



GUIDE TO SYNDICATED LOANS

CONTENTS

Clause	Page
1. Introduction	1
2. Types Of Facility Commonly Syndicated.....	1
3. Parties To A Syndicated Loan.....	2
4. Documentation For A Syndicated Loan.....	4
5. Timing	5
6. Syndication Loan Transfers.....	5

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1. INTRODUCTION

Borrowing by way of a loan facility can provide a borrower with a flexible and efficient source of funding. If a borrower requires a large or sophisticated facility or multiple types of facility this is commonly provided by a group of lenders known as a syndicate under a syndicated loan agreement. A syndicated loan agreement simplifies the borrowing process as the borrower uses one agreement covering the whole group of banks and different types of facility rather than entering into a series of separate bilateral loans, each with different terms and conditions.

The purpose of this note is to provide guidance on various aspects of a syndicated loan transaction, focusing on the following:

- (i) the types of borrowing facilities commonly seen in a syndicated loan agreement;
- (ii) a description of the parties to a syndicated loan agreement and an explanation of their role;
- (iii) a brief explanation of the documentation entered into by the parties;
- (iv) the time line for a typical syndicated loan transaction; and
- (v) a description of the common methods used by lenders to transfer syndicated loan participations.

The guidance in this note is given on the basis of a typical syndicated loan transaction undertaken in the European loan market as envisaged in the LMA Primary Loan documents and governed by the laws of England. This note is not intended to provide a detailed explanation of the provisions of the LMA Primary Loan Agreements - guidance on this is set out in the "Users Guide to the Recommended Form of Primary Documents" published by the LMA and available to LMA members on the LMA website.

2. TYPES OF FACILITY COMMONLY SYNDICATED

Two types of loan facility are commonly syndicated: term loan facilities and revolving loan facilities.

- 2.1 **Term Loan Facility** : Under a term loan facility the lenders provide a specified capital sum over a set period of time, known as the "term". Typically, the borrower is allowed a short period after executing the loan (the "availability" or "commitment" period), during which time it can draw loans up to a specified maximum facility limit. Repayment may be in instalments (in which case the facility is commonly described as "amortising") or there may be one payment at the end of the facility (in which case the facility is commonly described as having "bullet" repayment terms). Once a term loan has been repaid by the borrower, it cannot be re-drawn.

- 2.2 **Revolving Loan Facility:** A revolving loan facility provides a borrower with a maximum aggregate amount of capital, available over a specified period of time. However, unlike a term loan, the revolving loan facility allows the borrower to drawdown, repay and re-draw loans advanced to it of the available capital during the term of the facility. Each loan is borrowed for a set period of time, usually one, three or six months, after which time it is technically repayable. Repayment of a revolving loan is achieved either by scheduled reductions in the total amount of the facility over time, or by all outstanding loans being repaid on the date of termination. A revolving loan made to refinance another revolving loan which matures on the same date as the drawing of the second revolving loan is known as a "rollover loan", if made in the same currency and drawn by the same borrower as the first revolving loan. The conditions to be satisfied for drawing a rollover loan are typically less onerous than for other loans.

A revolving loan facility is a particularly flexible financing tool as it may be drawn by a borrower by way of straightforward loans, but it is also possible to incorporate different types of financial accommodation within it - for example, it is possible to incorporate a letter of credit facility, swingline facility or overdraft facility within the terms of a revolving credit facility. This is often achieved by creating a sublimit within the overall revolving facility, allowing a certain amount of the lenders' commitment to be drawn in the form of these different facilities.

- 2.3 **General:** Syndicated loan agreements may contain only a term or revolving facility or they can contain a combination of both or several of each type (for example, multiple term loans in different currencies and with different maturity profiles are not uncommon). There can be one borrower or a group of borrowers with provision allowing for the accession of new borrowers under certain circumstances from time to time. The facility may include a guarantor or guarantors and again provisions may be incorporated allowing for additional guarantors to accede to the agreement.

3. **PARTIES TO A SYNDICATED LOAN**

The syndication process is initiated by the *borrower*, who appoints a lender through the grant of a mandate to act as the *Arranger* (also often called a *Mandated Lead Arranger*) on the deal. There is often more than one Arranger on any transaction but for the purposes of this note we will refer to this role in the singular.

The Arranger is responsible for advising the borrower as to the type of facilities it requires and then negotiating the broad terms of those facilities. By the very nature of this appointment, it is likely that the Arranger will be a lender with which the borrower already has an established relationship, although it does not have to be. At the same time the Arranger is negotiating the terms of the proposed facility, one of the Arrangers appointed by the Borrower to act as *Bookrunner* also starts to put together a syndicate of banks to provide that facility.

