Bond Law

BOND LAW SLIDE 1

INTRODUCTION AND OUTLINE STRUCTURE

1. LOANS AND BONDS Historical Development Nature and Function
2. STRUCTURES, PARTIES AND DOCUMENTATION
3. ISSUE PROCEDURE
4. SPECIAL ISSUES AND TERMS
5. COMMENT AND CONCLUSIONS

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SLIDE 2

1. LOANS AND BONDS

General Differences
(1) Transferability
(2) Character of investors
(3) Number and anonymity of investors
(4) Issue mechanics

(1) ISSUE AND SALE FORMALITY
(2) DOCUMENTATIOSN COMPLEXITY
(3) TRANSFERABILITY
(4) CREDIT CONTROL
(5) DEFAULT AND RECOVERY

Bond Law

1. LOANS AND BONDS SLIDE 3

(1) ISSUE AND SALE FORMALITY
- (1) LOANS Simple
- (2) BONDS Complex

(2) DOCUMENTATION COMPLEXITY
- (1) LOANS Single Agreement
- (2) BONDS Multiple Documentation

(3) TRANSFERABILITY
- (1) LOANS Limited
- (2) BONDS Inherently Negotiable

(4) CREDIT CONTROL
- (1) LOANS Significant
- (2) BONDS Limited

(5) DEFAULT AND RECOVERY
- (1) LOANS Credit Risk
- (2) BONDS Sell-onsss

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SLIDE 4

OPERATIONAL DIFFERENCES

(1)	Disclosure requirements	No exemption
(2)	Documentation	More complex
(3)	Advance of funds	Single advance
(4)	Currency conversion	Impracticable
(5)	Interest	Fixed of floating (notes)
(6)	Repayment	Limited flexibility
(7)	Voluntary prepayment	Excluded (selective)
(8)	Margin protections	No increased costs

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SLIDE 5

OPERATIONAL DIFFERENCES

(9)	Payments and Equality	Coupons and no pro rata
(10)	Warranties	Subscription agreement
(11)	Covenants	Limited
(12)	Events of Default	Less strict / grace periods
(13)	Modifications	Consent unless meetings
(14)	Transfer	Fully negotiable
(15)	Prescription	Contractual cancellation
(16)	Governing Law	Standard

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SLIDE 6

2. STRUCTURE, PARTIES AND DOCUMENTATION

1. STRUCTURE

Marketing and distribution methods:
- (1) Private Placements — Selective placement
- (2) Preliminary Prospectus Offerings
- (3) Impact Day Offerings — Public advertisement

2. PARTIES

Bond transaction participants:
- (1) Managers — 3 to 12 to arrange issue
- (2) Underwriters — Large group underwrite
- (3) Selling Group — Professional dealers

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SLIDE 7

2. STRUCTURES, PARTIES AND DOCUMENTATION

3. Documentation

(1) Prospectus of Offering Circular	Issue information
(2) Subscription Agreement	Managers and issuer
(3) Underwriting Agreements	Managers and Unders
(4) Selling Agreements	Managers/selling group
(5) Managers Agreement	Lead Manager
(6) Trust Deed	Trustee and Issuer
(7) Fiscal Agency Agreement	Issuer and Agent
(8) Global Bond	Definitive bonds

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3. ISSUE PROCEDURES

SLIDE 8

Negotiation procedures

(1)	Lead Manager	Documentation preparation
(2)	'Launch Date'	Send invitational telexes/POC
(3)	Managers and Issuers	Agree 'coupon' and price
(4)	Managers and Issuers	Sign subscription agreement
(5)	Final Prospectus	Despatched
(6)	Selling Group	Agree amounts sell
(7)	Trust Deed/FA	Signed with Issuer
(8)	Stock Exchange	Listing confirmed
(9)	'Closing'	Deliver docs and global bond
(10)	Definitive bonds	Issued to custodian

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4. SPECIAL ISSUES AND TERMS

SLIDE 9

1. **STABILISATION** Managers authorised to stabilise

2. **LISTING** Access and price but comply listing rules

3. **NEGOTIABILITY OF BONDS** Perfect title

   Goodwin v Robarts (1876) 1 App Cas 476, Russian govt scrip issue negotiable
   Picker v London and County Co (1887) 18 QBD 515, Prussian bonds
   Edelstein v Schuler [1902] 2 KB 144, Bingham J 'usage so often proved' law
   Bechuanaland Exploration Co v London Trading Bank [1898] 2 QB 658
   London Joint Stock Bank v Simmons [1892] AC 201, Lord Macnaghten

4. **GOVERNING LAW OF NEGOTIABILITY** Chattels
   Lloyds Bank v Chartered Bank of India [1929] I KB 40, CA, place of negotiation or delivery

5. **CLEARING SYSTEMS**

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5. TERMS OF BONDS

SLIDE 10

(1)	Face of Bond		Promise to pay bearer
(2)	Fiscal Agency Agreement		Express incorporation
(3)	Form and Transfer		Bearer form and pass by delivery
(4)	Covenants		Rare unless trustee to monitor
(5)	Pari Passu Clause		Unsecured and rank pari passu
(6)	Negative Pledge		Limit to comparable securities
(7)	Information		Annual accounts and listing
(8)	Interest (a)	Fixed Rate	Annually in arrears specified date
	(b)	Floating	Reference agent fix rate
	(c)	Zero Coupon	Deep Discount (30% par)
	(d)	Swaps	Possible interest rate swap

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TERMS OF BONDS

SLIDE 11

(9)	Redemption	(1) Bullet — Single instalment (2) Instalments — Fixed periodic instalments (3) Purchase Funds — Purchase agent
(10)	Perpetuals	Only redeemable on default
(11)	Voluntary Redemption	Sliding premium
(12)	Early Redemption	Withholding tax redemption
(13)	Purchase by Issuer	Generally no restrictions
(14)	Payments	Coupons
(15)	Prescription	Statutory or contractual
(16)	Events of Default	Non-payment, non-compliance, cross-default, insolvency, bankruptcy, dissolution, other creditor's processes and possibly substantial disposals
(17)	Acceleration and Enforcement	Trust deed no-action
(18)	Notices and Governing Law	Same

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5. COMMENT AND CONCLUSIONS

SLIDE 12

1. Loans and bonds parallel origin and development at same time as discharge same economic function – early instruments same amount, term and approximate cost (interest rate)

2. More recently preference transferable debt instruments as aprt larger 'securitisation' process especially where fully negotiable but require secondary market and sufficient credit standing

3. Following early emergence bond format, number increasingly shorter term instruments evolve to dominate modern capital markets

4. Continuing advantage syndicated term loans remain control and flexibility which may be appropriate and indeed essential in certain circumstances

5. Both forms of financing remain core instruments in current best market practice within City of London and elsewhere.

INTERNATIONAL FINANCE LAW **G A WALKER**

4. INTERNATIONAL BOND FINANCE

BOND MARKETS

BOND STRUCTURES
- (1) **Amount, Term and Interest Payment**
- (2) **Form**
- (3) **Parties**
- (4) **Documentation**
- (5) **Ancillary and Additional Provisions**

BOND ISSUANCE
- (1) **Mandate**
- (2) **Launch Date**
- (3) **Documentation**
- (4) **Terms**
- (5) **Signing**
- (6) **Dealing and Stabilisation**
- (7) **Allotment**
- (8) **Trust Deed**
- (9) **Listing**
- (10) **Closing**
- (11) **Definitive Bonds**
- (12) **Global Bonds and Securities**

BOND NEGOTIABILITY

BOND CLEARING

EUROBONDS
- (1) **Plain Vanilla and Variable Bonds**
- (2) **Floating Rate Notes (FRNs)**
- (3) **Perpetuals**
- (4) **Warrants**
- (5) **Equity Linked Bonds**
- (6) **Euro Medium Term Notes (MTNs)**
- (7) **Euronotes**
- (8) **Euro Commercial Paper (ECP)**
- (9) **Certificates of Deposit (CDs)**
- (10) **Multi Option Funding Facility (MOFF)**

BOND STRUCTURES AND CORPORATE BONDS

- (1) **UK Gilts, Stocks and Bonds**
  - (a) **Gilt-Edged Securities**
  - (b) **Local Authority Stocks**
  - (c) **Public Sector Board Bonds**
- (2) **US Treasury, Agency and Municipal Bonds**
  - (a) **Treasuries**
  - (b) **US Federal Agency Securities**
  - (c) **Municipal Bonds**
- (3) **Japanese Government Bonds and Debentures**
- (4) **German Government Bonds and Debentures**
- (5) **Other Government Securities**
- (6) **Corporate Bonds**
  - (a) **UK Debentures and Loan Stock**
  - (b) **US Corporate Bonds**
  - (c) **Japanese Bond Market**
- (7) **Foreign Bonds**
- (8) **Bond Variants**

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4. INTERNATIONAL BOND FINANCE

The principal alternative to bank lending is the issuance of debt securities. These are most commonly referred to as bonds although particular bonds of Government securities may be issued (such as UK gilts or US Treasury bills) with corporate bonds constituting debentures.

The principal advantage of bonds or debenture stock is that they are inherently transferable following primary issuance on either formal or over-the-counter (OTC) secondary markets. This makes the debt more attractive to investors which increases supply of funds for investment stock. Transferability allows more flexible management of investment portfolios while secondary trading increases liquidity. While bonds can generally mimic loans with identical amounts, term and interest, borrowers with good credit standing will be able to obtain funds at considerably lower cost.

