Loan
Market
Association

the authoritative voice
of the EMEA market

Guide to Syndicated Loans & Leveraged Finance Transactions

A Loan Market Association Guide

A LOAN MARKET ASSOCIATION GUIDE

A GUIDE TO SYNDICATED LOANS & LEVERAGED FINANCE TRANSACTIONS

Loan Market Association

10 Upper Bank Street, London E14 5JJ

Published by the Loan Market Association

10 Upper Bank Street, London E14 5JJ
Telephone: +44 (0)20 7006 6007
Fax: +44 (0)20 7006 3423
Email: lma@lma.eu.com
Website: www.lma.eu.com

The Loan Market Association

The Loan Market Association (LMA) is the trade body for the Europe, Middle East and Africa (EMEA) syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 700 organisations, covering 60+ nationalities, and consists of banks, non-bank lenders, law firms, rating agencies and service providers. The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the EMEA loan market vis à vis lenders, borrowers, regulators and other interested parties.

CONTENTS

INTRODUCTION

Syndicated loans started as a way of allowing lenders to lend large sums of money to a single borrower, where the sums involved went far beyond the credit appetite of a single lender. Whilst the precise year is disputed, it is thought that the first syndicated bank loan agreement was executed in the London market in 1968, with syndications developing in the 1970s as a sovereign business. Over time, the range of borrowers to whom lenders made syndicated loans widened, lenders initially providing syndicated loans to corporate entities with very high credit ratings ('investment grade loans') before branching out, towards the end of the twentieth century, to provide loans to those companies with a lower credit rating, including 'leveraged loans' (for further discussion of which see Part II). In addition, a conscious effort was made to develop a secondary market in syndicated debt, enabling the growth of the syndicated loan market through the opening of that market to non-bank investors and through providing banks with a way to manage their loan portfolios and therefore continue to provide liquidity for new transactions. Today, non-bank investors are active in both primary and secondary markets.

This paper is split into two parts. Part I will provide guidance on various aspects of an investment grade syndicated loan transaction, focusing on the following:

1. the types of syndication commonly seen in the loan market;
2. the types of borrowing facilities commonly seen in a syndicated loan agreement;
3. a description of the parties to a syndicated loan agreement and an explanation of their role;
4. a brief explanation of the documentation entered into by the parties;
5. the time line for a typical syndicated loan transaction; and
6. a description of the common methods used by lenders to transfer syndicated loan participations.

Part II will set out an example of the structure commonly seen in a senior facilities agreement for a leveraged acquisition finance transaction and provide guidance on those aspects of a leveraged acquisition finance transaction which are different to an investment grade syndicated loan transaction.

PART I

SYNDICATED LOANS

The guidance in this Part of the paper is given on the basis of a typical investment grade syndicated loan transaction undertaken in the European loan market as envisaged in the LMA Primary Loan documents and governed by the laws of England. Whilst the documents are drafted for investment grade corporates, in practice they are used for a variety of borrowers across the credit spectrum with appropriate amendments. This Part is not intended to provide a detailed explanation on the provisions of the LMA Primary Loan documents - guidance on this is set out in the "Users Guide to Investment Grade Primary documentation" published by the LMA and available to LMA members on the LMA website.

Section 1

TYPES OF SYNDICATION

An investment grade syndicated loan is usually a multi-lender transaction, where lenders (usually banks but sometimes including non-bank investors) contract with a borrower to provide a loan on common terms and conditions governed by a common document (or sets of documents). Each lender acts on a several basis, whereby if a lender fails to honour its obligations as a member of the syndicate, the other syndicate members have no legal duty to satisfy these obligations on that lender's behalf.

A syndicated loan may be arranged on an underwritten or best-efforts basis, or by way of a club deal. These three types of deal are explained in more detail below.

A. UNDERWRITTEN DEAL

An underwritten deal is one for which the arrangers guarantee the entire commitment, and then syndicate the loan. If the loan is not fully subscribed, the underwriters will be obliged to lend the underwritten sum of money to the borrower themselves. The underwriters may later try to sell their commitment (or part of their commitment) to investors in the secondary market. Underwritten loans therefore usually attract higher fees than loans syndicated on a best-efforts basis.

B. BEST-EFFORTS DEAL

A best-efforts deal is one which is not underwritten by the arrangers. The arrangers will commit to a certain amount of the loan, and undertake to do their best to find other lenders to provide commitments for the remainder. However, the arrangers do not guarantee that they will succeed in this. The borrower therefore bears the risk that in the event that the arrangers fail to attract commitments for the total amount of the loan, the borrower will not receive sufficient funds.[2]

C. CLUB DEAL

A club deal will usually involve a loan that is pre-marketed to a group of relationship banks. The borrower may arrange the club loan itself, or alternatively, an arranger may be involved.

Section 2

TYPES OF FACILITY

Two types of loan facility are commonly utilised: term loan facilities and revolving loan facilities (within which there are options for swingline facilities, multicurrency-borrowing, etc.).

Syndicated loan agreements for an investment grade transaction may contain only a term loan or revolving facility, or they may contain a combination of both. There can be one borrower or a group of borrowers with provisions allowing for the accession of new borrowers under certain circumstances, from time to time. The facility may also include a guarantor or guarantors and again provisions may be incorporated allowing for additional guarantors to accede to the agreement. It is this flexibility which has enabled the syndicated loan market to remain a dominant provider of capital to the many and varied borrowers that use it.

A. TERM LOAN FACILITY

Under a term loan facility, the lender commits to lend to the borrower a specified amount of money over a set period of time (the "term"). The period of a corporate term loan is generally between one and five years.

Typically, the borrower is allowed a short period after executing the loan agreement (the "availability period"), to draw loans up to a specified maximum facility limit. The borrower will typically pay commitment fees in respect of committed undrawn amounts during the availability period.

