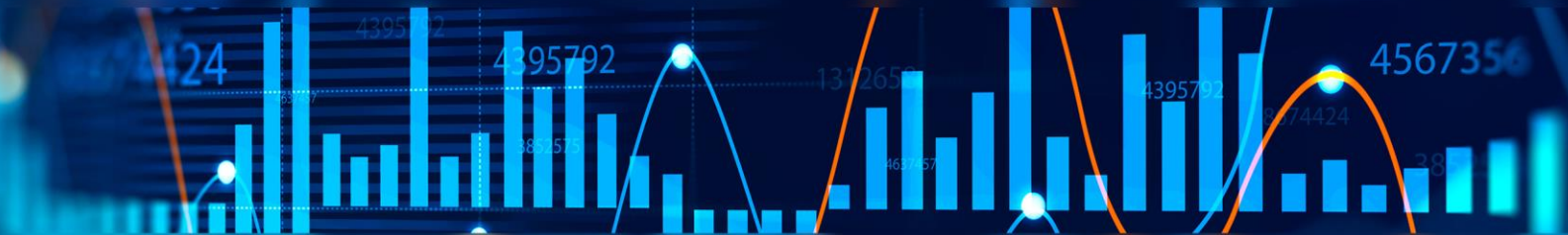


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# FUNDAMENTALS OF FINANCIAL MARKETS

HONG KONG | FRIDAY, 6 SEPTEMBER 2024



C L I F F O R D  
C H A N C E

**LOAN MECHANICS: STRUCTURE OF A LOAN TRANSACTION**

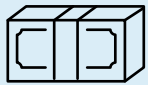
MAGGIE LO, ANTHONY CHAN & JITR VILAIVONGSE

HONG KONG | FRIDAY, 6 SEPTEMBER 2024

# TOPICS TO BE COVERED



Loan agreements are contracts: Some fundamental principles of contract law



Underlying principles of syndicated lending



Deal structure



Terms of a LMA/APLMA syndicated loan agreement

# FUNDAMENTAL PRINCIPLES OF CONTRACT LAW

## Freedom of contract

- General freedom of contract outside of the world of consumer finance and investment
- No general requirement for contracts to be in writing – but there are exceptions: land, guarantee under English law etc.
- Oral amendments?
- Money Lenders Ordinance in Hong Kong

## Consideration

- Essential element for a valid contract, except in the case of a deed
- Past consideration is no consideration
- Must a guarantee be executed as a deed?

## Offer and acceptance: offers to the world

- Carlill v Carbolic Smoke Ball Co [1903] 1 QB 256
- Transfer certificate mechanism in syndicated loan agreements

# FUNDAMENTAL PRINCIPLES OF CONTRACT LAW

## (CONTINUED)

### Intention to create legal relations

Letter of comfort

### Recovery of a debt vs. breach of contract claim

- A claim for payment of a liquidated sum
- No need to prove loss and no duty to mitigate
- Guarantee vs. keepwell deed