Government bond markets have always constituted a significant component within any domestic financial system with investment restrictions (such as on insurance companies or pension funds) requiring mandatory minimal investment amounts. Many companies have also preferred to issue debenture rather than equities as this avoids the need for increased shareholder representation, accountability and control. International bonds were also developed at an early stage in the evolution of the Euro-dollar markets although they became of particular importance during the 1980s especially with the restructuring of Third World Debt and the Debt Crisis beginning in 1982. A large number of variations have also been developed in recent years, in particular, with shorter duration euro notes (including floating rate notes (FRNs), medium term notes (MTNs) and note issuance facilities (NIFs)) and dis-intermediated commercial paper (CP) programmes.

Bond documentation tends to be simpler than with loans and, in particular, syndicated lending facilities. The number of documents involved may nevertheless be larger especially where the bonds are underwritten, coupon payment is to be made in more than one country and a bond trustee is to be appointed. Additional regulatory requirements will also apply where a public offering is involved. This will require compliance with all relevant local company and public listing or issuance requirements.

One of the most notable significant developments in international finance in recent decades has been the preference for transferable security based financing in preference to loan facilities. This increase in securitisation based credit has been further stimulated by the increase in cross-border lending and investment which favours the use of security based instruments. This growth has been further stimulated by the expansion and changing role and function of stock markets and exchanges including their demutualisation (incorporatisation) and subsequent consolidation. The introduction of demobilisation (depository held securities) and subsequent dematerialisation (issuance in only an electronic or digital form) has also further stimulated this process. Bond financing will accordingly become of even more importance in future years with the continued globalisation and digitalisation of modern credit provision.

The purpose of this chapter is to consider the nature and structure of the bond market including the principal characteristics of the instruments involved and the participating parties in the market. The different types of bond instrument available are then reviewed. The main types of issuance procedure are outlined. The principal documents and terms and conditions involved are reviewed including those produced by the main international trade associations, the International Capital Markets Committee (ICMA). Additional regulatory and tax issues are also reviewed.

BOND MARKETS

Bond markets can be considered to constitute the earliest types of security markets[1]. The earliest official or government debt instruments date from the 1300s in the City of Florence with the first issuance of long term municipal debt (the *Monte Commune*)[2].

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[1] A security is a type of transferable financial asset or claim which either represents a debt obligation issued by a government or corporate body or an interest in the body concerned. Walker, 'financial markets and exchanges ' para 1.56 in M Blair and G A Walker, *Markets and Exchanges Law* (OUP Oxford 2006), Ch 1. A security will either take the form of a debt obligation such as a bond or debenture or a share or equity interest.

[2] The Monte Commune was issued by the City of Florence with interest being paid through tax collections. The price of the debt subsequently fell when taxes fell into arrears. Early banking families, such as the Medici held shares in the Monte Commune, although they also engaged in private banking as well. The first clearing bank was the *Casa de San Giorgio* which

LEAD BANK AND AGENT BANK LIABILITY **G A WALKER**

(1) LIABILITY ***Re Colocotronis Tanker Securities Litigation*** **[1976]**

- **(a) Common Law Misrepresentation** ***s2(1) Misrepresentation Act 1967***
- **(b) Statutory Misrepresentation and Deceit** ***s19 Theft Act 1968***
- **(c) Agency Liability**
- **(d) Fiduciary Duties**
- **(e) Regulatory Liability FSMA 2000**
  - **(a)** ***Authorisation, Permission & Promotion*** **(ss 19,20,21)**
  - **(b)** ***Listing and False or Misleading Particulars*** **(ss 80,90**
  - **(c)** ***Damages (s 138D FSMA as amended)***
  - **(d)** ***Market Abuse (s 118 FSMA & EU MAReg 596/201)***
  - **(e)** ***Misleading Statements & Impressions*** **(s 397 FSMA) (ss 89, 90 FSA 2012).**

(2) LIMITED DUTY

- **(a) No Duty**
- **(b) Information Supply**
- **(c) Own Credit Assessment**
- **(d) No Reliance**
- **(e) No Fiduciary Duty**

(3) LIMITED LIABILITY

- **(a) Exclusion**
- **(b) Set-Off**
- **(c) Estoppel**
- **(d) Indemnity**
- **(e) Contributory Negligence** ***Law Reform (Contributory Negligence) Act 1945***

(4) EXCLUDING LIABILITY

- **(a) Construction** ***Contra Proferentem***
- **(b) No Application**
  - **(a) Fraud or Fraudulent Misrepresentation**
  - **(b) Criminal Liability**
  - **(c) Statutory Liability**
  - **(d) Clause Misrepresented**
  - **(e) Separate Oral Warranty**
- **(c) Statutory Terms**
  - **(a) Consumer Contracts Regulations 1999**
  - **(b) Unfair Contract Terms Act 1977**
  - **(c) Negligence s 1(1) UCTA**
  - **(d) Reasonableness s 11(1) and Sch 2**
  - **(e) Misrepresentation s 3 MA 1967 (s 8 UCTA)**

Re Colocotronis Tanker Securities Litigation **1976**
JP Morgan Chase Bank v Springwell Navigation Corporation **2008 and 2010**
IFE Funds SA v Goldman Sachs International **2007**
Peekay Intermark Ltd v Australia & New Zealand Banking Corporation **2006**
Deepak Fertilisers v ICI; Bankers Trust International Plc v P T Dharmala **1996**
Abu Dhabi Commercial Bank v. Morgan Stanley & Co.**, 651 F.Supp.2d 155, 170 (S.D.N.Y. 2009)**

(5) REMEDIES

- **(a) Suspension or Withholding Further Advance**
- **(b) Cancellation of Obligation to Lend under the Facility**
- **(c) Acceleration of Repayment**
- **(d) Rescission of the Loan Documentation**
- **(e) Damages for Breach of Contract or Tort**

LEAD BANK AND AGENT BANK LIABILITY **G A WALKER**

A number of important legal issues arise with regard to the potential liability of each of the parties to an international financial transaction. The function of the documentation is to record and allocate risk and liability between the various participants to the deal in accordance with their relative financial and bargaining positions. Much of this will be dealt with at the negotiation stage with advisors on each side trying to protect the position of their clients in so far as possible.

The issues arise with regard to the arranging bank or managers and co-managers as well as the agent bank under a syndicated lending facility as well as to the lead and agent banks under a bond, note or commercial paper programme. The main factors concerned can be assessed in terms of liability, limitation of liability, exclusion of liability, exclusion limits and remedy. Each of these is considered in turn.

(1) LIABILITY

Liability may attach under a term or syndicated facility against the borrower, the lead manager, other managers and the agent bank. The borrower may breach the payment or financial provisions contained in the agreement or other material non-financial clauses. The banks may agree to waive non-material breaches although payment or other material non-compliance will trigger default. The banks will then have the available contractual remedies including suspension of further payment, cancellation, acceleration, rescission and damages[1].

The borrower will principally be responsible for the information provided in the information (or placement) memorandum. This is often prepared by the borrower and simply passed on to the lead managers on distribution[2]. As misrepresentation will generally only be considered once the borrower has failed to make payment under the loan agreement, the syndicate banks may proceed against the lead manager. The potential liability of lead manager was confirmed in the 1976 *Colocotronis Tanker Securities Litigation*[3] in which the lead manager EABC agreed to remit the full amount of the participation of each of the original US banks within the syndicate[4]. The litigation was reported to have stunned the lending community with lead managers and their legal advisors only subsequently taking additional care to avoid liability under the information memorandum[5].

The agent bank may be liable for breach of these duties under the agreement although these are generally narrowly defined and only come into effect after the first advances have been made to the borrower. The agent bank will not be responsible for the content of the information memorandum. Liability would only otherwise attach if the agent bank had also acted as lead manager although this would be unusual in practice as agency functions are usually carried out by separate administrative departments within the larger financial groups, in particular, in light of the low fees paid.

Liability may also attach to each of the co-lead managers although it is unlikely that other members of the lending syndicate could be liable *inter se* in light of their several commitments[6] and non-involvement with the information memorandum. They may only be liable in contract of tort where they otherwise breached the terms of the loan agreement especially with regard to pari passu recovery and distribution[7].

The main heads of liability to consider are then common law misrepresentation (fraudulent, negligent and innocent), statutory misrepresentation or statutory deceit, breach of common law agency or fiduciary duty and potential regulatory liability under the Financial Services and Markets Act 2000 (FSMA).

(a) Common Law Misrepresentation

A party may be liable under common law for fraudulent, negligent or innocent misrepresentation xwith fraud also being subject to criminal penalty. Fraudulent misrepresentation arises where a misrepresentation is made with knowledge of its falsity or recklessly not caring whether it is true or false[8]. Rescission and damages are available.

A party may be liable for negligent misrepresentation where a special relationship or trust or confidence exists under the leading case of *Hedley Byrne & Co Ltd v Heller & Partners Ltd*[9]. This also requires actual inducement and causation[10].

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1 LMA 4.2 (no Default), 23.1-13 (events of default), 23.13 (acceleration), 34 (remedies and waivers) 35 (amendments and waivers). Sections 7 (loan default) and 8 (default remedies).

2 Slater, 'Syndicated Bank Loans' [1982] JBL 173, 175-176.

3 *Re Colocotronis Tanker Securities Litigation* 420 F Supp 998 (Sdny 1976).

4 European-American Banking Corporation (EABC) had set up a syndicate with a number of American regional banks to provide syndicated facilities to the Colocotronis Shipping Group. The participating banks argued that the lead manager had a duty to advise them on all material facts relevant to the credit with EABC being expert in international finance and in assessing and promoting relevant participations. EABC had then failed in its duty of care in releasing untrue statements of material fact and omitting other facts.

5 McDonald, *International Syndicated Loans* (1982) 126. For discussion, G A Penn, A M Shea and A Arora, *The Law and Practice of International Banking* (Sweet & Maxwell 1987) para.7.05.

6 LMA 2.2(a). Section 5(1).

7 LMA 28. Section 5(3).

8 *Derry v Peek* (1889) 14 App Cas 337 (HL).

