

3. INTERNATIONAL LOAN FINANCE

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LOAN TRANSFERS

Banks may use one or more of a number of techniques to transfer loans as with other balance sheet assets. Asset sales or transfers have become increasingly common in recent years. This has been associated with the development of active secondary markets in loan and other asset sales as risk management techniques have become more sophisticated and regulatory obligations more intense.

Banks may wish to transfer assets for a number of reasons. This will be principally concerned with releasing funds for alternative use. Banks will constantly monitor lending and credit opportunities as against available sources of funds. Such decisions will mainly be taken in accordance with internal lending allocations and limits and business development strategies. Product and portfolio diversification will also be affected by regulatory obligations, especially with regard to concentration limits or large exposures with regard to particular clients or groups of clients and capital adequacy support. Lead banks will wish to be involved in all large syndicates, although their participation may breach their existing concentration limits with the particular clients involved. Some form of disposal will then have to be considered. Lead banks may also wish to dispose of their credit commitments immediately to avoid having to maintain capital against the loan exposure created. Disposals may also be made for country risk, fiscal (taxation) and reserve requirement reasons. The bank may also wish to develop its loan trading capability through its separate sales division.

A number of transfer options are available. These include legal or equitable assignment, novation, funded participation (or sub-participation), risk participation and securitisation. Trusts and agency or broking structures can also be used.¹ All of these have different consequences in terms of priority and enforceability depending on the new relationship created between the original debtor and the transferee. A number of other consequences will also arise in terms of credit risk transfer, regulatory recognition, tax implications, governing law and jurisdictional recognition, impact on rights of lien and set-off as well as other regulatory and potential legal liability issues.

The principal means of transfer are as follows.

(a) Assignment

Debt obligations create purely personal rights. They exist as pure intangibles under English property law and were historically incapable of transfer.² Debts can now be transferred either by legal or equitable assignment.

Legal assignment is effected under the Law of Property Act 1925, section 136. This requires that the assignment is made in writing, notice is given to the debtor and that the debt is for an unconditional amount. An equitable assignment is any other agreement to assign not complying with the statutory conditions prescribed. The legal effect of the assignment is then dependent on the giving of notice to the debtor. A legal assignment is ineffective without notice, while an equitable assignment only protects its priority from the date of notice. An equitable assignor must still join the assignor as plaintiff in any action on the debt, although any other difference between legal and equitable assignment is procedural rather than substantive.³

The determining factor is accordingly the giving of notice to the debtor. This determines the priorities between equitable assignments and prevents the debtor from continuing to make payments to the original assignor. The assignee's remedies would then only be in tracing.⁴ The debtor is also prevented from setting up any new rights of set-off, counterclaim or other equities against the assignor.⁵ A bona fide legal purchaser will still acquire the debt subject to any prior equities over the right of the assignee.⁶ Notice can be given by either the assignor or the assignee. Only express notice in writing is required under a legal assignment.⁷

¹ Wood (n 16) para 7.2; and Penn (n) para 8.07

² Roy Goode, *Commercial Law* (Penguin third ed 2004) 25 and 47. Debt obligations were considered to be purely personal between the participating parties and problems of maintenance may arise with parties abusing remedies against debtors in connection with which they would otherwise have no legitimate interest. The courts of equity did allow the assignor's name to be used by the assignee in common law actions, this became unnecessary under the Law of Property Act 1925, S136.

³ CPRr 19.4. Goode (n) 48. See also Penn (n) para 8.03.

⁴ Goode (n) 52-54 and 452

⁵ Penn (n) para 8.03

⁶ LPA, S136 see also *Dearle -v- Hall* (1828) 3 Russ. Where the assignor fraudulently assigns the same debt to a third party, the first to give notice to the debtor obtains priority. Goode (n) 56, 745 and 749-750. See also Penn (n) para 8.03 and (n) 11.

⁷ LPA S136. Contrast *Lloyd -v- Banks* [1868] Ch App 488 (the debtor was given notice through a newspaper).