Interest on syndicated loans usually accrues at a floating rate (rather than a fixed rate, which is more usually found in the bond market). This variable rate of interest is reset periodically, the periods more frequently used being one, three and six months.

The loan may be repaid in instalments (in which case the facility is commonly described as "amortising") or through one payment at the end of the facility (in which case the facility is commonly described as having "bullet" repayment terms). Prepayment of the loan is commonly permitted without penalty (one of the advantages of a syndicated loan to a borrower vis-à-vis a bond) but, in any event, amounts that are repaid (or pre-paid) may not be re-drawn.

B. REVOLVING LOAN FACILITY

A revolving loan facility is similar to a term loan facility in that it provides a borrower with a maximum aggregate amount of capital, available over a specified period of time. However, unlike a term loan, the availability period usually extends for almost the entire life of the loan, allowing the borrower to drawdown, repay and re-draw all or part of the loan at its discretion (subject to complying with certain pre-agreed conditions).

Each loan is borrowed for a set period of time, usually one, three or six months, after which time it is repayable but may be redrawn. 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 final maturity date of the facility.

A revolving loan made to refinance another revolving loan and drawn on the same date as the maturing loan is to be repaid is known as a "rollover loan", provided it is made in the same currency, and is an amount equal to or less than, the maturing 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, or it is possible to incorporate different types of financial accommodation within it. For example, it is common to incorporate the following within the terms of a revolving credit facility:-

- a letter of credit facility – under this type of facility one or more of the lenders under the revolving facility agree to issue letters of credit at the request of the borrower to third parties. The letter of credit obliges the issuing bank to pay off a debt or obligation upon presentation of relevant documentation by the beneficiary. In turn, the borrower (and if the borrower does not, the rest of the syndicate banks) indemnify the issuing bank if a claim is made by a third party under the letter of credit; or

- a swingline facility - a very short-term (generally not more than five days) revolving sub-facility, typically provided by a subset of lenders, which permits amounts to be borrowed, often on a same-day basis. Often its purpose is to support a commercial paper issue.

This is often achieved by creating a sublimit within the overall revolving facility, allowing a certain amount of the lenders' commitments to be drawn in the form of these different facilities.

Section 3

PARTIES TO A SYNDICATED LOAN

The syndication process is initiated by the *borrower*, who appoints a lender (usually one with whom the borrower already has an established relationship) through the grant of a mandate to act as the *arranger* on the deal. In large transactions, the arranger (also often called a *mandated lead arranger)* is often appointed jointly with other arrangers, but for the purposes of this paper 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 with the borrower. The arranger will usually be paid an arranger's fee for undertaking these tasks.

At the same time the arranger is negotiating the terms of the proposed facility, a *bookrunner*, appointed by the borrower, will start to put together the syndicate of banks to provide the facilities. In some instances, the same lender will be appointed to act as both arranger and bookrunner. The bookrunner will want to ensure that they are fully in control of the syndication process and make sure that, with limited exceptions, no other debt from the borrower is being sold to the market at the same time (i.e. that the debt is being sold into a 'clear market').

Syndication is sometimes 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-arrangers.* As with the arranger and the bookrunner, there are many variations in the titles awarded by the borrower and it is a matter of some sensitivity - however, we shall continue to refer to this group of lenders as co-arrangers for the purposes of this paper. 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 will be appointed as *agent.* The agent acts as the agent of the lenders, not the borrower, and has a number of important functions:

1. *Point of Contact*: maintaining contact with the borrower and representing the views of the syndicate;

2. *Monitor*: monitoring the compliance of the borrower with certain identified terms of the loan agreement;

3. *Postman and Record-keeper*: the agent will receive all notices, compliance certificates, financial statements and other required information from the borrower and distribute them to the lenders; and

4. *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 then passes these monies to the banks to whom they are due. Similarly the lenders advance funds to the borrower through the agent, with the agent being responsible for organising the "utilisation" or "drawdown" of the facility.

The terms of a syndicated loan agreement empower the agent to undertake the roles described above in return for a fee. Usually the agent will not accept discretionary powers or, if it has them, it will seek majority lender approval before acting.

The loan agreement will set out the duties of the agent and will usually 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 will usually be appointed to act as *security agent* (commonly referred to as a *security trustee* under English law) to hold the security on trust for the benefit of all the lenders. The objective is to ensure that: (1) a single entity is responsible for the administrative aspects of the security (such as holding title deeds and other documents relating to the charged property) and for making distributions to the secured lenders on enforcement; and (2) where a lender assigns or transfers its interest to another entity (see Section 6 below), the new lender will benefit from the existing security package without the need for the security to be re-registered or for new security to be granted. The duties imposed upon the security agent will be set out either in a separate security trust deed or in the facility agreement. The borrower will generally be required to pay the security agent a fee, typically payable on an annual basis.

In the majority of syndicated deals some decision making power is delegated to the majority from time to time (often referred to as the 'majority lenders'). 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. However there is usually a list of important matters that would require all lender consent to waive or amend.

Section 4

DOCUMENTATION

The following documents will usually form part of a syndicated loan transaction.

A. MANDATE LETTER

The *mandate letter* is the document whereby the borrower appoints the arrangers and sets out the terms on which the arrangers will arrange the borrower's loan.

The content of the mandate letter varies according to whether the arrangers are mandated to use best efforts[1] to arrange the required facility or if the arrangers are agreeing to underwrite[2] the required facility. The provisions commonly covered in a mandate letter include:

1. an agreement to underwrite or use best efforts to arrange;
2. titles of the arrangers, commitment amounts and exclusivity provisions;
3. conditions to arrangers obligations;
4. syndication issues (including preparation of an information memorandum, presentations to potential lenders, clear market provisions, market flex provisions and syndication strategy); and
5. costs cover and indemnity clauses.