9 The court will consider the nature of the involvement of the lead manager in the preparation of the information memorandum. The degree to which the manager was identified as the source of information would also be considered with the complexity of the transaction, other access to information, solicitation and benefit. [1964] AC 65. *Chitty Law Contracts* ( ).

10 *JEB Fasteners Ltd v Marks Bloom & Co* [1983] 1 All ER 583; and *The Lucy* [1983] 1 Lloyd's Rep 188. The statement must also generally be one of fact rather than of law, advice, opinion or intention (unless the opinion or intention was not actually held). *Edgington v Fitzmaurice* (1885) 29 Chd 459 (the directors were held liable where they had represented that the proceeds of a debenture issue were to be used to purchase new equipment when the company was already insolvent and the funds were to be used to cover outstanding debts).

Statements of law are not misrepresentations to the extent that everyone is assumed to know the law. This would not apply where statements of law and fact are mixed which may apply with regard to any statements of legal capacity, legal validity, legal effect, security,

STRUCTURAL SUMMARY

INTERNATIONAL COMMERCIAL LOAN

BOND OFFERING

Borrower

Intermediaries (Fees)

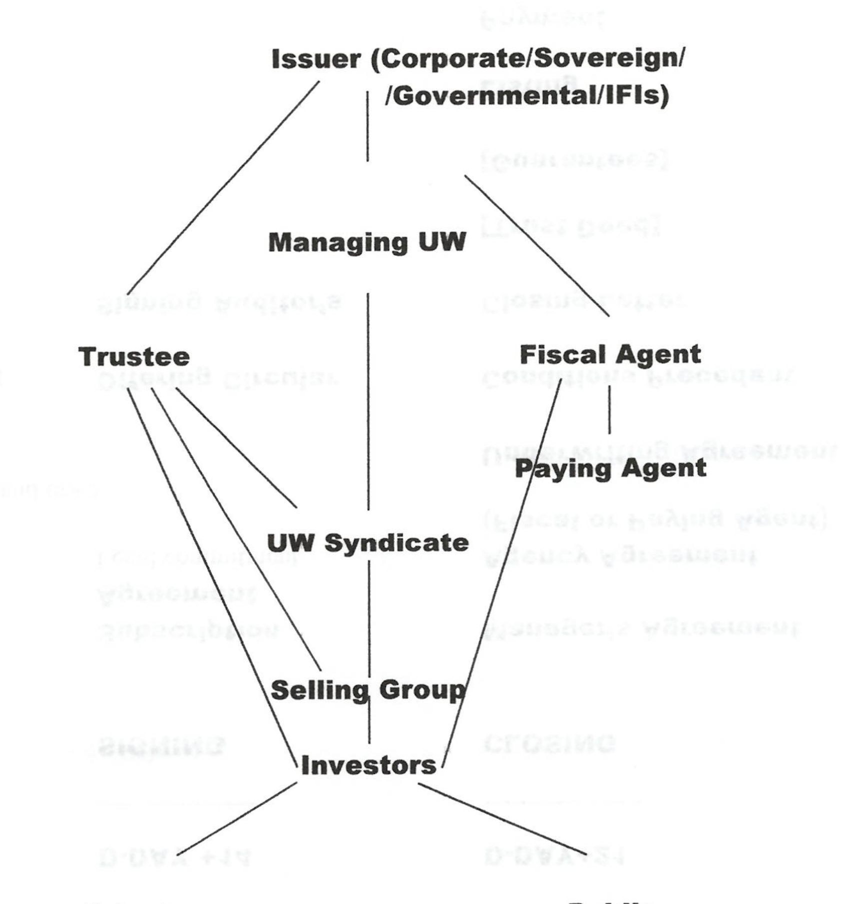
Credit Providers/Investors

Borrower

Agent

Syndicate Lenders

(Participants)



EUROBOND ISSUE **G A WALKER**

TIME LINE

MARKETING	D DAY - 7	D DAY	D-DAY +14	D-DAY+21
	PRE-LAUNCH	**LAUNCH AND SYNDICATION**	**SIGNING**	**CLOSING**
Initial Client Request or Approach	**Mandate Letter and Due Diligence**	**Invitation and Allotment Telex or Fax**	**Subscription Agreement** Legal commitment	**Manager's Agreement**
		Brief terms except coupon and price (par, discount or premium)		**Agency Agreement (Fiscal or Paying Agent)**
				Underwriting Agreement
		Preliminary Offering Circular	**Offering Circular**	**Conditions Precedent**
		Comfort Letter	**Signing Auditor's**	**Closing Letter**
				[Trust Deed]
				[Guarantees]
				Listing
				Payment
			[Common Depositary] Delivery global and final bonds	**Global Bonds**
				Closing Certificate

(1) Private Placement
Managers subscribe whole issue and place directly.

(2) Preliminary Prospectus Offering
Use 'red herring' or 'pathfinder' Prospectus to test market with subsequent public offering.

(3) Impact Day Offerings
Managers fix issue terms and announce offering by public advertisement on impact day.

'Bought Deals'
No preliminary prospectus with managers buy themselves and on-sell. Possibly announce to market on dealers screen at time terms fixed with invitational telexes follow. Managers place issue with clients and other dealers.

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CAPITAL MARKET LINKED DOCUMENTATION

ICMA
https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/ipma-handbook-home/

DEFINITIONS
http://www.investopedia.com/dictionary/
https://moneyweek.com/financial-glossary/
http://www.finance-for-non-financials.com/top-100-terms-alphabethically
https://moneyweek.com/financial-glossary/

DOCUMENTS

Sample Documents (US) https://www.onecle.com/
https://www.lawinsider.com/

Bond Subscription Agreement
http://www.ernestborel.ch/pdf/inspection/019_Material_contract_c_ Subscription_agreement_dated_5_January_2017_in_relation_to_the_Convertible_Bonds.pdf
http://documents.worldbank.org/curated/en/491301554821864140/pdf/Issuing-International-Bonds-A-Guidance-Note.pdf

Eurobond Market Background
http://scholarship.law.unc.edu/cgi/viewcontent.cgi?article=1339&context=ncilj

Notes Subscription Agreement
http://www.euro-private Placement.com/Euro_PP-Note-EN-Jan_2015.pdf

Sample Prospectus
https://www.accountancyeurope.eu/wp-content/uploads/170609-Model-Simplified-SME-Prospectus.pdf
https://www.belong.org.uk/sites/default/files/attachments/icm-30150635-v1-belong_-_final_prospectus.pdf

Financial Ratios
https://www.myaccountingcourse.com/financial-ratios
https://business.bankofscotland.co.uk/help/key-financial-ratios.html
https://corporatefinanceinstitute.com/resources/knowledge/finance/financial-ratios/

Bond Purchase Agreement (US)
https://www.sec.gov/Archives/edgar/data/276209/000095012304006017/y97137exv4w18.htm

Bond Purchase Contract (California)
https://www.treasurer.ca.gov/chffa/templates/contract.docx

Underwriting Agreement
https://contracts.onecle.com/etsy/goldman-underwriting-2015.shtml

Paying Agency Agreement
https://corporate.findlaw.com/contracts/operations/paying-agent-agreement-the-bank-of-new-york-and-qwest-capital.html

Fiscal Agency Agreement
https://webcache.googleusercontent.com/search?q=cache:3skBm1S5gZMJ:https://dps.mn.gov/divisions/ojp/grants/Documents/SampleFiscal%2520Agent%2520Agreement.doc+&cd=1&hl=en&ct=clnk&gl=uk&client=firefox-b-d

Model Trust Deed
http://www.steinhoffinternational.com/downloads/2017/Attachment-3.pdf

Repo Market
https://www.icmagroup.org/assets/documents/Regulatory/Repo/ERCC-Guide-to-Best-Practice-December-17-181217.pdf

BREXIT ICMA
https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/brexit-implications-for-icma-members-of-the-uk-vote-to-leave-the-eu/

DOCUMENTS (FOR FEE) https://www.lawdepot.co.uk/
https://templateagreements.co.uk/

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STANDARD FINANCE CLAUSES

LMA Standard (Investment Grade Agreement) Documentation
https://www.slaughterandmay.com/media/2536372/the-act-borrowers-guide-to-the-lmas-investment-grade-agreements.pdf
Term Loan https://www.investopedia.com/terms/t/termloan.asp
Euro$ https://www.investopedia.com/terms/e/eurodollar.asp
Covenants
https://www.investopedia.com/terms/c/covenant.asp
https://corporatefinanceinstitute.com/resources/knowledge/finance/loan-covenant/
Representations, Covenants and Events of Default
http://www.mondaq.com/Nigeria/x/730726/charges+mortgages+indemnities/Representations+Covenants+And+Events+Of+Default+Understanding+The+Basics+Of+Loan+Agreements
Misrepresentation https://www.investopedia.com/terms/m/misrepresentation.asp
Events of Default https://www.investopedia.com/terms/e/event-of-default.asp

No Proceedings Pending or Threatened
https://www.investopedia.com/terms/l/litigation-risk.asp

Sample Clauses
https://www.lawinsider.com/clause/no-litigation
https://www.contractstandards.com/public/clauses/litigation-representation
https://uk.practicallaw.thomsonreuters.com/7-525-8053?transitionType=Default&contextData=(sc.Default)&firstPage=true

Financial Covenants
https://www.investopedia.com/terms/c/covenant.asp
https://uk.practicallaw.thomsonreuters.com/2-383-3168?transitionType=Default&contextData=(sc.Default)&view=hidealldraftingnotes
Sample Clauses
https://www.lawinsider.com/clause/financial-covenants

