIBOR scandal broke undermining confidence in the benchmark estimated to underpin \$350 trillion in derivatives. There was widespread criticism during the 2007-2009 period that LIBOR rates did not accurately reflect lenders’ cost of funds. Now LIBOR has been withdrawn for a number of currencies (including New Zealand and Australian dollars) and there is

a real question mark over its future. Following the British government's statements that it intends to legislate to implement the recommendations from the Wheatley Report, it is clear that there will be changes to the operation of the benchmark.

In a separate note issued in April 2013, the LMA therefore proposed an amended definition of Screen Rate that refers to the rate administered by the British Bankers' Association (or any other person who takes over administration of that rate) for the relevant currency and period displayed on pages [x] and [y] of the Reuters screen (or any replacement Reuters page that displays that rate).

The amendment regarding a change of administration was not reflected in the APLMA Facilities Agreement; however, the Proposed APLMA Facilities Agreement does include both a floor of zero for LIBOR, EURIBOR and SIBOR and a reference to change of administration for LIBOR and EURIBOR.

In New Zealand, the local rate most commonly used is BKBM. The New Zealand Syndicated Facilities often refer to replacement pages on the relevant screen; however, the concept of replacement administration does not appear to be relevant as screen rate definitions tend to refer to the average bid rate.

- (c) In response to criticisms regarding the accuracy of LIBOR as a reflection of cost of funds, the LMA expanded the market disruption provisions in the LMA facilities documentation. LIBOR is defined by reference to either (i) a screen rate or a base reference bank rate. Should a screen rate be elected but be unavailable, there is an option for (ii) an interpolated screen rate (being the rate that results from interpolating on a straight line basis between the applicable screen rate for the longest period that is less than the relevant interest period for which a screen rate is available and the applicable screen rate for the shortest period which exceeds the relevant interest period for which a screen rate is available). If that is not available, (iii) a base reference bank rate. There is also the option for (iv) an alternative reference bank rate (intended to be an additional and larger group of lenders than the base reference banks) and, in the instance of an alternative market disruption event occurring in respect of alternative/reference banks, the (v) cost of funding notified by affected lender.

According to the Association of Corporate Treasurers, it is intended that the threshold percentage of lenders notifying the agent that their cost of funds exceeds the alternative reference bank rate will be higher to trigger an alternative market disruption event than is required to trigger a market disruption event.

In short, the new LMA provisions seek to provide more alternatives, before a lender can impose its actual cost of funds should reduce or delay the risk of this eventuality.

- (d) This approach is not reflected in the APLMA Facilities Agreement and does not appear to have gained much traction in New Zealand. In the New Zealand Syndicated Facilities, the approach seems to be the more traditional (i) screen rate, (ii) reference bank rate, (iii) cost of funding notified by affected lender. However, where borrowers request an interpolated screen rate, market participants have indicated a willingness to consider these proposals.

The Proposed APLMA Facilities Agreement has introduced a regime of (i) screen rate, (ii) interpolated screen rate, (iii) reference bank rate and (iv) cost of funding notified by affected lender.

2.5 Debt Buyback Restrictions

Optional debt buyback restrictions were introduced in the UK in response to private equity firms, in particular, buying up debt below par from their own borrowers using special purpose vehicles. Having the equity holders voting with and party to the discussions of the senior debt

holders, particularly in a distressed situation, can dramatically change the dynamic. The intent of the provisions was to either prohibit or provide a framework to permit the purchase of debt by the borrower or one of its affiliates.

It followed on from the 2006 UK court of appeal decision that in order 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 its place of creation and whose business concerns commercial finance". In particular, it was held that it was not necessary that the organisation's business include bank-like activities.

Although the LMA included suggested provisions for consideration, these types of provisions are often tailored. They range from a prohibition on purchasing the debt at all to disenfranchisement of the sponsor-related lender.

In the context of the New Zealand syndicated loan market, although these types of provisions may be negotiated in appropriate circumstances, it is not fair to say that they are standard. However, in transactions involving private equity sponsors there are sometimes included provisions disenfranchising sponsor affiliates who have purchased the debt directly or by virtue of a sub-participation. These may be based on the LMA wording.

It is interesting to note that the APLMA Facilities Agreement does not include any suggested debt buyback restrictions either. The Proposed APLMA Facilities Agreement does however include a debt buyback restriction that is based on the LMA but relates only to senior debt (with no option for subordinated debt – this may however be because it is an investment grade facilities agreement).

3. Response to regulatory change

In addition to the market response to the Lehmans collapse and the GFC, there has also been a regulatory response. Basel III is consistent in approach with Basel II but imposes more onerous capital requirements that are therefore more costly.