As multiple arrangers are common in syndications, the mandate letter also includes a provision to prevent front running, i.e. to prevent any arranger of a loan facility from actively encouraging a bank (or other investor), which is considering a primary participation, to await the secondary market. Front running can create anomalies in the market and significantly distort the primary syndication process, therefore the prohibition on front running is usually extended to the entire syndicate using a confidentiality and front running letter for primary syndication[3].

In the event that the loan transaction is not completed for any reason, most of the obligations in the mandate letter will lapse. However, certain terms are designed to bind the parties, even if the deal is not completed, for example, to keep the terms of the mandate letter confidential.

B. TERM SHEET[4]

The mandate letter will usually be signed with a *term sheet* attached to it.

The term sheet is a document which summarises the commercial terms of the proposed financing and is used as a basis for drafting the first draft of the loan agreement. It sets out the parties involved, their expected roles and many key commercial terms (for example, the type of facilities,

---

[1] See *LMA Mandate Letter – Best Efforts* for investment grade and leveraged transactions. Membership log-in details will be required to access all LMA documents.
[2] See *LMA Mandate Letter – Underwritten* for investment grade and leveraged transactions.
[3] See *LMA Confidentiality and Front Running Letter for Primary Syndication* and *LMA Front Running Letter of Undertaking* for investment grade and leveraged transactions.
[4] See *LMA Term Sheet* for investment grade and leveraged transactions.

the facility amounts, the pricing, the term of the loan and the covenant package that will be put in place).

C. INFORMATION MEMORANDUM

If there is to be an information memorandum, it is typically prepared by both the arranger and the borrower and is circulated by the arranger to potential syndicate members. It will typically contain an executive summary, a commercial description of the borrower's business, management and accounts, and a financial model, as well as the details of the proposed loan facilities being given, and typically includes a sample term sheet. In addition, the information memorandum will usually include a statement from the arranger limiting, as far as possible, its liability for the content of the information contained in the document.

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

D. SYNDICATED LOAN AGREEMENT

The loan agreement sets out the detailed terms and conditions on which the facility is made available to the borrower.

E. FEE LETTERS

In addition to paying interest on the loan and any related bank expenses, the borrower will usually pay fees to those banks in the syndicate which have performed additional work or taken on greater responsibility in the loan process, primarily the arranger, the agent and the security agent.

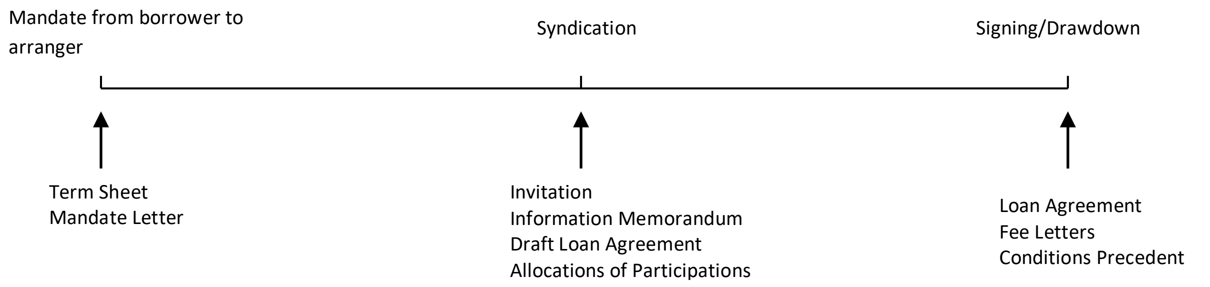
Details of these fees are usually contained in separate side letters to ensure confidentiality. The loan agreement should refer to the fee letters, and when such fees are payable, to ensure that any non-payment by the borrower carries the remedies of default set out in the loan agreement.

Section 5

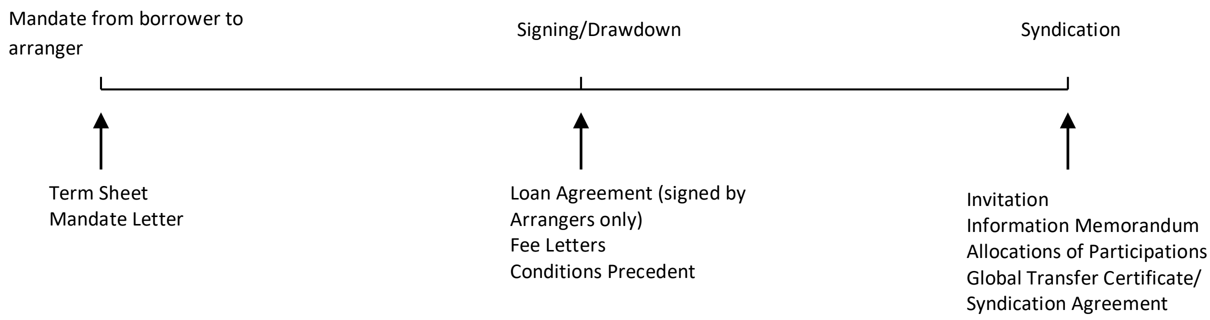
TIMING

Whilst the principal documents required for the provision of a syndicated loan are the same, the timing of producing such documentation often depends on whether or not the loan is being underwritten (see diagrams below).