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An assignment takes effect to transfer rights and benefits under the original contract but not the assignor's obligations.⁸ The original bank will accordingly remain liable to provide any committed funds under the loan contract subject to contrary agreement. Many standard term loan agreements will provide for assignment although this will only be of rights with rights and obligations only being transferred through novation.⁹

The loan documentation may require the consent of the borrower for the assignment although this is not necessary in law. This will nevertheless constitute notice with the effect of determining priorities and requiring the debtor to make any payments to the assignee from the date of notice.¹⁰ The contract may provide that consent is not to be unreasonably withheld or delayed.¹¹ Consent is not to be withheld only by reason that this may increase the mandatory costs imposed under the contract.¹² The borrower may also wish to ensure that any assignee (new lender) assumes the same obligations as if it had been an original party to the agreement.¹³

(b) Novation

Novation involves the cancellation of the original debt and its replacement by a new obligation between the original debtor and the transferee on the same terms as before. The original and new contracts are effectively substituted with the transfer of all rights and obligations. The borrower's agreement to repay the new debt effectively releases the original lender from the old debt.¹⁴

The difficulty that arises with regard to novation is securing agreement by all parties to the replacement contract. This can, nevertheless, be easily achieved by incorporating appropriate language and procedures in the original loan documents.¹⁵ These were previously referred to as Transfer Loan Certificates (TLCs) or Transferable Loan Instruments (TLIs) although this is less commonly used.¹⁶

The loan documentation will initially provide for consent, with consent not being unreasonably withheld or delayed.¹⁷ Consent is deemed to have been given where the assignment or transfer is to another existing lender or affiliate of an existing lender.¹⁸ The agent bank will be required to execute (sign) a duly completed transfer certificate in the form provided.¹⁹ The transfer clauses will provide that with effect from the transfer date, all existing rights and obligations are cancelled, corresponding new rights and obligations are assumed and the assignee becomes an original lender under the novated arrangements.²⁰ A copy of the transfer certificate will be sent to the borrower as soon as possible with any transfer fees being paid by the new lender.²¹ Any bank lender will also be given power to exchange information with its affiliates or assignee or transferee it considers appropriate.²² There will also be an exclusion of liability for any representations or warranties made with the new lender having to discharge any relevant 'know your customer' obligations and notify the agent bank accordingly.²³

⁸ *Trend Tex Corp -v- Credit Suisse* [1980] QB 629; *Tolhurst -v- Associated Portland Cement* [1902] to KB 660; and *United Dominions Trust -v- Parkway Motors* [1955] to All ER 557.

⁹ LMA 23.1 (a) and (b).

¹⁰ LMA 23.2 (a)

¹¹ LMA 23.2 (b)

¹² LMA 23.2 (c)

¹³ LMA 23.2 (d)

¹⁴ This avoids any problem with consideration under English Law. 'Selling loan assets under English Law: a basic guide'

International Financial Law Review (May 1986) 29.

¹⁵ [Julien Bailey, 'Novation' (1999) 14 *JCL* 189. Novation is distinct from variation or waiver. With variation, only the agreed terms are amended with the rest of the contract remaining in effect. Waiver is concerned with the voluntary surrender of a right or remedy. Sean Wilken, *The Law of Waiver, Variation and Estoppel* (2 ed 2002); Tony Dugdale and David Yates, *Variation, Waiver and Estoppel I - a Reappraisal* (1976) 39 *MLR* 680; P S Atiyah, 'Consideration and Estoppel: the thawing of the ice' (1975) 38 *MLR* 65. See also Goode (n) 104-107].

¹⁶ Arun Kumar Sarwal, *International Handbook of Financial Instruments and Transactions* (Butterworth London 1989 254-255). A transferable loan facility is a loan structured to allow portions of a medium term loan to be readily traded between lenders. A TLI is used to make transfer by way of legal assignment. A Transferable Loan Certificate (TLC) takes effect by way of novation which transfers rights and obligations. A Transferable Participation Certificate (TPC) involves novation of a sub-participation. This then combines a TLC with a sub-participation to avoid multi-tiering of participations. A subsequent participant will replace the prior participant to make funds directly available to the original lending bank. Paras

¹⁷ LMA 23.2 (a) and (b).

¹⁸ LMA 23.2 (a)

¹⁹ LMA 23.5 (a) and schedule 5. The transfer certificate is only provided in connection with novations. No separate form of assignment is provided under the LMA.

²⁰ LMA 23.5 (c) (I) (II) and (III)

²¹ LMA 23.6 and 23.3

²² LMA 23.7

²³ LMA 23.4 and 23.5 (b)

(c) Participation

A funded participation or sub-participation involves the transfer of the lending commitment and payment benefits by an original lending bank to a transferee. The participating transferee will then be funding the credit (or portion of the credit transfer) and receiving the benefits of the payments made by the borrower. This will, however, be on a non-recourse basis with the transferring bank assuming no separate liability to the transferee. Sub-participations are commonly used by lead banks to offload their lending commitment in whole or part to other banks not in the lead management group. These will commonly take effect on the date of the original loan agreement with the effect that the transferring bank assumes no separate financial or regulatory liability, although they do remain responsible for the credit risk of the borrower.