3.1 Basel III

There has been some discussion in the European loan market as to whether costs associated with Basel III will be included within the current wording of the LMA increased costs provision. The argument is that it will be the introduction of or any change in (or in the interpretation, administration or application of) any law or regulation. Although Basel III has not yet been implemented by legislation in the UK, the situation will be different once implemented.

It has conversely been argued that an increase in capital required as a result of Basel III will fall within the scope of the clause only to the extent it is attributable to the relevant finance party having entered into its commitment or funding or performing its obligations. It may be difficult for lenders to calculate in a sufficiently transparent manner the increased cost attributable to a particular loan.

Stronger borrowers like private equity houses that are repeat-participants have sought to expressly exclude this and also any costs arising out of the US Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, where US lenders have sought to reserve their position based on the approach of the LTSA Model Credit Agreement.

The APLMA Facilities Agreement indicates that, depending on the relevant timing, Basel III-type costs are intended to be caught within the scope of the provision. It expressly states that "This includes, without limitation, any law or regulation with regard to capital adequacy, prudential limits, liquidity, reserve assets or Tax." The Proposed APLMA Facilities Agreement however, includes a specific note that states that the provision is generally drafted widely with the intention of capturing Basel III. It goes on to recommend that, if Basel III is intended to be

included, there is extensive additional and specific drafting which is proposed to put the point beyond any doubt.

In New Zealand, approaches have varied. Some market participants have sought to include Basel-type changes by making specific reference to Basel II, Basel III or the "International Conveyance of Capital measurement and Standards" or by including a reference to capital maintenance or capital adequacy in the definition of "directive". Others have included reference to circumstances affecting the national or international funding markets generally or availability of finance to lending institutions in those markets generally. Although discussed in the course of negotiations, at this stage carve outs for Basel III in New Zealand seem to be rare. In relation to any new loan written since the beginning of 2013, this is likely to be to some extent academic as Basel III has already been implemented in New Zealand. However, for amendments of existing loan this remains a live issue and, of course, the future position as regards future increased capital requirements, will still fall to be determined under the increased costs provisions.

3.2 **FATCA**

The United States' Foreign Account Tax Compliance Act (**FATCA**) encourages foreign financial institutions to enter into agreements with the US Internal Revenue Service (**IRS**) that require such financial institutions to comply with onerous documentation, withholding and reporting requirements or be subject to a punitive withholding tax regime on US sourced income.

The extent to which FATCA will be relevant in a loan transaction is determined by:

- (a) the status of the parties as foreign financial institutions; and
- (b) whether any payments made in the transaction constitute US source income.

Depending on the precise drafting, we note that traditional gross-up clauses may not capture FATCA withholdings. Such clauses often apply to taxes that arise by operation of law and arguably would not extend to withholding required under a contractual arrangement with the IRS.

Currently, obligations under FATCA are scheduled to come into force on 1 July 2014 in New Zealand. New Zealand is currently in negotiations with the United States to enter an intergovernmental agreement (**IGA**) in relation to FATCA. It is hoped that the IGA will reduce the burden of FATCA for New Zealand financial institutions.

Anecdotal evidence indicates that the US loan market has generally allocated risk to the lenders on the basis that they are best placed to manage the application of FATCA. For example, under the Loans Syndication and Trading Association Loan Facilities FATCA withholding is specifically excluded from gross-up, and is at the risk of lenders.

The position is not so clear in the United Kingdom, where there has been concern regarding confidentiality and data protection rules. No specific provision has been adopted in the LMA Facilities Agreement. Instead the LMA has released a paper with three different FATCA riders that allocate risk to:

- (a) the borrower;
- (b) the lender where the loan will be grandfathered with an ability to the lender to veto changes that would result in the loan losing grandfathering; and
- (c) the lender.

The LMA guidance suggests that where financial institutions are not certain that they will be FATCA compliant they should allocate risk to the borrower. This is achieved by either requiring obligors to represent that they are compliant with FATCA or by requiring obligors to gross-up if FATCA withholding arises.

The Proposed APLMA Facilities Agreement includes an optional FATCA definition and additions to the gross up clause but cross refers to the LMA riders so does not reflect a settled position.

FATCA is currently being considered in the New Zealand market and no settled position has yet been reached in relation to it. Some syndicated agreements do however include FATCA representations from the borrower. Anecdotal evidence suggests that at this stage market participants have not been too concerned with this issue as they anticipate the IGA will be in place by the time the FATCA legislation comes into force.

3.3 AML/CFT requirements

The new anti-money laundering and countering the financing of terrorism (**AML**) regime introduced on 30 June 2013 in New Zealand has led to increased "know your customer", or KYC, requirements for lenders. This is sometimes referred to as CCD in the New Zealand context. The regime in New Zealand is similar to the UK but somewhat more onerous than Australia. For example, New Zealand largely already requires the enhancements raised in the May 2013 AUSTRAC Discussion Paper entitled "Consideration of possible enhancement to the requirements for customer due diligence".