A. TYPICAL TIMETABLE OF A SYNDICATED LOAN – NOT UNDERWRITTEN



B. TYPICAL TIMETABLE OF A SYNDICATED LOAN – UNDERWRITTEN



Section 6

LOAN TRANSFERS

A. WHY SELL A PARTICIPATION IN A SYNDICATED LOAN?

Secondary sales occur after the loan is closed and allocated. A lender under a syndicated loan may decide to sell its commitment in a facility for a number of reasons, including:

1. *Realising Capital*: if the loan is a long-term facility, a lender may need to sell its share of the commitment to realise capital or take advantage of new lending opportunities;

2. *Risk Management*: a lender may consider that its loan portfolio is weighted with too much emphasis on a particular type of borrower, industry or maturity. By selling its commitment in this loan, it may lend elsewhere, thus diversifying its portfolio;

3. *Regulatory Capital Requirements*: a bank's ability to lend is subject to both internal and external requirements to retain a certain percentage of its capital as cover for its existing loan obligations. These are known as 'Regulatory Capital Requirements'; and

4. *Crystallise a loss*: the lender might decide to sell its commitment if the borrower runs into difficulties. Specialists dealing in distressed debt 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.

B. FORMS OF TRANSFER[5]

English law provides several legal techniques to transfer a loan to a third party. The most common forms of transfer to enable a lender to sell its loan commitment are:

I. transfer by novation (the most common legal mechanic used in transfer certificates scheduled to loan agreements);

II. assignment (and a form of assignment agreement is scheduled to LMA Facility Agreements); and

III. sub-participation.

C. CONSENTS

A syndicated facility agreement will usually contain provisions dealing with the consents required for transfers. Whilst this is open to negotiation in many investment grade deals borrower consent is required for a transfer or assignment unless the transfer or assignment is to an affiliate or an event of default is continuing. In an investment grade deal the documents are often silent on sub-participations, which means that no borrower consent is required.

[5] See LMA Secondary Debt Trading documents.

PART II

LEVERAGED FINANCE LOANS

The summary in this Part of the paper is given on the basis of a typical syndicated leveraged acquisition finance transaction undertaken in the European loan market as envisaged in the LMA Primary Leveraged Loan documents which are governed by English law. It is not intended to provide a detailed explanation on the provisions of the LMA Primary Leveraged Loan documents - guidance on this is set out in the "Users Guide to the Recommended Form of Facility Agreement for Leveraged Acquisition Finance Transactions" published by the LMA and available to LMA members on the LMA website.

Section 7

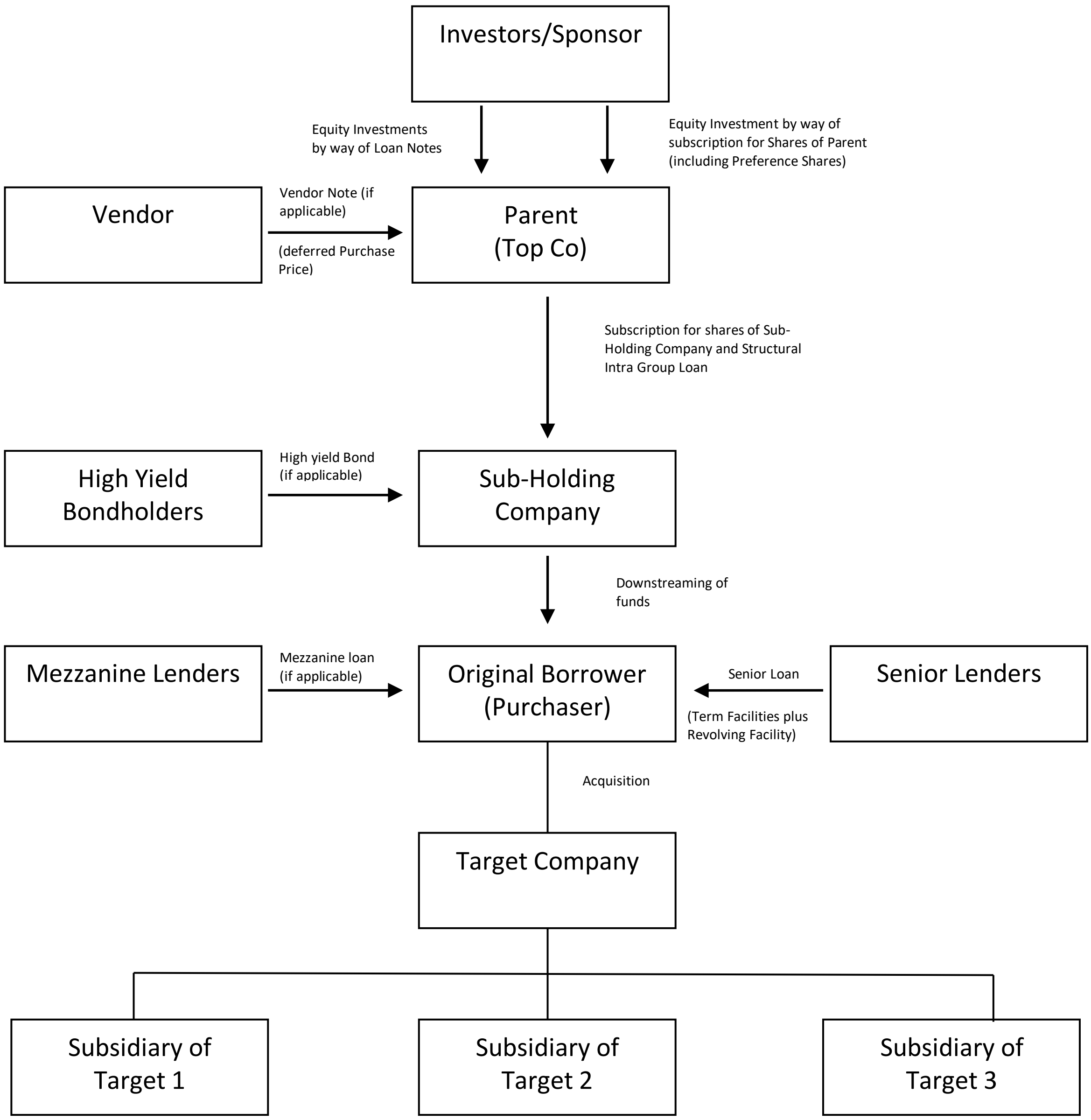
STRUCTURE OF A LEVERAGED FINANCE TRANSACTION

The capital structures for leveraged acquisition finance transactions vary from deal to deal, but the senior loan facilities are commonly structured to incorporate both multiple term loan facilities and a revolving loan facility. These senior loan facilities are made available to an acquisition vehicle which has been formed to acquire the target company (the *original borrower*) and certain of its designated subsidiaries (hereafter collectively referred to as the *borrowers*).