Negative Pledge Clause
https://www.investopedia.com/terms/n/negativepledgeclause.asp
[https://www.lawteacher.net/free-law-essays/commercial-law/pari-passu-clause-and-negative-pledge-commercial-law-essay.php]
https://www.upcounsel.com/negative-pledge
https://investinganswers.com/dictionary/n/negative-pledge-clause
'Negative Pledge as a Security Device' JSTOR
https://www.jstor.org/stable/24866901?seq=1#metadata_info_tab_contents
https://openarchive.cbs.dk/bitstream/handle/10398/7727/tamasauskas%20wp%202003.pdf?sequence=1
Sample Clauses
https://www.lawinsider.com/clause/negative-pledge

Cross-Default Clause
https://www.investopedia.com/terms/c/crossdefault.asp
Cross-Acceleration Clause (only if repayment accelerated under second agreement)
https://uk.practicallaw.thomsonreuters.com/1-382-3377?transitionType=Default&contextData=(sc.Default)&firstPage=true

Sample Clauses
https://www.lawinsider.com/clause/cross-default

Material Adverse Change (MDC) Clause
https://www.investopedia.com/articles/analyst/112702.asp
https://www.lexology.com/library/detail.aspx?g=ab2253db-a218-4104-9866-611bdd693210
https://www.divestopedia.com/definition/4954/material-adverse-change-mac
https://uk.practicallaw.thomsonreuters.com/0-107-6824?transitionType=Default&contextData=(sc.Default)
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ESTOPPEL BETWEEN BANKER AND CUSTOMER

[403]

With regard to estoppel and the general nature of the relationship between a bank and its customer, while the bank is obliged to honour the customer's cheques immediately on presentation (provided sufficient funds or credit are available for that purpose),[1] the customer must exercise care in issuing and preparing cheques so that the bank is not misled by the payment mandate or instruction given. The customer must also notify the bank of any forgeries as soon as he becomes aware of them[2]. If loss is suffered, this will be borne by the customer[3] whether the action is based on estoppel or not[4]. Reciprocal payment and care obligations are accordingly created although the customer is only required not to facilitate forgery which may cause the bank loss and to report forgeries once they have come to the customer's attention. Subsequent cases have re-examined estoppel with regard to misrepresentation and the enforceability of express contractual terms especially in sales and advisory relationships. These decisions have confirmed the difficulty in establishing misrepresentation and reliance and the need for certainty in contractual validity and commercial certainty[5]. The issue of estoppel by representation or convention was raised in a clarificatory ruling by Northern Rock Asset Management (NRAM) to determine whether certain 'Together' mortgages imported the protections available under s 77A of the Consumer Credit Act (as introduced under the Consumer Credit Act 2006)[6]. Parties cannot, however, use contractual clauses to avoid challenges of fact (referred to as 'basis clauses') only to avoid application of a reasonableness assessment under the UCTA.[7]

1 See Spencer Bower (3rd edn), para 63 and Spencer Bower (4th edn), para III.4.8 and IX.6.1. see also and D[23]. For early discussion of the nature of the estoppel which arises, see *Ogilvie v West Australian Mortgage and Agency Corpn Ltd* [1896] AC 257, PC; and *Fung Kai Sun v Chan Fui Hing* [1951] AC 489, PC.

2 See *London Joint Stock Bank Ltd v Macmillan* [1918] AC 777, HL which concerned the duty of the customer to refrain from drawing cheques or other payment orders in a manner likely to facilitate forgery; and *Greenwood v Martins Bank Ltd* [1933] AC 51, HL which confirmed the duty of the customer to inform the bank of any forged payment as soon as he became aware of it. But see also *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80, [1985] 2 All ER 947, PC in which the existence of any wider duty of care was rejected. See para [404] below; and C [48] and C [385] and D [23] and D [282]. The duty of care owed by a customer to a bank in respect of forged payments only arises where the customer has actual as opposed to constructive knowledge of the forgery. See *Price Meats Ltd v Barclays Bank plc* (2000) Times, 19 January.

3 See *London Joint Stock Bank v Macmillan and Arthur* [1918] AC 777, HL per Lord Finlay at 789, 793 and 794, Lord Haldane at 814–816, Lord Shaw at 824–825 and Lord Parmoor at 830.

4 See, for example, *Swan v North British Australasian Co* (1863) 2 H & C 175, Ex Ch in which Cockburn CJ expressed the view that the law permits the customer's negligence to be set up as a defence for the purpose of avoiding circuity of action which opinion was supported by Lord Haldane in Macmillan at 818. Spencer Bower argues that it is simpler and sounder to treat the customer's negligence as a representation that his mandate is in order and that it may be safely acted upon by the bank following which the customer will be estopped from complaining that the bank acted upon the mandate. This approach is also supported by remarks made by Lord Finlay at 793, Lord Haldane at 817 and Lord Parmoor at 830. See Spencer Bower (3rd edn), para 63; and Spencer Bower (4th edn), para III.5.2. Estoppel may not, however, be available against a statute nor can it prevent a trustee in bankruptcy from carrying out its statutory duties to realise a bankrupt's assets. See *Smith v Lock (a bankrupt)* [1998] BPIR 786.

5 The Appeal Court has held that parties are estopped by contract from asserting that facts are not true where they have already agreed that a particular state of affairs will form the basis for their relations. *Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386 (06 April 2006). Gloster J upheld the enforceability of contractual disclaimers and refused to imply a duty to advice in in *JP Morgan Chase Bank v Springwell Navigation Corporation* [2008] EWHC 1186 (Comm). Gloster J supported the doctrine of contractual estoppel as set out by Moore-Bick LJ in Peekay. Permission to appeal was refused in *JP Morgan Chase Bank v Springwell Navigation Corp* [2009] EWHC 282 (Comm) (20 February 2009). The appeal was dismissed by the Court of Appeal in *JP Morgan Chase Bank v Springwell Navigation Corpn* [2010] EWCA Civ 1221, [2010] 2 CLC 705, [2010] All ER (D) 08 (Nov). See also *Trident Turboprop (Dublin) Ltd v First Flight Couriers Ltd* [2008] EWHC 1686 (Comm) (17 July 2008). Contractual estoppel was upheld by in *Titan Steel Wheels Ltd v The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm) (11 February 2010). David Steel J held that the claimants were contractually estopped from arguing that the matters set out in the documents were not true or, in the alternative, that this created an evidential basis that negated the coming into existence of any duty of care. In *Raiffeisen Zentralbank Osterreich AG v The Royal Bank of Scotland plc*

[2010] EWHC 1392 (Comm) (11 June 2010), RBS was held not to have made any implied misrepresentation which had induced RZB to enter into an Enron related loan syndicate. No misrepresentations had been made and, even if they had been, they were not false. Clarke J further ruled that RZB was contractually estopped from advancing its claim on the basis of provisions in the syndication documentation, including the Information Memorandum, Confidentiality Agreement and other papers. A similar approach was followed by Mr Justice Flaux in *Barclays Bank plc v Svizera Holdings BV and Maneech Pharmaceuticals Ltd* [2014] EWHC 1020 (Comm), [2015] 1 All ER (Comm) 788, [2014] All ER (D) 65 (Apr) with reference inter alia to *Peekay and Springwell*, paras 58–62.

6 Mr Justice Burton concluded at first instance that the rights and remedies available under section 77A had been imported into the contractual documentation and that NRAM had been estoppel by convention or representation from denying reliance. He declined to rule on the issue of promissory estoppel. *NRAM plc v McAdam* [2014] EWHC 4174 (Comm), [2015] 2 All ER 340, [2015] 1 All ER (Comm) 1239. The decision was reversed on appeal with the Court of Appeal rejecting the existence of any contractual estoppel, estoppel by convention or estoppel by representation. See *NRAM plc v McAdam* [2015] EWCA Civ 751 (23 July 2015), para 56.

7 The use of a basis clause was upheld in *Peekay* with such provisions not being subject to determination under reasonableness under the UCTA following *JP Morgan v Springwell*. This was confirmed in *Barclays Bank v Svizera Holdings BV* [2015] 1 All ER (Comm) 788. Legatt J nevertheless questioned the use of basis clauses to avoid the UCTA in *First Tower Trustees Ltd v CDS (Superst\ores International) Ltd* [2018] EWCA Civ 1396 which concerned the lease of warehouse bays contaminated with asbestos. Legatt J stated that, 'whenever a contracting party relies on the principle of contractual estoppel to argue that, by reason of a contract term, the other party to the contract is prevented from asserting a fact which is necessary to establish liability for a pre-contractual misrepresentation, the term falls within section 3 of the Misrepresentation Act 1967. Such a term is therefore of no effect except in so far as it satisfies the requirement of reasonableness as stated in section 11 of UCTA.' The Court of Appeal upheld the decision at first instance and confirmed that the non-reliance clause was an exclusion clause in this case as liability for misrepresentation would have arisen under the Misrepresentation Act except for the application of the clause. Contrast *Premium Credit Limited v Primary Care Management Solutions Ltd* [2018] EWHC 3083 in which contractual estoppel was approved obiter at paras 50-55. Generous exclusion clauses have been held to be reasonable where there has been inter alia equal bargaining power and a clear understanding of the allocation of risk. *Goodlife Foods Ltd v Hall Fire Protection Ltd* [2018] EWCA Civ 1371; *Motortrak Ltd v FCA Australia Pty Ltd* [2018] EWHC 990 (Comm); and *Interactive E-solutions JLT v O3b Africa Ltd* [2018] EWCA Civ 62.

1. INTERNATIONAL FINANCIAL MARKETS – HISTORICAL DEVELOPMENT AND EVOLUTION

G A WALKER

4. EURO NOTES AND PAPER

The fixed rate euro bond market would continue to develop with this being particularly attractive for sovereign and major corporate borrowers during low interest rate periods. Durations have nevertheless shortened from 10-20 years or more down to 3-7 years during the early 1970s. This would remain an important funding mechanism especially for international financial organisations or institutions such as the World Bank or the European Union agencies. The most significant early innovation was the creation of a parallel floating rate note (FRN) market with the fixed bond market beginning in 1969.