- (a) The LMA Leveraged Facilities Agreement requires obligors to otherwise provide KYC information in any of three situations:
 - (i) a change in law or regulation or new law or regulation after signing;
 - (ii) a change in the status of an obligor or the composition of its shareholders after signing; or
 - (iii) a proposed assignment or transfer.

This obligation is limited in that a lender or prospective lender is entitled to request the information only where it is obliged by law or regulation to carry out KYC or similar identification checks. In addition, the information may only be requested in order for the lender to satisfy itself that it has complied with applicable law or regulation. The LMA Leveraged Facilities Agreement also includes an anti-corruption/bribery representation and general undertaking regarding use of proceeds and conduct of business.

We note that whilst the LMA Leveraged Facilities Agreement does not contain a condition precedent regarding KYC requirements, the inclusion of such a condition is usual in the European market.

- (b) In Australia, the APLMA Facilities Agreement does not limit the required supply of further KYC documentation or evidence to the specific situations set out in the LMA Leveraged Facilities Agreement. The introductory note specifically states that it does not include anti money laundering provisions as it is assumed they will be included in the security trust deed. The APLMA provisions instead broadly states that the borrower must promptly supply all documents and other evidence to carry out all necessary checks under all applicable laws and regulations. The provision otherwise includes the same limitations as set out in the LMA documentation.
- (c) In New Zealand, NZ Syndicated Loan Facilities contain provisions requiring obligors to provide information to the agent for the purpose of satisfying KYC requirements. No

one approach has yet been adopted. The LMA Leveraged Facilities Agreement KYC provision has been adopted in some instances.

Some NZ market participants have extended the obligation to provide information. Some NZ Syndicated Loan Facilities provisions require borrowers to furnish such information as is reasonably required by the lender to manage money-laundering, terrorism-financing or economic and trade sanction risk, or simply to comply with the lender's internal procedures. This is an extension of the power of a lender to request information. It may have been adopted as the New Zealand legislation was not in force at the time the relevant loan facilities were adopted (although equally the drafting did not carve the position back once the law came into force).

Other New Zealand market participants have also included provisions that allow lenders to delay, block or refuse to process any transaction without incurring any liability should the lender suspect that:

- (i) the transaction may breach any law or regulation;
- (ii) the transaction involves a person that is, or is directly or indirectly connected to a person, subject to sanctions;
- (iii) the transaction involves the proceeds of unlawful conduct.

Borrowers are also required to warrant that they are acting on their own behalf and to declare and undertake that they are not breaching any laws in entering the transaction.

The APLMA Proposed Facilities Agreement includes a similar provision that enables a finance party to delay, block or refuse to process any payment or other transaction without incurring any liability if the finance party knows or reasonably suspects that the transaction or the application of proceeds will:

- (i) breach or cause the finance party to breach any laws or regulations in any applicable jurisdiction (including any sanctions); or
- (ii) allow the imposition of any penalty on any finance party or its affiliates under any such law or regulation,

including where the transaction or the application of its proceeds involves any entity or activity the subject of any applicable sanctions of any jurisdiction binding on any finance party, or the direct or indirect proceeds of any unlawful activity.

In New Zealand, some market participants have also included further representations regarding compliance and activities, with an confirmation that the borrower will cooperate with any audit of any finance party and make its books and records available to the auditors of any finance party on request.

4. Personal Property Securities legislation

Although the Personal Property Securities Act 1999 (NZ) came into force on 1 May 2002, the Australian federal legislation only came into force on 30 January 2012. Although the Australian legislation is substantially similar to the New Zealand position, there are some important differences and additional details. It will therefore be interesting to see how influential New Zealand jurisprudence in this area will be to the evolution of Australian PPSA law. It is, however, interesting to note that *Maiden Civil (P & E)*, one of the first substantial Australian PPSA cases, drew heavily on NZ jurisprudence.

Some key differences include:

- under the Australian Act, leases of serial-numbered goods for 90 days or more are a PPS lease, whereas in New Zealand the lease must be for more than one year;
- there are wider categories of serial-numbered goods in Australia. Watercraft and certain IP (including trademarks) are included;
- under the Australian legislation a creditor claiming a PMSI must record on the financing statement that the interest is a PMSI in order to obtain super priority over a first-in-time GSA. Conversely, if the financing statement erroneously indicates that a security interest is a PMSI, the financing statement will be ineffective and the security interest will be unperfected;
- unperfected security interests do not survive insolvency in Australia – there are very limited exceptions (e.g. some deemed security interests and some turnover trusts). In New Zealand unperfected security interests are effective in an insolvency. Lack of registration impacts priority rather than the validity of the security interest;
- the Australian legislation introduces a new form of perfection (control) that applies to a limited class of property (principally “financial” property) and gives super priority (even over a PMSI);
- the Australian PPSA requires a reasonable belief about the future existence of a security interest before a financing statement may be registered. This is not a feature of the NZ PPSA. The Australian approach may create issues if a security interest will only arise on the occurrence of an uncertain (or unlikely) contingent event, such as a default under a contract;
- turnover trusts constitute security interests under the Australian Act whereas in New Zealand the interpretation adopted by many market participants is that turnover trusts do not constitute security interest;
- the Australian transitional period of two years is still on-going. This means that it still is not yet possible to establish how many deemed security interest holders have adopted the PPSA as part of their business process. For example, a lessee still does not have to perfect their security interest for another few months.