A schematic diagram of a (simplified) leveraged acquisition finance structure is produced below. Generally, the senior loan facilities will be lent to the original borrower and will benefit from guarantees and security granted by the target company and its operating company subsidiaries, whereas subordinated debt (such as high yield bonds and any structural intra-group loans) may be lent to holding companies which are situated higher in the leveraged acquisition finance structure. In this case, such subordinated creditors will be 'structurally subordinated' to the senior loan facilities.

The key parties to the transaction are also parties to an intercreditor agreement (see section 10 below) which includes contractual subordination arrangements to ensure that the senior loan facilities rank senior to the claims of other creditors.

TYPICAL (SIMPLIFIED) DEBT STRUCTURE CHART



Section 8

TYPES OF FACILITY

Senior facilities agreements for leveraged acquisition finance transactions generally make available a combination of term loan facilities for the purpose of financing the acquisition and a revolving facility for the purpose of funding the target group's working capital requirements. These facilities may be available to be drawn in different optional currencies and generally have different maturity profiles (commonly a term facility A with a 6 year maturity and a term facility B with a 7 year maturity, together with a revolving facility with a 6 year maturity). Up until the occurrence of the global financial crisis, leveraged acquisition finance transactions would commonly also include a term facility C with a maturity of 8 or 9 years (and a higher margin than the term facility B). Since 2009, the inclusion of a term facility C has become much less common but arrangers may re-introduce this feature into leveraged acquisition finance transactions in the event that they identify an increased willingness on the part of institutional investors (see Section 9 below) to lend for longer maturities in exchange for a higher margin. The LMA Primary Leveraged Loan documents include optional wording to allow for the inclusion of a term facility C.

Loans drawn under each facility will accrue interest at an agreed margin above a floating benchmark interest rate (such as LIBOR).

In addition to the original borrower, which is party to the senior facilities agreement from the signing date, the senior facilities agreement often allows for subsidiaries of the target company to accede to it at a later date as additional borrowers under the revolving facility and/or any capital expenditure/acquisition facilities with the consent of the lenders.

The senior loan facilities generally have the benefit of 'up-stream' and 'cross-stream' guarantees and security granted by the original borrower, the target company and certain of its subsidiaries, subject to any restrictions under applicable law relating to corporate benefit, financial assistance or other local law restrictions on granting guarantees or security for acquisition financings (see Section 10 below).

A. TERM LOAN FACILITIES

Typically, the senior facilities agreement provides the original borrower with a short period after signing (the *availability period*) to use the term loan facilities up to specified maximum facility limits for the purpose of completing the acquisition of the target company, refinancing the existing debt of the target company and meeting certain costs and expenses relating to the acquisition. Any term loan facilities which have not been drawn at the end of the availability period will be cancelled.

The duration of the availability period generally depends on the proposed timing for the acquisition.

A capital expenditure/acquisition facility (with a longer availability period) is sometimes also included to permit further loans for defined capital expenditure, restructuring or supplementary acquisitions.

The senior facilities agreement generally requires the relevant borrower(s) to repay the term facility A and/or capital expenditure/acquisition facility in instalments (such that these facilities are amortising) while the relevant borrower(s) will be required to repay the term facility B in a single 'bullet' repayment on its final maturity. Once a term loan has been repaid by the relevant borrower, the relevant term loan facility cannot be re-drawn.

B. REVOLVING FACILITIES

A revolving facility provides borrowers with a maximum aggregate amount of funds, available (over a specified availability period) to finance the general working capital needs of operating companies within the target group. The borrowers may draw down, repay and re-draw revolving facility loans advanced to them over the duration of the availability period for the revolving facility.

In some cases, the senior facilities agreement also allows for the revolving facility to be utilised for the purpose of issuing letters of credit on behalf of the relevant borrower to beneficiaries. An issuing bank would issue any such letter of credit on a 'fronted' basis, such that each other revolving facility lender indemnifies the issuing bank (*pro rata* to that lender's participation) in the event that any amount is paid out by the issuing bank to the beneficiary under the letter of credit and the relevant borrower fails to reimburse the issuing bank.

In each case, the original borrower (and any other borrowers) will only be able to use the revolving facility to the extent that there remain available (undrawn) commitments and the original borrower and its subsidiaries (the *borrower group*) remains in compliance with the terms of the senior facilities agreement (including the agreed financial covenants and undertakings).

A senior facilities agreement for a leveraged acquisition finance transaction often includes a 'clean down' obligation which requires the original borrower to ensure that, for a certain number of consecutive days each year, the aggregate amount of all revolving facility loans is reduced to zero or another pre-agreed level. The clean down requirement is aimed at ensuring that the borrower group uses revolving facility loans for the purpose of financing the target group's working capital cycle only (and not for long-term financing requirements).

A revolving facility made available as part of a leveraged acquisition finance transaction often incorporates different types of financial accommodation within it which are referred to as *ancillary facilities* - for example an overdraft facility; a guarantee, bonding, documentary or stand-by letter of credit facility; a short term loan facility; a derivatives facility; or a foreign exchange facility. These ancillary facilities may be provided on a bilateral basis by a lender in place of all or part of that lender's unutilised revolving facility commitment.