### Penalty

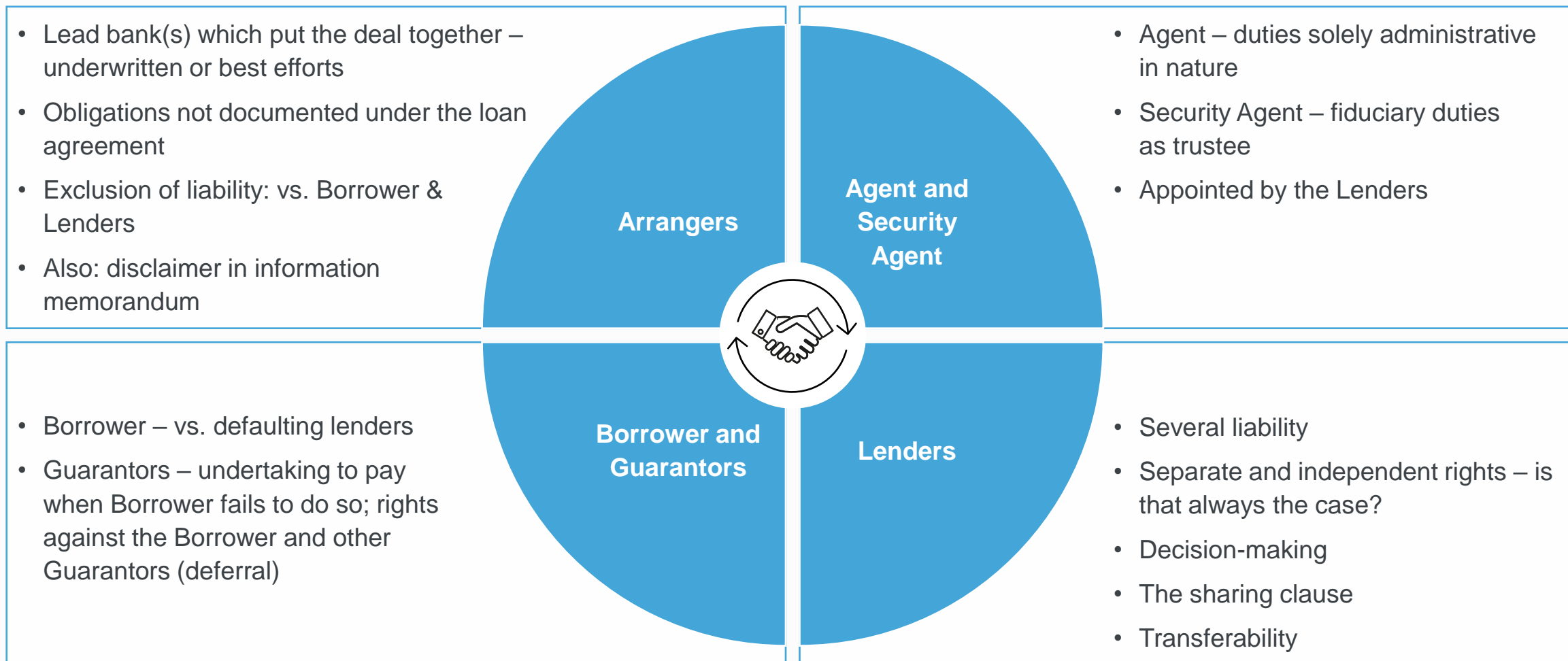
A term requiring a person to pay amounts imposed in circumstances of breach or default may be held to be unenforceable on the grounds that it is a penalty

### Privity of contract

- Obligors party to the facility agreement vs. those who are not
- Legislation on rights of third parties

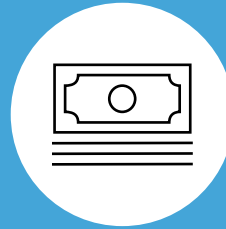
# UNDERLYING PRINCIPLES OF SYNDICATED LENDING

THE SYNDICATED LOAN AGREEMENT ADDRESSES THE RELATIONSHIP BETWEEN MULTIPLE PARTIES



# UNDERLYING PRINCIPLES OF SYNDICATED LENDING

(CONTINUED)