5. **General market developments**

There are a number of additional innovations that have been adopted in the context of syndicated facilities in the European market that are worthy of note:

5.1 **Facility change/structural adjustment provisions**

- (a) On transactions involving large syndicates the traditional LMA lender consent distinction between unanimous, super-majority and majority lender decisions was demonstrated to be too inflexible in the context of debt restructurings for the larger borrowers. As a result, there were some transactions in the market that had used the traditional LMA formulation when liquidity was good and subsequently adopted debt exchange structures in order to refinance part of their senior debt requirements when market conditions deteriorated. Responding to the market the LMA then moved to include an optional structural adjustment provision that allowed for:
 - (i) the introduction of a new tranche;
 - (ii) an increase in the amount of any existing tranche;

- (iii) an extension of the availability period for the revolving facility;
- (iv) an extension of the date of payment of any amount under the finance documents;
- (v) a reduction in the margin or a reduction in the amount of any payment of principal, interest, fees or commission payable,

with the consent of either the super-majority lenders or the majority lenders, the affected lenders and the parent. A distinction was drawn between major and minor structural adjustments. In market transactions it was however more usual to see majority lender plus affected lender consent thresholds applying.

- (b) The APLMA Facilities Agreement does not include an optional structural adjustment provision. However, the Proposed APLMA Facilities Agreement, whilst still not providing for structural adjustment, allows for one lender to split its vote such that only a proportion of its commitment is voted and the remainder is subject to the snooze or lose provision.
- (c) In New Zealand, many of the syndicated facilities are sufficiently small that the parties have not considered it necessary to adopt this type of provision. On some of the larger syndicated facilities, variants on the structural adjustment concept have been adopted. The super-majority consent (usually 90 per cent.) threshold for release of transaction security does not however appear to have been adopted.

5.2 **Yank the bank for non-consenting lenders/Snooze or lose**

- (a) Associated refinements were the ability of the borrower to buy out or force a transfer of commitments for any lender that did not consent in circumstances where the super majority lenders or (as applicable) a specified majority of the lenders) did consent. In addition, any lender that did not respond within an agreed period of a consent request would not be counted for the purposes of assessing whether the requisite majority of lenders had consented.
- (b) Neither the APLMA Facilities Agreement nor many syndicated facilities in the New Zealand market include either of these refinements. However, the Proposed APLMA Facilities Agreement includes an optional snooze or lose provision. Some market feedback in New Zealand indicates a willingness to adopt the approach in larger syndicates for majority lender decisions but a reluctance to adopt it for unanimous decisions.

5.3 **Equity cure – financial covenant breach**

Another area in which borrowers, particularly in highly leveraged transactions, have pushed for accommodation is in relation to curing financial covenant breaches. The GFC clearly demonstrated that financial covenant breach was the main issue for companies as they traded down.

This is an area where general market precedent documents do not necessarily assist as deals are very specifically negotiated. Strong financial sponsors in the Europe looked to achieve “house” positions that were agreed by regular lending counterparts. Lenders who wanted a proportion of their business were forced to agree terms or face exclusion from the relevant syndicate.

In New Zealand, these types of terms are also very specifically negotiated. It is probably not fair to say they are agreed across the market but are bespoke arrangements negotiated in specific contexts. Concepts like cure of financial covenant breach in a preceding period as a

result of compliance in the immediately following period are relatively rare. Market participants indicate a willingness to consider equity cures where there is a reduction in debt, the cure is applied a limited number of times over the life of the facilities (generally three) and not in consecutive periods.

6. **Conclusion**

The Proposed APLAMA Facilities Agreement indicates a trend in the Australian market towards the LMA approach. Looking forward, it will be interesting to see if the New Zealand market follows suit. Discussions with market participants in New Zealand highlight the following issues:

- borrowers are not necessarily prepared to pay to include terms that cover eventualities they consider to be remote;
- generally, the market is very relationship rather than distribution driven and syndicates tend to be smaller. The market is characterised by more take-and-hold positions operated on a club basis; and
- as there have been relatively few new money transactions means that it is difficult to accurately identify trends.

It is therefore incumbent on individual lenders and borrowers to decide which provisions they wish to pursue on a case by case basis.