Section 9

PARTIES TO A SENIOR LEVERAGED FACILITIES AGREEMENT

The syndication process is initiated by the *sponsor* (usually a private equity house which manages funds provided by its investors) seeking to make the leveraged acquisition. The sponsor, on behalf of the original borrower, appoints one or more financial institutions to act as the arrangers on the deal for the *senior facilities*.[6] For further detail on the arrangers' responsibilities, see Section 3 above.

The arrangers underwrite the term loan facilities and revolving facilities in order to fund the (i) senior element of the buy-out; (ii) refinancing of existing debt in the target group (iii) fees and expenses; and (iv) working capital requirements. The arrangers (or their respective affiliates acting in their capacity as bookrunners of the primary syndication of the senior facilities) then find more lenders to participate in the senior facilities, such that the arrangers can each reduce their exposure under the senior facilities to a pre-agreed level.

Institutional investors (such as insurance companies, collateralised loan obligations and other 'non-bank' lenders) often invest in a percentage of the term facility B made available as part of a leveraged acquisition finance transaction. These facilities are particularly favoured by such institutions on account of their bullet repayment characteristics and higher yielding interest margins, as compared to the amortising and slightly lower yielding term facility A.

To facilitate the process of administering the senior facilities on a daily basis, a lender from the syndicate (or another financial institution) is appointed as *facility agent*. The facility agent acts as the agent of the lenders, not of the original borrower, and has a number of important functions.[7]

The leveraged syndicated finance transaction includes security, therefore a lender from the syndicate (or another financial institution) is appointed to act as *security agent* (or *security trustee*) to hold the security for the benefit of all the lenders from time to time.[8]

The senior facilities agreement provides that certain decisions relating to amendments or waivers of the terms of the senior facilities agreement and related documentation (the *finance documents*) may be taken by the majority (or super-majority) of the lenders from time to time (often referred to as the *majority or super-majority lenders*). The majority lenders will usually be defined as those members of the syndicate at the relevant time which (taken together) hold a specified percentage of the total commitments under the senior facilities (typically two-thirds by commitment). Super-majority voting might also be included in an agreement where a higher consent threshold is deemed appropriate for particularly significant amendments or waivers, such as for proposed changes in the security structure. The senior facilities agreement also provides that certain amendments/waivers requested by the original borrower may only be permitted with unanimous lender consent. These 'all lender' decisions generally include (amongst other things) changes to the principal amount of any senior facility, the amounts payable by way of interest or fees and/or the maturity of any senior facility.

---

[6] The leveraged buyout may also incorporate various types of subordinated debt such as 2nd lien loans, mezzanine loans or high yield bonds or notes, however detail of these types of subordinated debt is outside the scope of this guide.
[7] The functions are similar to those of an agent as described more fully in Section 3 above.
[8] The functions are similar to those of a security agent as described more fully in Section 3 above.

Section 10

DOCUMENTATION FOR A LEVERAGED ACQUISITION FINANCE TRANSACTION

As with most syndicated facilities (see Section 4 above), the original borrower will appoint the arrangers to underwrite the required facilities by way of a mandate letter, which shall have a term sheet attached to it. The information memorandum will typically be prepared by the arrangers, with the assistance of the sponsor, and sent out to potential syndicate members.

Where a leveraged acquisition finance transaction includes the issuance of public securities (such as high yield bonds) in addition to the senior facilities, it is typical for the arrangers and the sponsor to prepare two different information memoranda. One will be a public document incorporating only information which is available in the public domain and will be used by potential lenders who want to be able to freely trade in the public securities. The other will be a private document, disclosing more detailed information, including due diligence reports. To receive this, potential lenders will be required to sign a confidentiality undertaking.

Fee letters will also be provided to those institutions that have performed particular roles or taken on greater responsibility in the loan process, primarily the arrangers, the facility agent and the security agent.

In addition to those documents detailed above, the following documents will also form part of a leveraged acquisition finance transaction.

A. SENIOR FACILITIES AGREEMENT

The senior facilities agreement sets out the detailed terms and conditions on which the senior facilities are made available to the borrowers. These may include:-

I. Certain Funds

It is a precondition of the City Code on Takeovers and Mergers that a person making an offer (the *offeror*) to purchase of a public company listed in the UK must arrange for an appropriate third party (e.g. the offeror's bank or financial adviser) to confirm that resources are available to the offeror which are sufficient to satisfy full acceptance of the offer (so as to protect accepting shareholders of the target company). This means that facilities agreements relating to such public offers include an obligation for the lenders to provide the senior facilities on a *certain funds* basis. This clause obliges the senior lenders to provide funding to the original borrower in order to complete the cash element of an acquisition (unless a major event of default or major misrepresentation has occurred).

This certain funds requirement may also be included in a facilities agreement relating to a private leveraged acquisition, where the original borrower aims to minimise the risk that the senior facilities may be cancelled prior to completion, given that generally there will be no conditions to the completion of the acquisition under the terms of the share purchase agreement (other than receipt of necessary merger control or other regulatory approvals).

The certain funds period is time limited (typically not more than 3 to 6 months from the date of the senior facilities agreement).

II. Clean-up provisions

The terms of the senior facilities agreement generally allow the original borrower a period of up to 3 or 4 months from the closing of the acquisition during which time any minor or technical breaches of the representations, undertakings or other obligations relating to the target company and its subsidiaries will not constitute events of default. This is known as the *clean-up period* and is aimed at giving the original borrower sufficient time to engage with management of the target company and its subsidiaries in order to identify and remedy any possible events of default.

The clean-up rights are further subject to (i) the original borrower being able to remedy the breach; (ii) reasonable steps having been taken to remedy the breach; (iii) the circumstances giving rise to the breach not having been procured by or approved by the original borrower and; (iv) the breach not being reasonably likely to have a material adverse effect.