Creditor equality

Pari passu ranking

Negative pledge

Cross default/cross  
acceleration

Sharing among  
Finance Parties

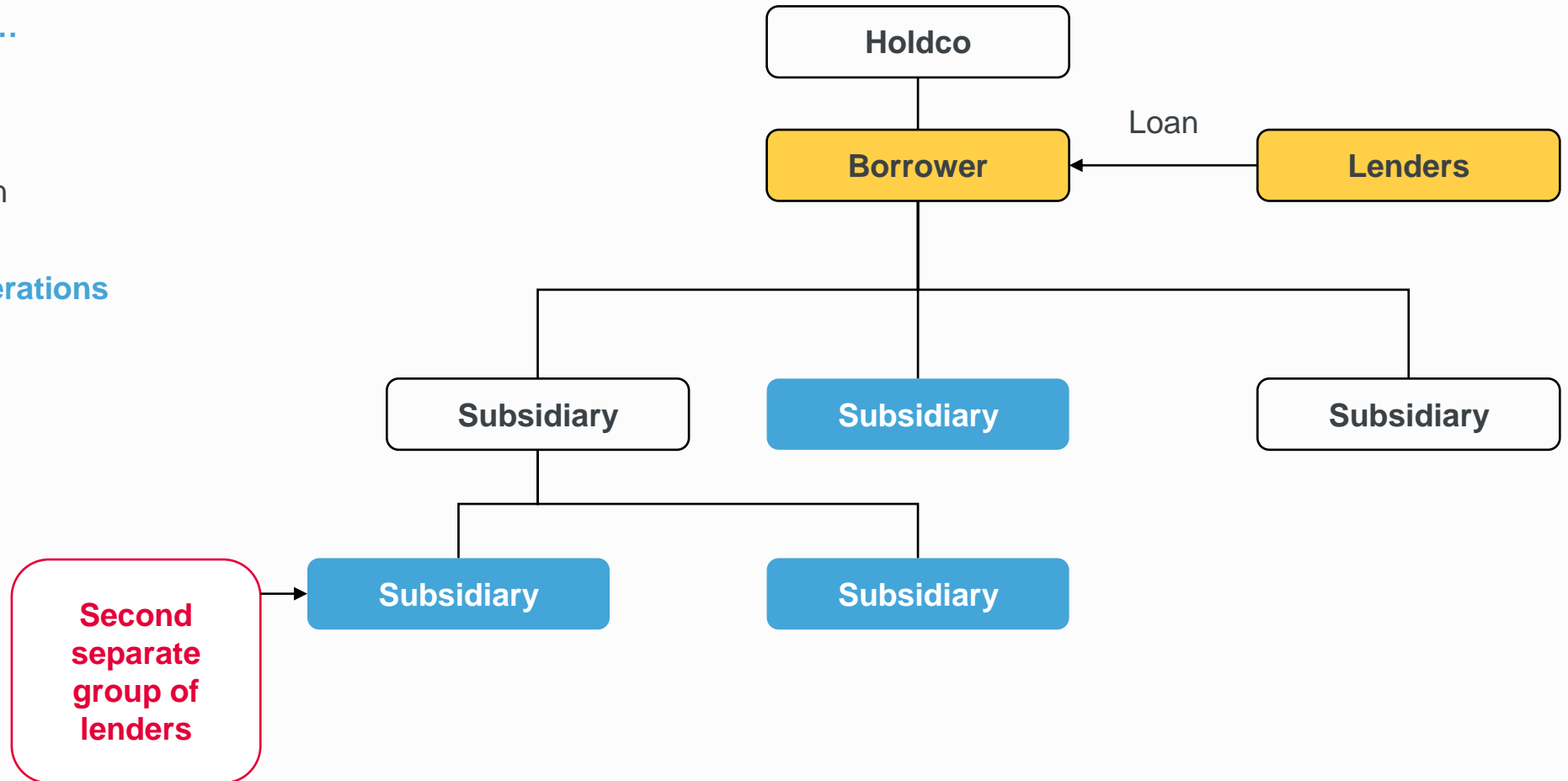
# DEAL STRUCTURE

## Creditor equality applied...

- Who are the creditors?
- Structural subordination
- Contractual subordination

## Other structuring considerations

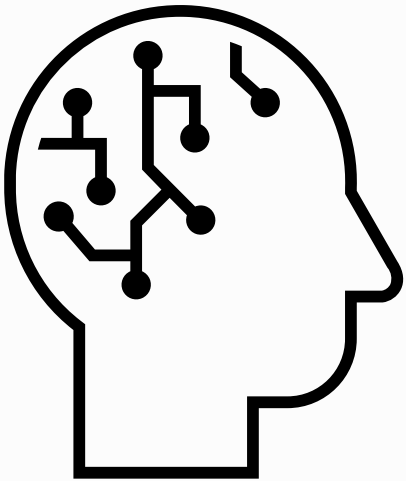
- Borrowing entity
- Guarantee and security
- Group
- Change of control
- Foreign exchange
- Tax
- and more...