Syndication is often done in stages, with an initial group of lenders agreeing to provide a share of the facility. This group of lenders is often referred to as *Co-Arranger*,

although other titles may be used - however, we shall continue to refer to this group of lenders as Co-Arrangers for the purposes of this note. The Co-Arrangers then find more lenders to participate in the facility, who agree to take a share of the Co-Arrangers' commitment.

To facilitate the process of administering the loan on a daily basis, one bank from the syndicate is appointed as *Agent*. The Agent who is appointed acts as the agent of the lenders not of the borrower and has a number of important functions:

- *Point of Contact*: (maintaining contact with the borrower and representing the views of the syndicate)
- *Monitor*: (monitoring the compliance of the borrower with certain terms of the facility)
- *Postman and Record-keeper*: (it is the agent to whom the borrower is usually required to give notices)
- *Paying Agent*: (the borrower makes all payments of interest and repayments of principal and any other payments required under the Loan Agreement to the Agent. The Agent passes these monies back to the banks to whom they are due. Similarly the banks advance funds to the borrower through the Agent).

The terms of a syndicated loan agreement empower the Agent to undertake the roles described above in return for a fee. Any decisions of a material nature (for example, the granting of a waiver) must usually be taken by a majority, if not by the whole syndicate. Whilst the Agent carries the standard duties and responsibilities of any agent under English Law, the facility agreement will contain a number of exculpatory provisions to limit the scope of the Agent's relationship with the syndicate lenders and with the borrower.

If the syndicated loan is to be secured, a lender from the syndicate is usually appointed to act as *Security Trustee* to hold the security on trust for the benefit of all the lenders. The duties imposed upon the Security Trustee are typically more extensive than those of an agent.

In large syndicates, it is sometimes decided that some decision making power should be delegated to the majority from time to time (often referred to as the 'majority lenders' or 'instructing group'). This group usually consists of members of the syndicate at the relevant time that hold a specified percentage of the total commitments under the facility. By delegating some of the decision-making, the mechanics of the loan are able to work more effectively than if each and every member of the syndicate had to be consulted and subsequently reach unanimous agreement on every request from the borrower.

4. **DOCUMENTATION FOR A SYNDICATED LOAN**

- 4.1 **Mandate Letter:** The borrower appoints the Arranger via a Mandate Letter (sometimes also called a Commitment Letter). The content of the Mandate Letter varies according to whether the Arranger is mandated to use its "best efforts" to arrange the required facility or if the Arranger is agreeing to "underwrite" the required facility. The provisions commonly covered in a Mandate Letter include:
- (i) an agreement to "underwrite" or use "best efforts to arrange";
 - (ii) titles of the arrangers, commitment amounts, exclusivity provisions;
 - (iii) conditions to lenders' obligations;
 - (iv) syndication issues (including preparation of an information memorandum, presentations to potential lenders, clear market provisions, market flex provisions and syndication strategy); and
 - (v) costs cover and indemnity clauses.
- 4.2 **Term Sheet:** The Mandate Letter will usually be signed with a Term Sheet attached to it. The Term Sheet is used to set out the terms of the proposed financing prior to full documentation. It sets out the parties involved, their expected roles and many key commercial terms (for example, the type of facilities, the facility amounts, the pricing, the term of the loan and the covenant package that will be put in place).
- 4.3 **Information Memorandum:** Typically prepared by both the Arranger and the borrower and sent out by the Arranger to potential syndicate members. The Arranger assists the borrower in writing the information memorandum on the basis of information provided by the borrower during the due diligence process. It contains a commercial description of the borrower's business, management and accounts, as well as the details of the proposed loan facilities being given.

It is not a public document and all potential lenders that wish to see it usually sign a confidentiality undertaking.

Syndicated Loan Agreement: The Loan Agreement sets out the detailed terms and conditions on which the Facility is made available to the borrower.

- 4.4 **Fee Letters:** In addition to paying interest on the Loan and any related bank expenses, the borrower must pay fees to those banks in the syndicate who have performed additional work or taken on greater responsibility in the loan process, primarily the Arranger, the Agent and the Security Trustee. Details of these fees are usually put in separate side letters to ensure confidentiality. The Loan Agreement should refer to the Fee Letters and when such fees are payable to ensure that any non-payment by the borrower carries the remedies of default set out in the Loan Agreement.

- 6.1.4 **Crystallise a loss:** the lender might decide to sell its commitment if the borrower runs into difficulties - specialists dealing in distressed debts provide a market for such loans.

However, before the lender can go ahead and transfer its participation in a syndicated loan, it must consider the implications of the methods of transfer available to it under the Syndicated Loan Agreement.