III. Guarantees

The senior facilities agreement generally includes a requirement that the original borrower and certain of its subsidiaries (*obligors*) grant up-stream and cross-stream guarantees in favour of the senior lenders in respect of the performance of the other obligors' obligations under the finance documents.

There is usually a guarantor coverage requirement which specifies that sufficient members of the target group must accede as obligors (and grant guarantees) in order to ensure that such obligors (taken together) account for an agreed proportion of the consolidated gross assets, operating profit or turnover of the borrower group from time to time.

As mentioned above, there may be legal restrictions (such as financial assistance, corporate benefit or similar legislation) which restrict the ability of members of the target group to grant up-stream or cross-stream guarantees of the obligations of the original borrower and its subsidiaries. In this case, the guarantee provisions are subject to limitation language in order to ensure compliance with such restrictions.

Subject to any such legal restrictions, the up-stream and cross-stream guarantees should provide the senior lenders with the ability (after an event of default) to bring a claim against those companies which account for the majority of the consolidated gross assets, operating profit or turnover (as applicable) of the borrower group.

B. TRANSACTION SECURITY DOCUMENTS

These include any document entered into by any obligor creating, or expressing to create, any security over all or any part of that obligor's assets in respect of the obligations of any of the obligors under any of the finance documents.

The security is held by a security agent (or security trustee) on behalf of the senior lenders, the hedge counterparties and any other secured creditors (such as any mezzanine lenders or high yield noteholders).

The security trustee provisions are typically contained in the intercreditor agreement (see below).

C. INTERCREDITOR AGREEMENT

The intercreditor agreement is made between (amongst others) the obligors, the senior lenders, any mezzanine lenders, the trustee for any high yield bondholders, the hedge counterparties and any other subordinated creditors (such as the lenders of any structural intra-group loan). This document sets out the terms of the contractual subordination arrangements in respect of the ranking of the senior facilities ahead of any subordinated creditors. It also restricts the other creditors from taking any enforcement action while the senior facilities remain outstanding and (amongst other things) sets out the mechanics for the majority lenders or any other instructing group to direct the security trustee to take enforcement action.

D. STRUCTURAL INTRA-GROUP LOAN AGREEMENT

Depending on the structuring of the leveraged acquisition, there may be a structural intra-group loan agreement which is entered into between the parent (as lender) with the original borrower or an intermediate holding company (as borrower) for the purpose of downstreaming funds from the sponsor to finance the leveraged acquisition. The structural intra-group loan agreement provides that the relevant loan is unsecured and is subordinated to the secured debt facilities. There is generally no right to receive payments of interest or principal in respect of any structural intra-group loan except to the extent expressly permitted by the finance documents.

E. MEZZANINE FACILITY AGREEMENT OR INDENTURE FOR HIGH YIELD BONDS

These agreements set out the detailed terms and conditions on which any mezzanine facilities or high yield bonds (as the case may be) are made available to certain companies within the acquisition group. Any mezzanine lenders will be contractually subordinated to the senior lenders pursuant to the terms of the intercreditor agreement. The position of any high yield bondholders tends to vary according to the structuring of the specific transaction: the high yield bonds may rank *pari passu* with the senior facilities or may be contractually subordinated pursuant to the intercreditor agreement.

F. HEDGING LETTER

The original borrower will be required to undertake to enter into interest rate hedging (within a certain period of time after completion of the acquisition) in respect of a pre-determined percentage of the funded debt and for a pre-determined period of time. This is required in order to create a greater degree of certainty over the funding costs, given that the interest payable under the senior facilities agreement will be calculated by reference to the applicable margin above a floating benchmark rate, such as EURIBOR. The interest rate hedging is aimed at protecting against fluctuations in the relevant benchmark rate.

G. OTHER DOCUMENTS

Other transaction and financing documents required in respect of a leveraged acquisition finance transaction may include (depending on the specific transaction): the acquisition documents (such as any public offer documents or share/asset purchase agreement (as applicable)); the fee letters, the shareholders/investment agreement; constitutional documents, corporate authorisations and directors' certificates from each original obligor; the due diligence reports; a base case model setting out the projected financial performance of the target group; a group structure chart; a funds flow statement setting out the movement of funds at completion; the most recent financial statements for the target company; and legal opinions as to the capacity/authorisation of the original obligors and the validity/enforceability of the finance documents.

Section 11

MANDATORY PREPAYMENTS/FINANCIAL COVENANTS

Monitoring the financial position of the borrower group is vitally important in leveraged acquisition finance transactions and various clauses in the senior facilities agreement provide lenders with protection.

A. MANDATORY PREPAYMENT CLAUSE

This provision requires the borrower group to apply all or a portion of certain cash receipts in prepayment of senior facilities in advance of their scheduled maturity. This prepayment requirement applies to the net proceeds from any claims in connection with the acquisition itself (such as warranty claims against the vendor or claims against providers of due diligence reports), the net proceeds of any disposals which have not been reinvested within an agreed period and the net proceeds of any insurance claim which are not used in ameliorating the relevant insured loss.

There is also a requirement to prepay an agreed proportion of any excess cashflow generated in the most recently-ended financial year. Excess cashflow is calculated by reference to the borrower group's cashflow (see below) after the deduction of all scheduled repayments of principal and interest, together with certain prepayments, any capital expenditure and certain other payments made in such financial year.

Generally mandatory prepayments are required to be applied to prepay term loans first and then to reduce any revolving loans.

B. FINANCIAL COVENANTS

Financial covenants allow the senior lenders to monitor the financial performance of the borrower group on an ongoing basis over the life of the senior facilities. In particular, the financial covenants act as an early warning system for the senior lenders if the target group is failing to meet the projected financial performance set out in the base case model agreed with the senior lenders prior to the completion of the leveraged acquisition.