# DEAL STRUCTURE

## (CONTINUED)

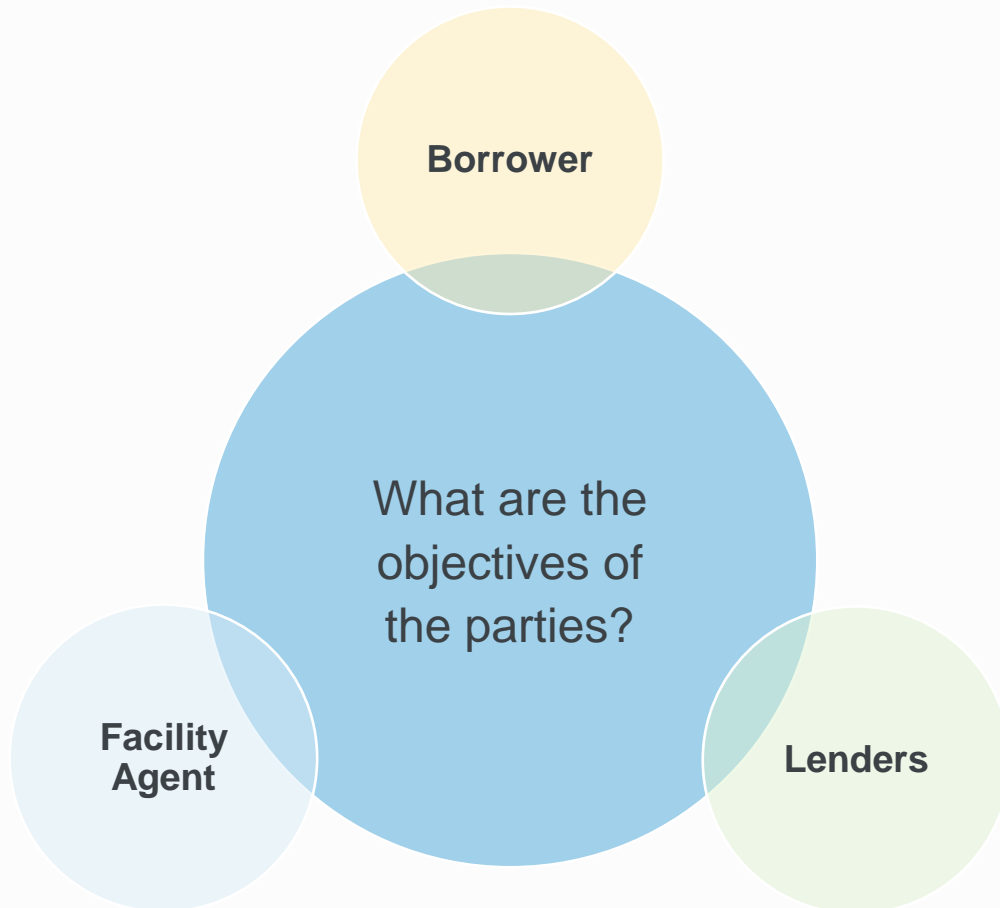


Dictates how parts of the Facility Agreement are structured/written

### Consider:

- Who is/are the Borrower(s)?
- Who should be Guarantors?
- Where is the value/are the assets in this group of companies? What is the credit?
- Who should be in the “Group”?
- What can we take security over?
- Cross border transactions: foreign exchange, withholding tax, upstream/cross-stream guarantee and security (including guarantee limitations)
- Regulatory issues: e.g. license to conduct lending business in the relevant jurisdiction/margin lending

# NEGOTIATING THE TERMS OF THE LOAN AGREEMENT

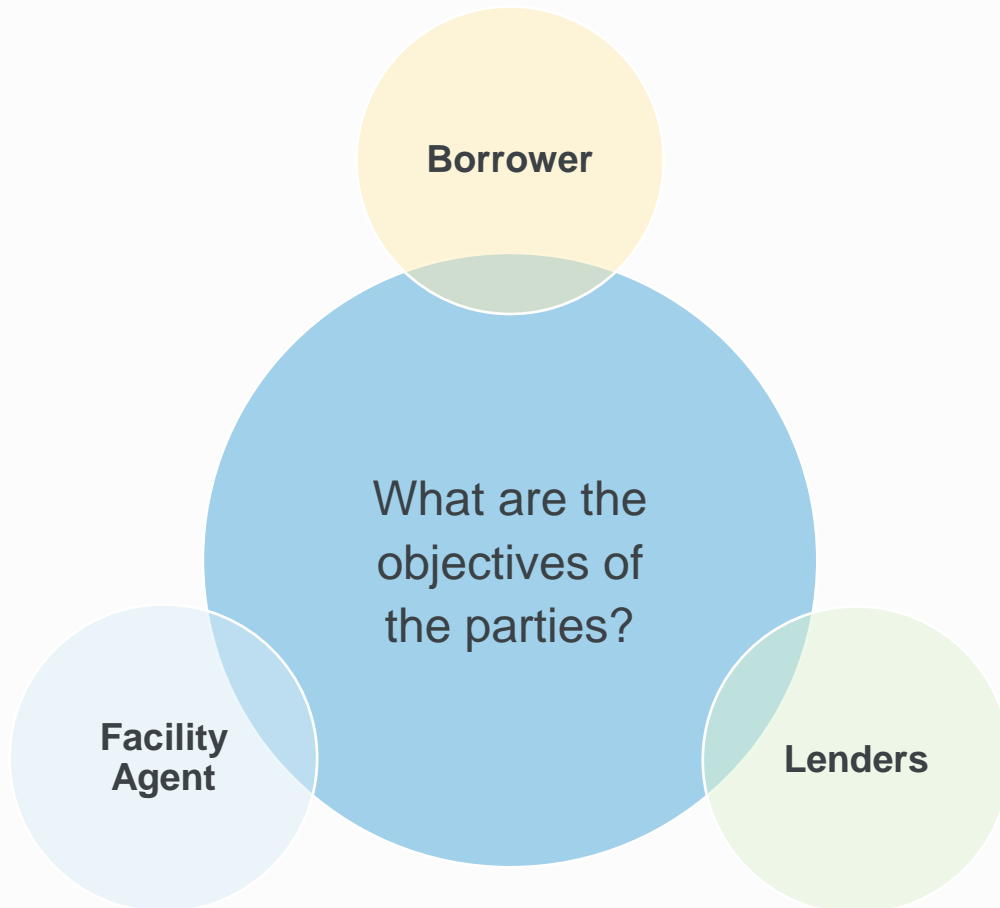


## Borrower

- Certainty of funding
- No unexpected costs
- Ability to conduct and develop its business: carve-outs and materiality thresholds; material companies (or restricted subs vs. unrestricted subs)
- Cure rights and grace period
- Control over composition of syndicate: competitors/relationship banks
- Amendments and waivers: snooze you lose; reasonableness