The sub-participations may be used where transfer restrictions are imposed under the original loan documentation. The difficulty for the participant is that it assumes the double credit risk of original borrower and the transferring lender's default. This is important where the payments that the participant will receive are made through the original lender via the agent bank. The participant will also have no direct rights and remedies under the original contract documentation although the participation agreement will generally allow it to veto or direct the consents given or withheld by the transferring bank.²⁴

A sub-participation is distinct from a participated loan. This involves the borrower entering into a loan contract with one bank with any other participating institutions being unknown to the borrower.²⁵ These may either be medium-term participation agreements or short-term master participation agreements with a rollover facility. US participations are also distinct.²⁶

(d) Risk Participation

A risk participation is used where the bank has a non-funded asset, usually in the form of a contingent liability, such as a guarantee or a confirmed letter of credit or accepted bill of exchange. The participant will undertake to compensate the original bank in the event of default by the borrower. This then takes the form of a credit guarantee or insurance undertaking. This is less common especially with the growth of the credit derivatives market.

Credit derivatives are used to package and sell credit risk by banks to other market counterparties. These can take a number of forms, with different regulatory conditions being applied. The key determinant is generally the extent to which credit risk is effectively transferred from the protection buyer to the protection seller.²⁷

(e) Securitisation

Securitisation involves the repackaging of categories or classes of loans into single portfolios which are then sold to Special Purpose Companies (SPVs). Bonds or other debt securities are sold by the SPV secured on the underlying loan portfolio. The effect is to convert the underlying loan based instruments into a securitised and tradable form.

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²⁴ Penn (n) para 8.06 and 8.14

²⁵ Sarwal (n 3) 251. The difference between a participated loan and a sub-participation would then depend on whether the participants were committed at the time the original loan comes into effect or only acquired their commitment subsequently. As an original bank lender may enter into the sub-participation contract before the original loan agreements comes into effect with effect from the same date and time, the distinction in practice may be minimal.

²⁶ Reade Ryan, *International Financial Law Review* (October 1984) *IFLR*.

²⁷ Section

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**SCHEDULE 5
Form of Transfer Certificate**

To: [] as Agent
From: [The Existing Lender] (the "Existing Lender") and [The New Lender] (the "New Lender")
Dated: [Company] – [] Facility Agreement

dated [] (the "Agreement")

1. We refer to the Agreement. This is a Transfer Certificate. Terms defined in the Agreement have the same meaning in this Transfer Certificate unless given a different meaning in this Transfer Certificate.
2. We refer to Clause **Error! Reference source not found.** (*Procedure for transfer*):
 - (a) The Existing Lender and the New Lender agree to the Existing Lender transferring to the New Lender by novation all or part of the Existing Lender's Commitment, rights and obligations referred to in the Schedule in accordance with Clause **Error! Reference source not found.** (*Procedure for transfer*).
 - (b) The proposed Transfer Date is [].
 - (c) The Facility Office and address, fax number and attention details for notices of the New Lender for the purposes of Clause **Error! Reference source not found.** (*Addresses*) are set out in the Schedule.
3. The New Lender expressly acknowledges the limitations on the Existing Lender's obligations set out in paragraph (c) of Clause **Error! Reference source not found.** (*Limitation of responsibility of Existing Lenders*).
4. [The New Lender confirms that the person beneficially entitled to interest payable to that Lender in respect of an advance under a Finance Document is either:
 - (a) a company resident in the United Kingdom for United Kingdom tax purposes;
 - (b) a partnership each member of which is:
 - (i) a company so resident in the United Kingdom; or
 - (ii) a company not so resident in the United Kingdom which carries on a trade in the United Kingdom through a permanent establishment and which brings into account in computing its chargeable profits (for the purposes of section 11(2) of the Taxes Act) the whole of any share of interest payable in respect of that advance that falls to it by reason of sections 114 and 115 of the Taxes Act; or

a company not so resident in the United Kingdom which carries on a trade in the United Kingdom through a permanent establishment and which brings into account interest payable in respect of that advance in computing the chargeable profits (for the purposes of section 11(2) of the Taxes Act) of that company.]
- [4/5]. This Transfer Certificate may be executed in any number of counterparts and this has the same effect as if the signatures on the counterparts were on a single copy of this Transfer Certificate.
- [5/6]. This Transfer Certificate is governed by English law.

THE SCHEDULE

Commitment/rights and obligations to be transferred

[insert relevant details]

[Facility Office address, fax number and attention details for notices and account details for payments,]

[New Lender]

[Existing Lender]

By:

By:

This Transfer Certificate is accepted by the Agent and the Transfer Date is confirmed as [].

[Agent]

By: