

CURRENT ASPECTS OF UNSECURED LENDING
SUBORDINATION

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I have views on this but I am not sure that they are very helpful. I have struggled with subordination, we all have in London. Our analysis of the law is really word for word what you have heard people speaking about here. When the last remark was made that the flawed asset theory probably works well we really think that it does work, but basically we are all saying the same thing. But I find the whole thing a complete pain and where the pain is I will leave you to decide. But it is really a pain.

Over the years I have talked to my colleagues who devote their lives to thinking of these things and I say "Can I use contractual subordination". "Good go, no" they say "no, no, you must follow the trust route. We are very worried about the contractual subordination".

So a year later I go back to him and say "I have just done the most marvellous contractual subordination you would be proud of me". "My god" he said "you are not still using that. No, no, everybody is into the trust route now. No it is all trusts". We have gone backwards and forwards and now we are into flawed assets and I think the whole thing is a real bore because I can think of no reason why the law should not enable us to achieve subordination simply.

I think it was Maurice Cashmere who said that we will ignore the American experience for the purpose of this discussion because it does not help us. That is quite true. But the fact is that they do it without all this agony and they seem to have survived somehow. You need only look at the classic kind of projects financed to realise that subordination is vital to sensible lending where you want to regulate priorities between unsecured creditors. Public policy operates simply because the legislators in their wisdom or ignorance have more likely laid down that all unsecured creditors have to be paid out *pari passu* and we are struggling with those rules. But I cannot think of any public policy beyond that rule.

I do not see how it is wicked to subordinate capital. Everybody does it now through one of these ingenious routes. All the

capital market work involving banks invariably involves subordination of some kind. So the sooner the legislators here and everywhere else get on to it with a short statute saying: "Whereas in the past an enormous amount of legal ingenuity has gone into the subordination question, and whereas the last time we legislators had a go at it we made a complete 'muck' of it, and whereas it is about time to get it right, now we hereby declare that subordination is alright." I do not see there are great problems in having to have registers of degrees of priority if that is the right word for subordination, because the basic principle is, and should be, that any creditor who becomes a creditor lends money is "senior". You can only become subordinate through your own voluntary act and if you have lent money to a company and find that unknown to you there are some subordinating creditors - that is great! Have a party! So I think the whole thing is a nonsense but it certainly exists.