# NEGOTIATING THE TERMS OF THE LOAN AGREEMENT

## (CONTINUED)



### Lenders

- Adverse events: drawstop + acceleration
- Margin protection
- Preserve the status quo
- Ability to exit the deal, including when things go wrong: transferability
- Compliance risks: bribery, terrorism financing and sanctions
- Individual Lender: risks of being out-voted

### Facility Agent

- Clarity as to who makes the determination; and what needs to be done
- Exclusion of liability; ability to refrain from acting unless indemnified
- All costs and expenses for the account of the Borrower (failing which, the Lenders)
- Ability to charge for management time?

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**You have been provided with a list of syndicate lenders for insertion into the finalised facility agreement (unsecured working capital loan to a Hong Kong incorporated company). The lenders include Ethiopia National Bank and ABC Credit Fund LP. Can these lenders lend without a license?**

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**Under a guaranteed syndicated facility, interest is due but unpaid by the borrower on an interest payment date. Can an individual lender (by itself) sue the guarantor for payment?**

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**The borrower missed principal repayment on the final maturity date of a US\$1 billion syndicated facility.**

**The borrower holds an account with Bank X, one of the syndicate lenders, with a credit balance of US\$100m. The account is unsecured. Can Bank X exercise its set-off right against such US\$100m and apply it to discharge its participation in the syndicated facility (US\$100m) in full?**

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**Which one of the following matters do not  
require all Lenders' consent  
under the LMA / APLMA facility agreement?**

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C L I F F O R D  
C H A N C E

## **LOAN MECHANICS: INTRODUCTION TO LOAN AGREEMENTS**

MAGGIE LO, ANTHONY CHAN & JITR VILAIVONGSE  
HONG KONG | FRIDAY, 6 SEPTEMBER 2024



# STRUCTURE OF A SYNDICATED LOAN

## Four broad categories of clauses:

- Mechanics (purpose/the facilities/funding)
- Margin protection
- General protection (representations, covenants and Events of Default)
- “boilerplate”.

## Guarantee and indemnity

**Schedules** (including day-one Commitment amounts and conditions precedent)



# THE FACILITIES

## Main instruments

- Term Facility.
- Revolving Facility.

## Term Facility

- Availability Period.
- Interest Periods.
- Repayment (Amortising or bullet).
- Amounts repaid/prepaid cannot be redrawn.

# THE FACILITIES

## (CONTINUED)



### REVOLVING FACILITIES

- Availability Period.
- One Interest Period.
- Repayment at end of Interest Period.
- Rollover Loans (actual vs notional repayment).
- Amounts repaid/prepaid (but not cancelled) may be redrawn.

# CONDITIONS PRECEDENT

## Risk assessment and mitigation

- Initial due diligence.
- Covenant enhancement.

## Confirmation of various assumptions

- Factual.
- Legal.
- Financial.

Satisfaction of conditions triggers rights for the Borrower

Lenders obliged to lend if CPs satisfied

Waiver of CPs or convert into conditions subsequent

Further conditions precedent – drawstops

# REPAYMENT, PREPAYMENT AND CANCELLATION

## Repayment of principal

- Term Facility.
- Revolving Facility.

## Voluntary cancellation

## Voluntary prepayment

- How should a prepayment be applied against the repayment schedule?
- Timing of prepayments -> Break costs?



# REPAYMENT, PREPAYMENT AND CANCELLATION

## (CONTINUED)

### Mandatory prepayment

- Illegality
- Change of control.
- Flotation/Exit.
- Disposal proceeds.
- Not an Event of Default.

# FEES

## Fees

- Commitment fee.
- Arrangement fee.
- Agency fee.
- Security Agency fee.

# INTEREST RATE

## Interest rate

- Floating reference rate (e.g. LIBOR / HIBOR) plus Margin
- Margin – fixed or fluctuate with financial performance
- Cessation of LIBOR
  - Risk free rate interest (compounded SOFR) vs term rates (Term SOFR)
  - Arguments against break costs and market disruption





# **INTEREST**

(CONTINUED)

**Interest Periods**

**Market Disruption**

**Break Costs**

**Default Interest**

# MARGIN PROTECTION

## Tax

- Tax gross up.
- Tax indemnity.
- Stamp taxes.
- Indirect taxes.

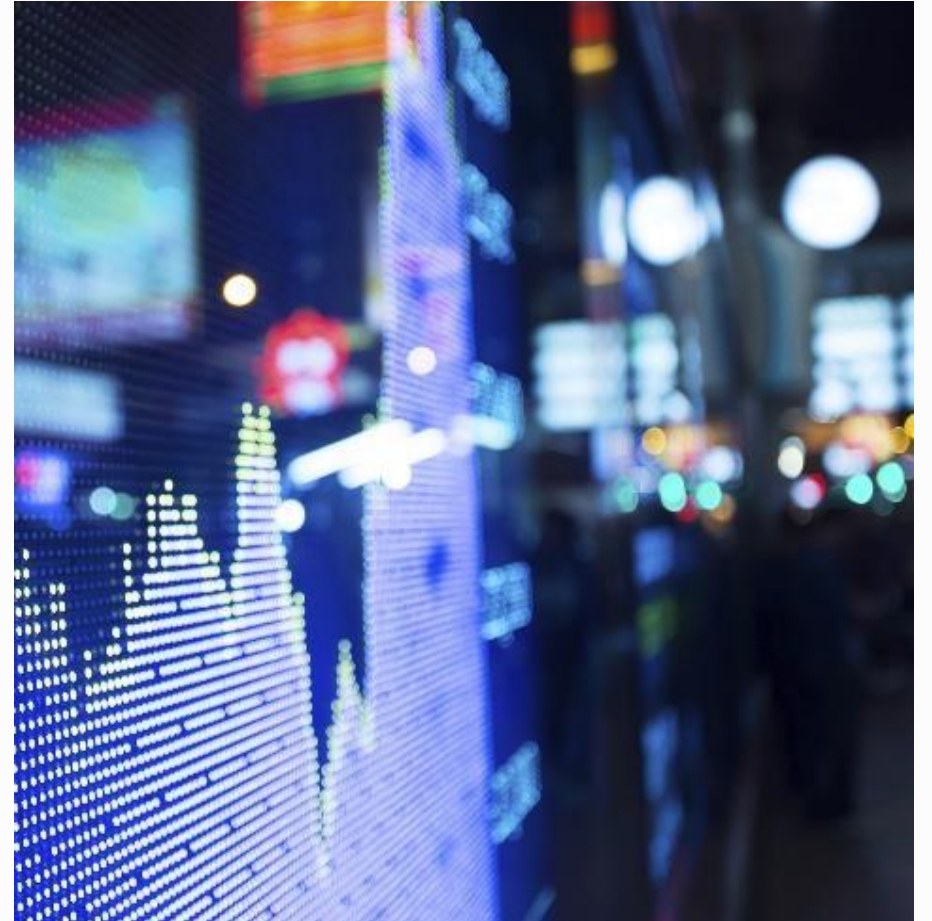
## Increased Costs

## Indemnities

- Currency.
- Indemnity to Agent.
- Indemnity to Security Agent.
- Other indemnities.

# FINANCIAL COVENANTS

- Early warning system – measure performance against prediction/target
- Precise trigger for default
- Examples of financial covenants:
  - Cashflow Cover: the ratio of Cashflow to Debt Service.
  - Interest Cover: the ratio of EBITDA to Finance Charges.
  - Leverage: the ratio of Total Debt to EBITDA.
  - Capital Expenditure: Capped amount for each Financial Year
- Cure rights?
- Maintenance vs incurrence?
- Margin ratchet

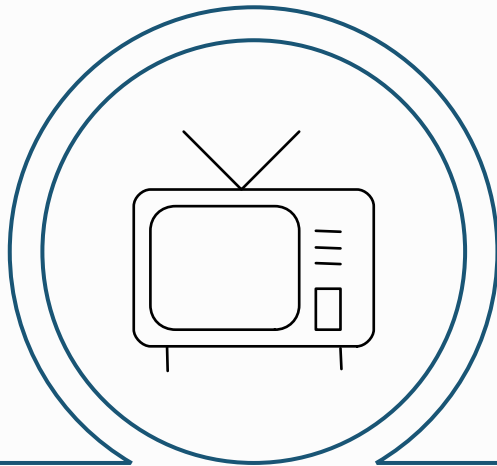


# **GUARANTEE AND INDEMNITY**

- Guarantee
- Undertaking to pay
- Indemnity as principal debtor and primary obligor
- Immediate recourse
- Deferral of Guarantor's rights