6.2 **Forms of Transfer**

The most common forms of transfer to enable a lender to sell its loan commitment are:

- (i) Novation (the most common legal mechanic used in transfer certificates scheduled to loan agreements);
- (ii) legal assignment;
- (iii) equitable assignment;
- (iv) funded participation; and
- (v) risk participation.

Methods (i) and (ii) result in the lender disposing of its loan commitment with the new lender assuming a direct contractual relationship with the borrower, whilst methods (iii) to (v) result in the lender retaining a contractual relationship with the borrower. Each of these methods is now examined in more detail.

- 6.2.1 **Novation:** Novation is the only way in which a lender can effectively 'transfer' all its rights and obligations under the Loan Agreement. The process of transfer effectively cancels the existing lender's obligations and rights under the loan, while the new lender assumes identical new rights and obligations in their place.

Therefore the contractual relationship between the transferring lender and the parties to the loan agreement cease and the new lender enters into a direct relationship with the borrower, the agent and the other lenders. At the time the new lender becomes a party to the Loan Agreement the loan could be fully drawn, particularly if it is a term loan facility. However, particularly in the case of a revolving credit facility the new lender could be assuming obligations to advance monies to the borrower.

The borrower has to be a party to the novation process. The documentation required to effect a novation of a participation in a syndicated loan depends on the provisions in the Loan Agreement. However most Loan Agreements (including the LMA recommended form) have a transfer certificate attached as a schedule that operates by way of novation. There is also a provision in the Loan Agreement where all parties (including the borrower) agree that provided the other conditions to any transfer set out in the Loan Agreement

are complied with they consent to the novation effected by the execution of the transfer certificate. The Agent, the new lender and the existing lender are the only parties usually required to execute the transfer certificate.

6.2.2 **Legal Assignment:** Assignment involves the transfer of rights, but not obligations. For a legal assignment, s.136 of the Law of Property Act 1925 provides that the assignment must be:

- absolute (i.e. the whole of the debt outstanding to the existing lender);
- in writing and signed by the existing lender; and
- notified in writing to the borrower.

If any element of this requirement is missing, the assignment is likely to be equitable (see 6.2.3 *Equitable Assignment*).

In the context of the syndicated loan, a legal assignment will transfer all of the existing lender's rights under the Loan Agreement (including the right to sue the borrower and the right to discharge the assigned debt) to the new lender. The obligation of the existing lender to provide funds to the borrower cannot be transferred by legal assignment and thus remains with the existing lender. The new lender pays the existing lender any funds due under the loan and the existing lender sends those funds on to the Agent, who then passes such funds on to the borrower.

6.2.3 **Equitable Assignment:** As mentioned above, an equitable assignment is created when one or more of the provisions of section 136 of the Law of Property Act 1925 is not met, provided the intention to assign is present between the parties.

In contrast to a legal assignment, the new lender, as the equitable assignee, must join the existing lender, as assignor, in any action on the debt. The most significant difference between a legal and equitable assignment arises if the borrower is not notified of the assignment. If the borrower is not notified of the assignment, the new lender will be subject to all equities (for example, mutual rights of set-off) which arise between the existing lender and the borrower, even after the loan has been assigned.

6.2.4 **Funded participation:** Under a funded participation the existing lender and the participant enter into a contract providing that in return for the participant paying the existing lender an amount equal to all or part of the principal amount of the Loan made by the existing lender to the borrower ("the deposit"), the existing lender agrees to pay to the participant all or the relevant share of principal and interest received by the existing lender from the borrower in respect of that amount.

A funded participation agreement is made between the existing lender and the participant. This creates new contractual rights between the existing lender and the participant which mirror existing contractual rights between the existing lender and the borrower. However this is not an assignment of those existing rights and the existing lender remains in a direct contractual relationship with the borrower.

In a funded participation, the participant agrees that its deposit will be serviced (in terms of payment of interest) and repaid only when the borrower services and repays the loan from the existing lender. The participant has effectively taken on the risk of the first loan. The funded participation agreement must ensure that the existing bank is put in funds by the participant in time to meet the borrower's demands for drawdown in order to remove the risk.

The existing lender remains liable under the Syndicated Loan Agreement.

- 6.2.5 **Risk Participation:** Risk participation is a form of participation which acts like a guarantee. The risk participant will not immediately place any money with the existing lender, but will agree, for a fee, to put the existing lender in funds in certain circumstances (typically on any payment default by the borrower). Risk participation may be provided by a new lender as an interim measure before it takes full transfer of a loan.

No borrower consent is required for either a Funded Participation or a Risk Participation, so this process can be confidential. There is no direct contract between the new lender and the borrower but the participant usually obtains rights of subrogation, therefore if the participant has to pay after the borrower defaults, the participant gains the right to step into the existing lender's shoes and pursue all remedies of the existing lender against the borrower.