This was followed by the introduction of shorter duration instruments that could be rolled-over beginning with 3-6 months euro notes in 1978 and even shorter euro commercial paper based on the US domestic commercial paper market. Longer duration euro medium-term notes (euro-MTNs) were then introduced from 1985 with multi-option funding facilities (MOFFs) having been first used in 1984. Each of these new shorter duration instruments is considered in turn. With the introduction of floating rates and shorter durations, the markets were also characterised by 'pre-priced' deals and 'bought' deals and then with the development of revolving and then multiple option structures.

(a) Floating Rate Notes (FRNs)

Floating rate notes (FRNs) were developed in the early 1970s to allow companies to borrow on a floating rather than fixed basis. The first FRN was for 0.75% above LIBOR US$50m by the Italian national energy agency, *Ente Nazionale per L'Energia Elettrica* (ENEL), managed by S G Warburg and Bankers Trust International in May 1970.[1] Bankers Trust International raised a further US$75m for Pepsico in February 1970. The floating rate formula was developed by Evan Galbraith at Bankers Trust to create a more secure form of borrowing bridging the loan and bond markets. Debentures with floating interest rates had been offered previously such as with the Dreyfus Offshore Trust NV US$14.7m 5-year participating debentures although this was tied to a common share offering.[2] Opinion differs as to which was the first FRN issue. FRNs became common with rising interest rates during the early 1970s and the difficulty in placing fixed rate debt.

The first US$100m issue was by Morgan Stanley for Esso Overseas Finance NV in March 1971[3] and a further US$100m offer for New Zealand in 1971 by Kidder Peabody. Kidder Peabody also launched the first pre-price deal for New Zealand with a US$50m bond in 1975 without any open pricing[4]. Convertible issues became increasingly popular during the early 1970s[5] with other currencies also being used including specifically the Deutsch mark as the value of the dollar fell.[6] Growth was strong until October 1973 with the outbreak of the Middle East war and quadrupling of oil prices in 1974. US President Richard Nixon had announced the closure of the 'gold window' which precipitated the collapse of the fixed currency arrangements under Bretton Woods and the introduction of floating currencies. Nixon was forced to resign after Watergate with Edward Heath and West German Chancellor Willie Brandt also being removed from office. The FRN market closed during 1975 with low interest rates although bond maturities were cut from 10-20 years to 5-7 years.[7] The first euro yen issue and the first floating rate certificates of deposit (FRCDs) were

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1 The notes provided for 0.75% interest above 6 months LIBOR subject to redemption if the rate exceeded 13%. Warburg had identified ENEL following discussions between Peter Spira and Siegmund Warburg with Guido Carli, the Governor of the Bank of Italy, although the FRN mechanism was developed by Evan Galbraith and Dimitri de Gunzberg at Bankers Trust. Kerr (n) 35.

2 The Dreyfus offer was in May 1969 and lead managed by Kuhn Loeb Inc with Kuhn Loeb advising Howard Stein, President of Dreyfus in the US, to use a floating rather than fixed rate coupon. Kerr (n) 36.

3 The Esso issue was for US$100m euro bond with a 7 and a 15-year tranche.

4 The pre-priced deal allowed for smaller syndicates to be used with fewer managing and selling agents although the risk of mispricing the issue increased. Dosoo (n 26) 36.

5 The Eastman Kodak US$70m convertible in May 1968 was reported to have been US$530m oversubscribed. Jardine Matheson International NV offering 7.75% 15-year debentures with equity warrants attached in November 1971. Kerr (n) 41.

6 The Deutsch mark had been revalued by 9.3% in 1969 and 13.6% in December 1971 following the Smithsonian Agreement.

7 [The first dual currency bond was for A$30m for the Rural and Industries Bank of Western Australia with repayment either in Australian dollars or Deutsch marks in 1972 managed by the Orion Royal Bank.]

in 1977[8] and the introduction of the 'grey market' in 1978[9] and the first currency linked swap and opening of the 'grey market' in 1979.[10] The first 'drop-lock' issue was in April 1979 for TVO Power.[11] The first convertible issue with the option to exchange into fixed debt was by Goldman Sachs for US$50m 10.75% convertible debentures for NICOR Overseas Finance NV in April 1980.

Markets were disrupted again by the second oil price crisis in 1978 and 1979. Paul Volker was appointed Chairman of Federal Reserve Board on 5 August 1979 and had to attempt to deal with a collapse in the value of the dollar with rising interest rates. (Jimmy) 'Carter' bonds were issued with separate Deutsch mark and Swiss franc tranches to support the dollar. Bond markets rallied between March and July 1980 following Carter's monetary and credit restraint program although the market fell between July 1980 and 1982. Credit Suisse introduced 'bought deals' in 1980 for General Motors Acceptance Corporation (GMAC)[12] with the investment bank undertaking to manage the whole issue including arranging the syndication, participation and underwriting[13]. The first US$1bn issue was for the Kingdom of Sweden on 5 January 1982.[14] The FRN market grew between 1980 and 1981 with the US 30% withholding tax being removed in July 1984. Commercial banks issued US$19bn of perpetual FRNs in the mid-1980s before the collapse of the market at the end of 1986.[15] Despite further innovations, the FRN as a whole collapsed in 1987 through increased competition and the availability of better rates in the fixed bond market or new shorter duration euro commercial paper market.[16] The dollar was supported under the Louvre Accord in February 1987 by the G7 although tensions continued, particularly, between the US and West Germany.[17] The New York Stock Market crashed on 16 October 2007 and the London market on 19 October 2007 despite the earlier promise of the UK 'Big Bang' under the Financial Services Act 1986. This led to a collapse in the FRN and fixed rate bond markets with investors only looking for higher quality sovereign debt.

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8 The first FRCD was for US$10m for Dai-Ichi Kangyo Bank in April 1977 managed by Credit Suisse First Boston. Japanese city banks had been prevented from borrowing through the FRN market by the Ministry of Finance in 1977 with the FRCD mechanism being developed to allow them to obtain 3-5 years funds. This was followed by an issue on behalf of Sumitomo Bank with 'tap' FRCDs being introduced by Credit Suisse subsequently. Kerr (n) 48.

9 The grey market required managers to quote prices for issues before being officially priced. This replaced the earlier non-transparent system of discounting. Dosoo (n 26) 37-38. This led to bond brokers moving from the US to the UK. Brokers would typically charge a fee of 0.0625%. US style broking was transferred to London in August 1978 with Sandy Joyce of Purcell Graham. While initially resistant, bond brokers are now treated as an essential of the market. Kerr (n) 110-111. [On defaulted bond issues, Kerr (n) 113-114.]
Stanley Ross was considered to be the first to publish pre-issue prices for bonds at the end of 1978 with the first official grey market pricing for a US$200m Dow Chemical 9.625% loan in February 1979. This effectively brought the primary and secondary markets together. Kerr (n) 57.

10 The first currency swap related bond was for the Royal Bank of Canada subsidiary, Royalease, in September 1979 for DM60m 6.75% notes due 1984 managed by Orion Bank with the Royal Bank of Canada and Westdeutsche Landesbank. The funds could be immediately converted into Canadian or US dollars with low cost original borrowing in Deutsch marks. Dosoo (n 26) 37; and Kerr (n) 56.

11 Credit Suisse managed the US$30m issue with a 0.25% premium over LIBOR on the FRNs which would automatically be converted into 9% 12-year fixed rate bonds if the LIBOR fell below 9%. This was later used again for the Kingdom of Sweden with a US$150m FRN issue in 1979. The formula was nevertheless criticised with its mandatory rather than optional conversion and was not commonly used. Kerr (n) 57.

12 This was a US$100m 13.35% 5-year note issue offered on 8 April 1980 managed by Credit Suisse. The deal had been initially offered to IBM. Kerr (n) 62.

13 This is distinct from a 'standby' commitment (for any unsold issue) and a 'best efforts' commitment (best efforts to sell the issue). With the deal also being 'pre-priced', the bank assumes the market risk although it can still profit from selling the issue to investors at a price higher than the bought price. The underwriting can still be managed through smaller 'clubs'. Bought deals allow for competitive bidding which would not be possible under more traditional syndication. Dosoo (n 26) 40.

14 US$1.2bn 10-year notes had been issued at 0.25% above LIBOR managed through Credit Suisse First Boston. This was followed by an EC US$1.8bn offering for France with a further US$1bn 20-year floating rate bond for Sweden in December 1983. Dosoo (n 26) 42; and Kerr (n) 75.

15 Regulators had been concerned that banks had become the main purchasers as well as issuers of perpetual FRNs which concentrated rather than diversified risk. Bank ratings were reduced as the secondary market dried up and prices collapsed. Many perpetuals were repackaged although it was not expected that they would be commonly used again. Dosoo (n 26) 45.

16 The FRN market had expanded substantially between 1984 and the beginning of 1986 with new currencies being introduced and market entrants such as UK building societies which were allowed to use the market under the Building Societies Act 1986. 'Reverse FRNs', 'high margin' FRNs and 'collateralised mortgage obligations' (CMOs) were also introduced. Margins had nevertheless narrowed with early redemptions increasing with a collapse in liquidity and market prices. Dosoo (n 26) 45.

17 James Baker called on West Germany to increase growth on 12 October 1987 rather than contract contrary to the Louvre Accord.