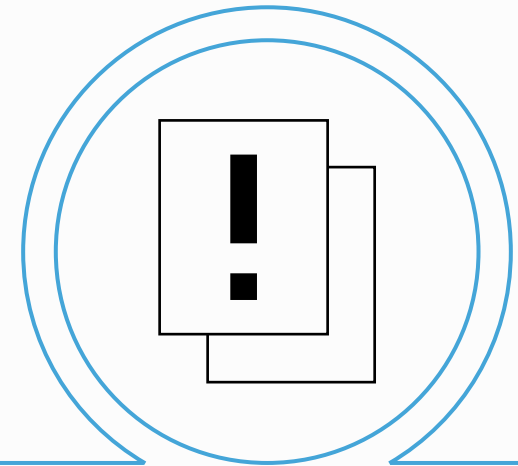
# GENERAL PROTECTION CLAUSES



Representations



Covenants



Events of Default

# REPRESENTATIONS

Unambiguous statements of fact (not opinion) made to induce lenders to make the loan

## Remedies for misrepresentation

- Legal remedies – what are they?
- Contractual remedies – what are they?

## Representations are:

- Investigatory (disclosure letter?)
- A condition precedent to drawdown.

## Relationship between representations and events of default

# REPRESENTATIONS

## (CONTINUED)

### Why repeated?

### When repeated?

- Date of Facilities Agreement.
- Closing Date.
- Syndication Date.
- Date of Utilisation Request, each Utilisation Date and first day of each Interest Period.
- On accession of Additional Obligors.
- By reference to the facts and circumstances existing at the date made.





# CUSTOMARY REPRESENTATIONS

## Legal

- Status, binding obligations, power and authority.
- No conflict.
- Validity and admissibility in evidence.
- Governing law and enforcement.
- No filing or stamp tax.
- Deduction of tax.
- Pari passu ranking.





# CUSTOMARY REPRESENTATIONS

## (CONTINUED)

### Information

- No misleading information.
- No default.
- Financial statements.
- No proceedings pending or threatened.
- Authorised signatures.
- Group structure chart.

### Security/credit support

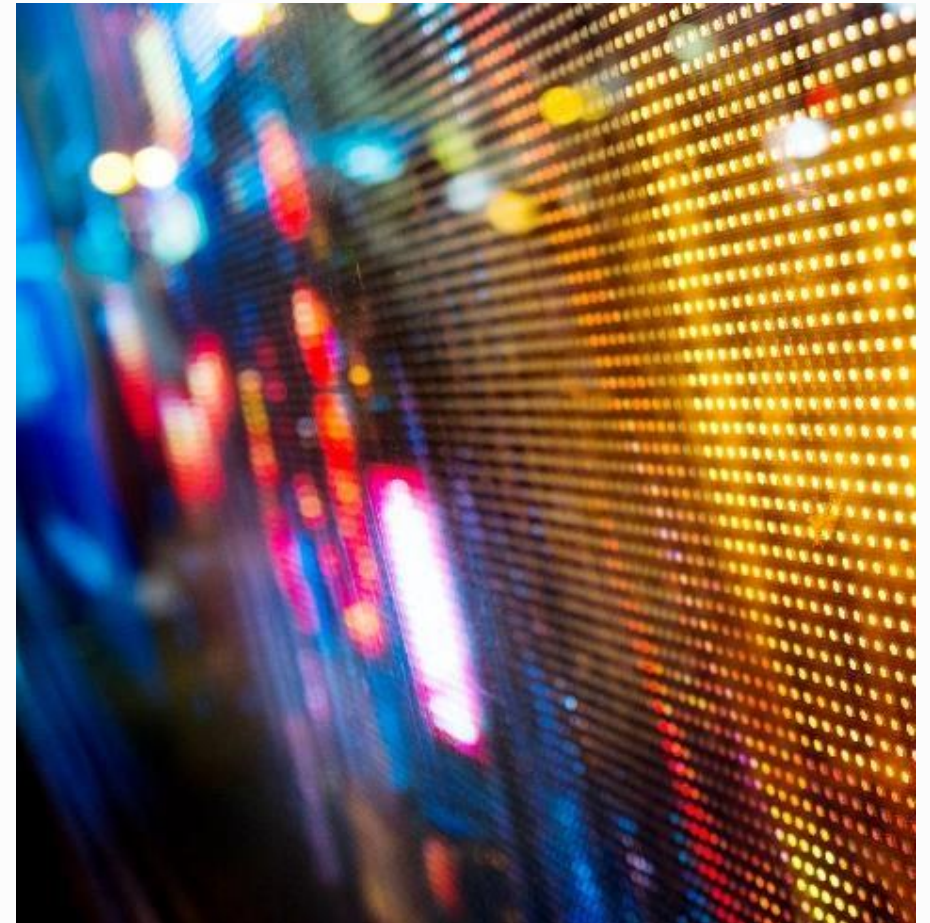
- Ranking.
- Good title to assets, legal and beneficial ownership.

# CUSTOMARY REPRESENTATIONS

## (CONTINUED)

### State of business/Group

- Insolvency.
- No breach of law.
- Environmental Laws.
- Taxation.
- Intellectual Property.
- Holding companies.
- Security and Financial Indebtedness.



# COVENANTS

Why do we have covenants?

Positive covenants/negative covenants

Usually split:

- Commercial covenants/protection of assets
- Financial covenants
- Information covenants

# CUSTOMARY COVENANTS

Authorisations	Acquisitions
Compliance with laws	Change of business
Pari passu ranking	Loans and guarantees
Negative pledge	Financial Indebtedness
Disposals	Environmental compliance and claims
Merger	Syndication

# CUSTOMARY COVENANTS

(CONTINUED)

Joint Ventures	Guarantors
Holding Companies	Dividends and share redemption
Taxation	Treasury Transaction
Insurance	Arm’s length basis
Access	Intellectual Property
Group bank accounts	

# CUSTOMARY COVENANTS

## (CONTINUED)

### Information undertakings

- Financial statements – annual audited/semi-annual/quarterly/monthly management accounts.
- Compliance Certificate.
- Budget.
- Presentations.
- Notification of Default.
- Miscellaneous information.



# EVENTS OF DEFAULT

Why do we have Events of Default?

Brings borrower to the negotiating table which may result in:

- increased fees
- increased margin
- tighter covenants
- all of which may be justified as consideration for the increased risk.

Enforcement

# EVENTS OF DEFAULT

(CONTINUED)

Rights on occurrence of an Event of Default which is continuing (unless remedied/waived)

Cancel all or part of the Commitments	Declare amounts immediately due and payable	Declare amounts due and payable on demand	Direct Security Trustee to take enforcement action
---------------------------------------	---	---	--



# CUSTOMARY EVENTS OF DEFAULT

- Non payment (with a grace period)
- Financial covenants
- Other obligations (including information undertakings)
- Misrepresentation
- Cross default/cross acceleration
- Insolvency related



# **CUSTOMARY EVENTS OF DEFAULT**

## (CONTINUED)

- Ownership of the Obligors
- Unlawfulness and invalidity
- Repudiation
- Moratorium on External Indebtedness
- Cessation of business
- Change of control
- Material adverse change



# MATERIAL ADVERSE CHANGE

Material adverse change:



**ANY EVENT OR CIRCUMSTANCE OCCURS WHICH THE MAJORITY LENDERS  
REASONABLY BELIEVE HAS OR IS REASONABLY LIKELY TO HAVE A MATERIAL  
ADVERSE EFFECT**



Do Lenders ever rely on this Event of Default?

# MATERIAL ADVERSE CHANGE

## (CONTINUED)

**“Material Adverse Effect” means [in the reasonable opinion of the Majority Lenders] a material adverse effect on:**

- a) the business, operations, property, condition (financial or otherwise) or prospects of the Group taken as a whole; or
- b) the ability of any of the Obligors to perform its obligations under the Finance Documents; or
- c) the validity or enforceability of, or the rights or remedies of any Finance Party under, the Finance Documents.

### **For secured transactions**

include a material adverse effect on the effectiveness or ranking of any Security granted or purporting to be granted pursuant to any of the Finance Documents.

# “BOILERPLATE”

Payment mechanics

Assignment/transfer

- Why do Lenders need the right to transfer.
- What can be transferred/assigned.
- Consultation or consent (hedge funds/competitors).
- Minimum transfer amounts.

# **“BOILERPLATE”**

## (CONTINUED)

### Partial invalidity

#### Amendments and waivers

- Majority Lender consent.
- Unanimous consent.
- Consent of the affected party.
- “Yank-the-Bank”.
- “Use it or lose it”/“Snooze you lose”.

### Set-off

#### Notices

#### Counterparts

#### Governing law

#### Jurisdiction

#### Arbitration



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**Each Interest Period for a Loan shall start on the Utilisation Date or (if a Loan has already been made) on the last day of the preceding Interest Period of such Loan.**

**For an interest period from 1 March 2024 to 31 March 2024, how many days of interest will be payable at the end of such interest period?**

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**Which of the following  
representation is not usually  
included as a Repeating  
Representation?**

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**Which of the following is usually an immediate Event of Default (i.e. not subject to any grace period)?**

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