If the financial covenants are breached by the borrower group, this will trigger an event of default and therefore give lenders the opportunity to take remedial action (including accelerating the senior debt and/or enforcing the guarantees and security) against the obligors. The financial covenants typically included in a senior facilities agreement are generally tested on a quarterly basis and may include the following:

1. *leverage* (also referred to as *debt cover*), which measures the ratio of the borrower group's total borrowings against the borrower group's earnings (*EBITDA*). In crude terms, the leverage ratio acts as an indicator of the risk profile of the capital structure of the borrower group and gives a rough indication (on the basis of its EBITDA) of how many years it is likely to take the borrower group to repay its outstanding borrowings;

2. *interest cover*, which measures the ratio of EBITDA of the borrower group against the aggregate amount of interest payments and other finance charges paid by borrower group. The interest cover covenant requires the borrower group to show that its EBITDA exceeds its

interest payments and finance charge costs by an agreed ratio;

3. *cashflow cover* (sometimes also referred to *fixed charge cover* or *debt service cover*), which measures the ratio of the *cashflow* generated by the borrower group against the aggregate of its debt service obligations. Cashflow measures the difference between cash inflows and cash outflows over the testing period; and

4. *maximum annual capital expenditure limits* which restrict the amount of capital expenditure which may be incurred by the borrower group in each financial year. This covenant is aimed imposing financial discipline on the borrower group by restricting capital expenditure by reference to the forecast levels of capital expenditure set out in the base case model and minimising the risk of excessive capital expenditure which may result in the borrower group becoming over-stretched.

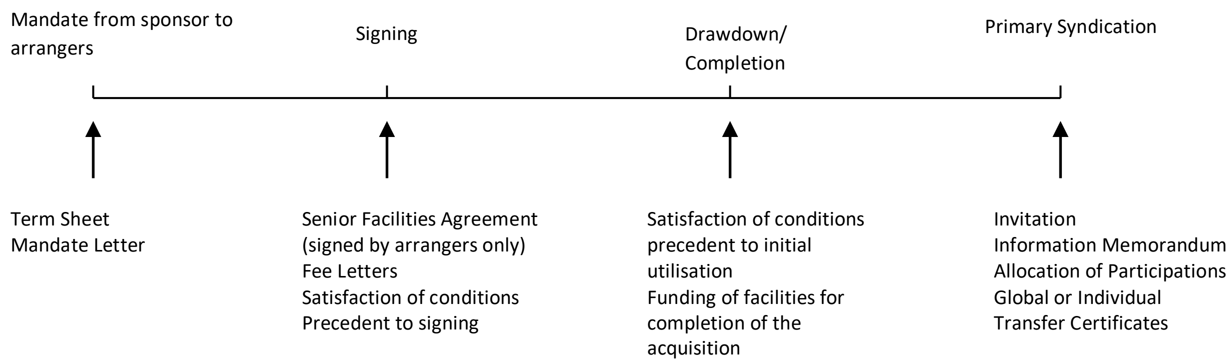
Section 12

TIMING/PROCESS

Leveraged acquisition finance transactions generally involve a high degree of due diligence by vendors, sponsors and potential lenders. The time frame for this type of deal may therefore extend over a number of months from inception to final allocation of the debt to a group of lenders. Additionally, the arrangers are mandated to underwrite the senior facilities for the relevant acquisition rather than being mandated to arrange the senior facilities on a best efforts basis.

As a result, the senior facilities agreements for leveraged acquisition finance transactions are generally signed by the arrangers, facility agent, security agent and the relevant original obligors only (subject to certain conditions precedent to signing having been met). Once the conditions precedent to the initial utilisation have been met the senior facilities are drawn down to fund the completion of the acquisition. Following completion, the arrangers complete the primary syndication of the senior facilities to a larger group of lenders and in doing so reduce their participation in the senior facilities to pre-agreed 'hold levels'.

TYPICAL STEPS FOR A LEVERAGED ACQUISTION FINANCE TRANSACTION



Section 13

LEVERAGED ACQUISITION FINANCE TRANSFERS

Lenders taking participations in the senior facilities during primary syndication will usually do so by way of novation, either through a global transfer certificate entered into between the arrangers and all of the incoming lenders or (more commonly) through individual transfer certificates. In each case the arrangers transfer a portion of their commitments to the new lenders, using a similar process as that seen for a secondary transfer of commitments (see Section 6 above) except that no transfer fees are payable by the new lenders to the facility agent.

The senior facilities agreement may contain certain restrictions on secondary transfers of commitments after the completion of primary syndication: for example, lenders may be required either to consult with the original borrower or to obtain the consent of the original borrower (not to be unreasonably withheld or delayed) for transfers to third parties which are not already lenders or affiliates or related funds of existing lenders.

Loan
Market
Association

the authoritative voice
of the EMEA market

Guide to Syndicated Loans & Leveraged Finance Transactions

A Loan Market Association Guide

Syndicated loans started as a way of allowing lenders to lend large sums of money to a single borrower, where the sums involved went far beyond the credit appetite of a single lender. Whilst the precise year is disputed, it is thought that the first syndicated bank loan agreement was executed in the London market in 1968, with syndications developing in the 1970s as a sovereign business. Over time, the range of borrowers and type of lenders active in the loan market has expanded to include corporates and institutional investors.

The aim of this paper is to provide guidance on syndicated loan transactions and leveraged finance transactions, indentifying, amongst other things, the types of facilities commonly seen in the loan market, the parties to a typical loan agreement and common methods used by lenders to transfer loan participations.

LMA contact

T: +44 (0)20 7006 6007
F: +44 (0)20 7006 3423
lma@lma.eu.com

www.lma.eu.com