(b) Euro Notes and Note Issuance Facilities (NIFs)

Euro notes are short duration promissory notes issued by non-banking borrowers. These have durations for between 5 and 7 years and emerged as floating rate alternatives to shorter fixed bonds. The first euro notes were in the late 1970s and were issued by a non-US corporate borrower and then by a sovereign entity. The notes were generally underwritten which distinguished them from the even shorter duration commercial paper market which originally developed in the US in the late 19th century.[18] The first euro note was for the New Zealand Shipping Corporation in 1978 and managed by Citicorp with 3 or 6 months notes over a 6-year period.[19] The market for euro notes grew substantially during the early 1980s from US$1.03bn in 1981 to US$33.14bn in 1985.[20] Euro notes subsequently grew from US$50.3bn in 1985 to US$77.1bn in 1988.[21] Euro note issuance fell to US$40.5bn in 1987 as investors preferred shorter euro commercial paper programs with dealership rather than panel structures. Secondary trading was also always limited.[22]

As shorter duration instruments, euro notes were typically issued under a Note Issuance Facility (NIF) with the underwriting banks being committed to sell or purchase the notes issued. Notes were generally issued in amounts of US$500,000 or more. Revolving underwriting facilities (RUFs) were introduced in 1982 with the lead bank acting as a 'sole placing agent' to distribute the notes with a separate underwriting group taking up any unsold amounts or providing loans to the same value. 'Tender panels' were introduced in 1983 to allow the panel group to bid for the notes with only the residue being taken up by the underwriters under a 'backstop facility'. 'Continuous tender panels' were created in 1984 to allow underwriters to purchase the notes up to a pro rata share during the offer period. Underwriters can sell their commitments under a transferable revolving underwriting facility (TRUF). The borrower can also issue smaller amounts under a 'tap issue' as investor demand varies.

(c) Euro Commercial Paper (ECP)

Euro commercial paper is a specific form of commercial paper which is a short negotiable unsecured promissory note. Commercial paper began in the US with companies attempting to raise funds in other states through the sale of bankers' acceptances of commercial paper to avoid the restrictions of the McFadden Act.[23] UK companies were only allowed to issue sterling commercial paper (SCP) from April 1986 under exemption from the need to obtain authorisation under the Banking Act and now the Financial Services and Markets Act 2000[24]. Relevant conditions were amended in 1989 and [ ] with standard procedures being issued by the British Bankers' Association.[25] Banks and building societies previously issued short-term paper in the form of certificates of deposit (CDs) or London CDs.[26]

The first euro commercial paper (ECP) was reported to be in 1985[27] although commercial paper was used in the euro markets by US firms in the early 1970s[28]. Minimum denominations are US$100,000 with maturities of between 2 and 365 days. The domestic and euro markets can be accessed through 'global commercial paper' (GCP) using 'global notes'.[29] The market was damaged by corporate defaults in the late 1980s[30] although the market has recovered since.

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[18] Subsection

[19] Dosoo (n 26) 73.

[20] Sarwal (n 45) 122.

[21] Bank of England quoted in Sarwal (n 45) 125.

[22] Sarwal (n 45) 125.

[23] Consumer finance companies also began to issue commercial paper during the 1920s with bank holding companies, foreign companies, banks and sovereign borrowers also issuing US commercial paper subsequently. Issues are for between US$25,000 and US$5m. US paper may be backed by a separate letter of credit guarantee. The US commercial paper was worth US$375m in 1987. Sarwal (n 45) 78-79.

[24] See generally Michael Blair QC, George Walker and Robert Purves, *Financial Services Law* (Oxford University Press Oxford 2nd ed 2008).

[25] http://www.bba.co.uk .

[26] Sarwal (n 45) 80-81.

[27] Sarwal (n 45) 81.

[28] Dosoo (n 26) 73.

[29] Some global notes were issued in the form of 'grid notes' with a grid agent managing transfers by book entry. 'Universal notes' have also been used with non-specific bearer notes being issued and security printed notes only being used if delivery is necessary outside the clearing system. Sarwal (n 45) 82-83.

[30] These included Integrated Resources (US$63m) June 1989; Wang Laboratories (US$96m) August 1989; Lomas Financial Corporation (US$70m) September 1989; DFC New Zealand (US$270m) October 1989; and Drexel Burnham Lambert (US$30.5m) February 1990. Dosoo (n 26) 74.

International Financial Markets

(d) Euro Medium-Term Notes (MTNs)

Euro medium-term notes (euro-MTNs) were introduced in 1985 from the US medium-term note market.[31] Euro-MTNs had greater flexibility in term of speed, timing and size of issuance. Notes can be issued on short notice as market opportunities open at attractive rates. Later euro-MTNs were issued with currency and interest rate swaps or other ad hoc features.

US medium-term notes (US-MTNs) were again developed in the early 1980s to bridge the corporate bond and commercial paper markets. Typical maturities were between 9 months and 15 years. Issues grew from US$12bn in 1984 to US$36bn by 1986. As revolving facilities, MTNs were issued under SEC Rule 415 (shelf registration) or exempt under Regulation D. Foreign banks were also allowed to issue deposit note MTNs from September 1986 in place of certificates of deposit.[32]

(e) Multi-Option Facilities (MOFs)

Borrowers can also set up multiple component facilities or multiple option funding facilities (MOFFs) or multi-option facilities (MOFs). The first MOFF was by a sovereign in 1984 with additional flexibility being provided in achieving the best maturity, currency and interest rate availability. This can be considered to be an extension of the NIF with further borrowing options provided. These include short-term multi-currency advances, swing-line facilities, domestic and euro commercial paper, bankers' acceptances and medium-term notes (MTNs). This allows a mixture of committed and uncommitted facilities to be made available at any time. A multiple loan facility (MLF) is a combination of committed credit options such as a revolving credit and short-term advances and acceptances option.[33] A 'BONUS' (Borrowers' Options for Notes and Underwriting Standby) is a specific type of MOFF.

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[31] Issues grew from 2 in 1985 with a value of US$800,000 to 165 with a value of US$89.9bn in 1990. Dosoo (n 26) 78.

[32] Sarwal (n 45) 202 and 202-205.

[33] MOFFs grew from US$1,500m in 1984 to US$7,118m in 1985 with a drop to US$5,724m in 1986 and then increased to US$7,898m in 1987. Multiple loan facilities grew from US$250m in 1985 to US$5,487m in 1986 to US$32,170m in 1987. IFR quoted in Sarwal (n 45) 131-132.

EUROBONDS **G A WALKER**

4. INTERNATIONAL BOND FINANCE

Bonds may be issued in a number of forms, with differing rights and entitlements, as well as corresponding obligations attached. Bonds are essentially negotiable certificates (either paper or an electronic representation) evidencing an underlying medium to long term debt. The issuer undertakes to pay the principal amount (set out on the face of the bond) on maturity as well as to make interest or coupon payments (on either a fixed or floating basis) during the term of the bond.

The four main classes of bonds are international (Eurobonds), domestic government and domestic corporate as well as foreign bonds (issued by overseas parties in a local capital market). While original issues were ten to fifteen years (and up to thirty years), the more recent trend has been towards short medium (two to ten years) and then other short notes (of less than one year). These principally include US Medium Term Notes (MTNs) and Euronotes (including Note Issue Facilities (NIFs) or Revolving Underwriting Facilities (RUFs)) and Commercial Paper (US or UK) (the difference between Euronotes and Commercial Paper is that there is an underlying commitment to purchase Euronotes). A large number of variations nevertheless exist within each of these main formats.

Some of the most commonly used structures are considered next.

(1) Eurobonds

Eurobonds are transferable debt securities denominated in a currency other than that of the issuer's home territory. Eurobonds are generally unsecured and issued in a bearer form. They are usually negotiable as well as transferable and sold to international investors rather than solely within the domestic capital markets. The investor group principally consists of other financial institutions or professional investors as well as other sophisticated investors and wealthy individuals.

The Eurobond markets began in the early 1960s and developed in parallel with the syndicated loan market. The first Eurobond issue was for the Italian motorway corporation, Autostrade (US dollars 15 million) in July 1963. Early growth was stimulated by the imposition of an interest equalisation tax in the US in 1963 by President Kennedy. As well as the Voluntary Restraint Program introduced by President Johnson. The first imposed a tax on the purchase of foreign bonds by American investors while the second required international investors to obtain funds outside the US[1]. Subsequent growth was substantial, mainly due to the transferable and anonymous nature of
the instrument.

The use and value of the security was subsequently improved with the development of a large number of variations on the core debt obligation involved.

(1) Plain Vanilla and Variable Bonds

The basic Eurobonds is referred to as a plain vanilla fixed coupon instrument. This pays the interest or coupon in fixed equal amounts at agreed intervals (usually six months) in arrears calculated having regard to a specified reference rate. Other fixed rate options include:
(i) Zero Coupon Bonds[2];
(ii) Foreign Currency Bonds[3];
(iii) Reverse Dual Currency Bonds[4];
(iv) First Coupon on Partly Paid Bonds[5];
(v) Currency Change Bond[6].
(vi) Annuity Bonds[7];

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1 Arun Kumar Sarwal, 'KPMG International Handbook of Financial Instruments and Transactions' (Butterworths London 1989) 94.

2 No interest is paid with the investor benefiting from the increase in value of the bond over time. This may either be issued at a discount and redeemed at par or issued at par and redeemed at a premium. Deep discount securities are issued at a substantial discount, with a lower interest being paid during term. Zero coupon bonds pay no interest with the investor benefiting from the difference between the original discount price and the par value.

3 Interest is paid in a different currency (other than that in which the bond was originally issued and denominated) at the spot rate at the time of payment.

4 Interest is paid in a currency other than that of denomination at a fixed rate (rather than spot rate as under a foreign currency bond).

5 Interest varies having regard to the amount of the issue price paid up.

6 Interest payments are made in different currencies at fixed exchange rates set at the time of issue.

7 Partial repayments of principal are included within the fixed interest rate payments.

(2) Floating Rate Notes (FRNs)

Floating Rate Notes (FRNs) provide for the payment of interest at a variable rather than fixed rate. The most commonly used reference rate is the London Inter Bank Offered Rate (LIBOR)[8]. The first FRN was in 1970 with FRN issues making up 37% of the bond market by 1983[9]. Maturities were also shortened as issuers were reluctant to commit themselves to long periods of fixed interest payments with the high levels of market volatility that persisted. Typical maturities were between five and fifteen years with minimum denominations of 1,000 dollars[10]. FRNs nevertheless still have the disadvantages of not being able to offer flexible draw downs or interest payment adjustment options[11].

Apart from plain vanilla FRNs, other options include:
(i) Floor FRNs[12];
(ii) Drop Lock FRNs[13];
(iii) Double Drop Lock FRNs[14];
(iv) Cap FRNs[15];
(v) Caller FRNs (or Minimax FRNs)[16];
(vi) Inverse FRNs (or Bull/Reverse FRNs)[17];
(vii) Step Down FRNs[18];
(viii) Step Up FRNs[19];
(ix) Margin as a percentage FRN[20];
(x) Floating then Zero FRNs;
(xi) Fixed then Floating FRNs;
(xii) Variable Rate Notes (VRNs)[21];
(xiii) Zero Coupon (or Deep Discount) FRNs[22];
(xiv) Rolling Rate Notes (RRNs)[23].
Other interest rate options include:
(i) Bunny (or Multiplier) Bonds or Notes[24];

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8 LIBOR (or LIBID or LINEAN) will be calculated on six monthly intervals with regard to the relevant LIBOR rate. Shorter three month LIBOR rates may also be used or six month SUS Treasury Bill Rates.

9 Fisher, *International Bonds* (Euro Money).

10 Sarwal (n 62) 96.

11 Sarwal notes that they were described as "disguised syndicated loans" despite these disadvantages. Sarwal (n 62) 98.

12 The note only fluctuates above a minimum floor rate such as 5% (for US, Sterling and French Franc bonds) and 3% (for earlier Deutsche Mark bonds). An "initial floor" FRN only operates for a minimum commencement period. 80% of FRNs issued in 1986 were Floor FRNs. Sarwal (n 62) 107.

13 The interest becomes fixed at the floor rate when it arrives at an agreed "trigger level". If interest rates subsequently rise, the bonds may be purchased by other investors preferring fixed rate instruments (such as pension funds or insurance companies) for a ¾% or $^{1}/_{16}$% annual fee. Sarwal (n 62) 107.

14 The interest rate only becomes fixed or Locked where the trigger level is breached on two consecutive fixing dates. This is used where rates may vary widely.

15 The interest rate is limited (or capped) at a certain level (such as 13% for US dollar FRNs). This imposes an upper limit. A "Delayed Cap FRN" only operates for a specified period after the initial commencement time.

16 Both maximum and minimum interest rate limits are imposed (floors and caps). A Minimax FRN operates within narrower upper and lower limits.

17 Interest rates move in an inverse relationship with the benchmark rate selected. They are also known as Yield Curve Adjustable Notes (YCANs). "High Margin FRNs" operate on a fluctuating basis until a specified rate is reached, after which they are converted into inverse FRNs. Sarwal notes that Inverse FRNs were used after mid-1986. Sarwal (n 62) 108.

18 The margin is reduced proportionately over time. This is only common in longer bonds such as thirty year or perpetual FRNs. This will be supported by a right of re-purchase (callable at par) after an initial period (such as five years) "high first coupons" provide for an initial large payment and then subsequent fixed rate margins over the life of the bond. Sarwal (n 62) 108.

19 The margin increases proportionately over the duration of the instrument. A "Step Up With Claw Back" allows negative interest payments to be deducted subsequently where the margin was set at a rate below the reference rate.

20 The rate is set as a percentage of the benchmark rate.

21 The margin or spread is re-set for each interest period. This can either be calculated on an auction basis (such as under the Warburg model) or by agreement (under the Merrill Lynch model). These were introduced in 1988 to promote interest in declining FRN use. Sarwal (n 62) 110.

22 Deep discount securities are issued at a discount on their par or redemption value with a lower interest or coupon being paid during term. Zero coupon bonds pay no interest with an amount equivalent to the interest otherwise payable over the life of the instrument being deducted up front. They are then redeemable at par value. The interest would effectively be rolled up within the redemption price which would benefit from capital gains tax which may be payable at a rate lower than income tax. This was particularly attractive in the UK for corporate and wealthy individual investors, although the tax advantage has since been closed. Sarwal (n 62) 197 – 198.

23 Interest is calculated on a monthly but payable six-monthly basis using the agreed six month reference rate with the accrued interest being added to the capital amount. George S Ugeux, *FRNs* (Euromoney); Fisher, *International Bonds* (Euromoney); and "Types of Bonds" *Current Issues of International Financial Law* [116].

(ii) Lender's Option-Borrower's Option (LOBO)[25];
(iii) Borrowers' Option-Lender's Option (BOLO)[26].

Other interest rate variations include:
(i) Graduated Rate Coupon Bonds[27];
(ii) Deferred Coupon Bonds[28];
(iii) Profit Sharing Bond[29];
(iv) Indexed Bonds[30];
(v) Duet Bonds[31].

(6) Euro Medium Term Notes

Medium Term Notes (MTNs) are unsecured debt instruments (generally promissory notes) issued for durations between nine months and fifteen years[32]. These are accordingly interim maturity instruments between long bonds and short notes. MTNs are issued on a rolling or continuous basis under a programme agreement with a separate agency agreement and information memorandum as well as possible trust deeds[33].

MTNs were introduced in the US in the early 1980s[34]. Total issue volumes increased from US 12 billion in 1984 to 36 billion dollars by 1986[35]. They are issued in small denominations (of between US 2 – 5 million dollars), bear interest and are quoted at a percentage of their face value. Issuers and investors both benefit from increased flexibility in terms of the options available in structuring the amount, maturity and interest payable on the notes at any time.

US MTNs issues will have a set of posted rates and maturities of between nine months to one year, one year to eighteen months, eighteen months to two years. Investors can then elect particular maturity dates. Most maturities are less than five years[36]. MTNs also benefit from certain regulatory concessions being issued on a continuous basis[37].

Variations on the plain vanilla MTN include:
(i) Euro MTNs (EMTNs)[38];
(ii) Global MTNs[39];
(iii) Continuously Offered Long Term Securities (COLTS)[40];
(iv) Continuously Offered Intermediate Notes (COINS)[41];
(v) Multi-Tranche Tap Notes (MTTNs)[42].

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24 The investor is given the option to have the interest payments re-invested in identical bonds which provide a separate income stream. The option allows the issuer to pay lower interest rates while this may also be of advantage to the investor, depending upon whether interest rates are expected to rise or fall and the investor's preference for fixed or floating instruments. Sarwal (n 62) 110.

25 The investor can vary the interest rate at their choice, subject to the issuer's right to redeem at face value. This has been used by UK local authorities in issuing twenty year securities with an agreed opening interest rate.

26 The issuer is entitled to vary the interest, with the investor either being able to accept or call for redemption of all outstanding amounts due.

27 Interest is paid at different rates in the schedule attached at issue.

28 The first fixed interest payment is delayed until a pre-determined time.

29 Interest payments are linked to dividends on equity issued by the same company. The alternative is to make the bond convertible into equity.

30 Fixed interest payments calculated with regard to an agreed index, such as the Retail Price Index (RPI) in the UK.

31 The purchase and sale of two fixed rate bonds in different currencies which allows the issuer to benefit from different interest rates in the markets selected. Sarwal (n 62) 106 – 107.

32 Sarawl (n) 201. Wood notes that Euro MTNs can have a maturity range of between one month and thirty years. Wood (n 26) 9.37.

33 Wood (n 26) paras 9.38 – 39.

34 Early issuers were General Motors Acceptance Corporation, Ford Motor Credit and other automobile credit companies. Sarwal (n 62) 203.

35 Sarwal (n 62) 201.

36 Sarwal (n 62) 201. Interest may be fixed or floating.

37 MTNs fall within SEC Rule 415 (Shelf Registration) or may be exempt under SEC Regulation D. Foreign banks can now issue US MTNs (referred to as Deposit Notes) since September 1986 in place of earlier certificates of deposit (CDs). Non-banking based issues can also be made without registration provided a "letter of credit" is entered into by an exempt entity such as a bank. This is referred to as credit support. Sarwal (n 62) 202.

38 The EMTN market began in 1986. Maturities are generally between one and five years, with the notes being listed and cleared through Euroclear or Clearstream.

39 The issuer may either use the domestic US or Euro market with non-dollar denominations being supported by a currency swap.

40 World Bank issues are referred to as COLTS with a maturity of between three and thirty years.

41 Euro MTNs issued through an offshore insurance company.

(7) Euronotes

Euronotes are short dated bearer promissory notes with maturities of between seven days and one year[43]. Euronotes are usually issued at a discount and redeemed at par. Euronotes are usually issued in US Dollars or Euros with other countries prohibiting locally denominated notes. Currency swaps may, nevertheless, be used to obtain funding in a particular currency. Short dated instruments can, nevertheless, be issued as Sterling Commercial Paper under the relevant UK provisions. The terms Euronote and Commercial Paper are sometimes used interchangeably, although Euronote issues are generally underwritten by banks, whereas Commercial Paper is not. Euronotes are also generally issued by non-banks, with bank paper being referred to as certificates of deposit (CDs)[44].

The Euronote market was established in the late 1970s following the removal of exchange controls and other deregulatory changes and the dis-intermediation and securitisation of credit markets[45]. The first programmes were referred to Note Issuance Facilities (NIFs)[46]. Revolving Underwriting Facilities (RUFs) were subsequently developed in the early 1980s[47]. Other options included the Grantor Underwritten Note (GUN). These either operated on a sole placing agency (or Tap) basis or with a tender panel. Later variations included:
(i) Dual or Multiple Placing Agency[48];
(ii) Dealership Placement[49];
(iii) Issuer Set Margin[50];
(iv) Specialised Tender Panel[51];
(v) Unsolicited Tender[52];
(vi) Transferable Revolving Underwriting Facility (TRUF)[53].

The issuer will pay separate participation, underwriting, commitment and utilisation fees[54]. NIFs are generally 0.10% and 0.50% cheaper than a syndicated loan.

Euronote variations include:
(i) Short-Term Note Issuance Facility (SNIF);
(ii) Securities Note Commitment Facility (SNCF);
(iii) Revolving Acceptance Facility by Tender (RAFT);
(iv) Global Note Facility.

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42 Merrill Lynch developed issues with an initial issue followed by subsequent tap issues to enhance liquidity. Sarwal (n 62) 204 – 205.

43 Sarwal (n 62) 121 – 129; Tennekoon (n 23) Ch 23 and 24; and Penn, Shea and Arora (n) Ch 10. See also Ugeux, *Floating Rate Notes* (1985); Bankson and Lee (ed), *Euronotes* (1985); Fabozzi, *Floating Rate Instruments* (1986); and Bullock, *Euronotes and Euro-Commercial Paper* (1987). See also Henderson, "Structuring and Documenting Euronotes" (1985) *IFLR* 18; Beaumont, "The Difference Between NIF's and RUF's" (1985) *IFLR* 31; and "Euronote Offer Documents Under UK Law" (1985) *IFLR* 32. [The first Euronote issuance was by Citicorp Investment Bank for New Zealand Shipping Corporation in 1978. The commercial objective was to create an instrument parallel to a bank certificate of deposit (CD) which could be issued by a high credit non-banking institution. Penn, Shea and Arora (n) para 10.02.

44 Sarwal (n 62) 121.

45 Sarwal notes that the first issue was by a non-US company which could raise funds from investors in Europe more easily than in the US domestic market. The second issue was by a sovereign borrower which was offered competitive financing provided that it could issue a marketable security rather than a loan. (n) 121 – 122.

46 A NIF is a medium term programme under which a borrower can issue short term securities in its own name with underwriting banks either purchasing any unsold notes or providing standby credit. NIFs were issued in denominations of over 500,000 dollars and had maturities of between five and seven years, with notes being issued on a revolving basis.

47 The first RUF was in 1982. This provides for the separation of the underwriting and sale with a sole placing agent (placing the notes) and a separate underwriting group purchasing any residual notes or extending loans in an equivalent value. A tender panel was subsequently introduced in 1983 to provide a back-stop facility with member banks bidding for notes with a specified spread. Continuous tender panels were then developed in 1984 to allow the underwriters to purchase notes from the lead manager up to a specified proportionate amount. Tender panels can be made up of between thirty and sixty member banks. Sarwal (n 62) 122 – 123. [A Tap issue is used with a sole placing agent to allow the borrower to feed paper into the market depending on investor interest, using one or more placing agents.]

48 Dealers compete to place the notes on a best efforts basis, with the competition producing better prices for the issuer.

49 Banks act as agents (rather than principal) in selling the paper and maintaining a secondary market.

50 The issuer sets the interest rate, with underwriters taking up agreed proportions through a continuous tender panel at the agreed (cap) rate.

51 A smaller tender panel is used with an existing high quality client base to take up the issue.

52 The banks bid to place paper as selling opportunities arise.

53 Underwriters are entitled to transfer their commitment subject to borrower approval.

54 The participation fee is for front end management in setting up the facility (0 – 0.20%). Annual or quarterly underwriting fees ($^1/_{32}$% and $^1/_8$%) and commitment fees (0.05% - 0.10%) based on the unutilised facility. A separate utilisation fee may also be charged for large "maximum spreads" (0.05% - 0.20%).

EURONOTES AND COMMERCIAL PAPER

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4. INTERNATIONAL BOND FINANCE

(6) Euro Medium Term Notes

Medium Term Notes (MTNs) are unsecured debt instruments (generally promissory notes) issued for durations between nine months and fifteen years[1]. These are accordingly interim maturity instruments between long bonds and short notes. MTNs are issued on a rolling or continuous basis under a programme agreement with a separate agency agreement and information memorandum as well as possible trust deeds[2].

MTNs were introduced in the US in the early 1980s[3]. Total issue volumes increased from US 12 billion in 1984 to 36 billion dollars by 1986[4]. They are issued in small denominations (of between US 2 – 5 million dollars), bear interest and are quoted at a percentage of their face value. Issuers and investors both benefit from increased flexibility in terms of the options available in structuring the amount, maturity and interest payable on the notes at any time.

US MTNs issues will have a set of posted rates and maturities of between nine months to one year, one year to eighteen months, eighteen months to two years. Investors can then elect particular maturity dates. Most maturities are less than five years[5].

MTNs also benefit from certain regulatory concessions being issued on a continuous basis[6].

Variations on the plain vanilla MTN include:

(i) Euro MTNs (EMTNs)[7];
(ii) Global MTNs[8];
(iii) Continuously Offered Long Term Securities (COLTS)[9];
(iv) Continuously Offered Intermediate Notes (COINS)[10];
(v) Multi-Tranche Tap Notes (MTTNs)[11].

(7) Euronotes

Euronotes are short dated bearer promissory notes with maturities of between seven days and one year[12]. Euronotes are usually issued at a discount and redeemed at par. Euronotes are usually issued in US Dollars or Euros with other countries prohibiting locally denominated notes. Currency swaps may, nevertheless, be used to obtain funding in a particular currency. Short dated instruments can, nevertheless, be issued as Sterling Commercial Paper under the relevant UK provisions. The terms Euronote and Commercial Paper are sometimes used interchangeably, although

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1 Sarawl (n) 201. Wood notes that Euro MTNs can have a maturity range of between one month and thirty years. Wood (n 26) 9.37.

2 Wood (n 26) paras 9.38 – 39.

3 Early issuers were General Motors Acceptance Corporation, Ford Motor Credit and other automobile credit companies. Sarwal (n 62) 203.

4 Sarwal (n 62) 201.

5 Sarwal (n 62) 201. Interest may be fixed or floating.

6 MTNs fall within SEC Rule 415 (Shelf Registration) or may be exempt under SEC Regulation D. Foreign banks can now issue US MTNs (referred to as Deposit Notes) since September 1986 in place of earlier certificates of deposit (CDs). Non-banking based issues can also be made without registration provided a "letter of credit" is entered into by an exempt entity such as a bank. This is referred to as credit support. Sarwal (n 62) 202.

7 The EMTN market began in 1986. Maturities are generally between one and five years, with the notes being listed and cleared through Euroclear or Clearstream.

8 The issuer may either use the domestic US or Euro market with non-dollar denominations being supported by a currency swap.

9 World Bank issues are referred to as COLTS with a maturity of between three and thirty years.

10 Euro MTNs issued through an offshore insurance company.

11 Merrill Lynch developed issues with an initial issue followed by subsequent tap issues to enhance liquidity. Sarwal (n 62) 204 – 205.

12 Sarwal (n 62) 121 – 129; Tennekoon (n 23) Ch 23 and 24; and Penn, Shea and Arora (n) Ch 10. See also Ugeux, *Floating Rate Notes* (1985); Bankson and Lee (ed), *Euronotes* (1985); Fabozzi, *Floating Rate Instruments* (1986); and Bullock, *Euronotes and Euro-Commercial Paper* (1987). See also Henderson, "Structuring and Documenting Euronotes" (1985) *IFLR* 18; Beaumont, "The Difference Between NIF's and RUF's" (1985) *IFLR* 31; and "Euronote Offer Documents Under UK Law" (1985) *IFLR* 32. [The first Euronote issuance was by Citicorp Investment Bank for New Zealand Shipping Corporation in 1978. The commercial objective was to create an instrument parallel to a bank certificate of deposit (CD) which could be issued by a high credit non-banking institution. Penn, Shea and Arora (n) para 10.02.

Euronote issues are generally underwritten by banks, whereas Commercial Paper is not. Euronotes are also generally issued by non-banks, with bank paper being referred to as certificates of deposit (CDs)[13].

The Euronote market was established in the late 1970s following the removal of exchange controls and other deregulatory changes and the dis-intermediation and securitisation of credit markets[14]. The first programmes were referred to Note Issuance Facilities (NIFs)[15]. Revolving Underwriting Facilities (RUFs) were subsequently developed in the early 1980s[16]. Other options included the Grantor Underwritten Note (GUN). These either operated on a sole placing agency (or Tap) basis or with a tender panel. Later variations included:

(i) Dual or Multiple Placing Agency[17];
(ii) Dealership Placement[18];
(iii) Issuer Set Margin[19];
(iv) Specialised Tender Panel[20];
(v) Unsolicited Tender[21];
(vi) Transferable Revolving Underwriting Facility (TRUF)[22].

The issuer will pay separate participation, underwriting, commitment and utilisation fees[23]. NIFs are generally 0.10% and 0.50% cheaper than a syndicated loan.

Euronote variations include:

(i) Short-Term Note Issuance Facility (SNIF);
(ii) Securities Note Commitment Facility (SNCF);
(iii) Revolving Acceptance Facility by Tender (RAFT);
(iv) Global Note Facility.

(8) Euro Commercial Paper

Euro Commercial Paper (ECP) provides for the issuance of unlisted short dated paper for periods of up to one year. This was initially developed by banks during the early 1980s to allow them to buy and sell short term notes between themselves. ECP is generally issued in accordance with the British Bankers' Association London Market Guidelines as revised[24]. Short term instruments may alternatively be issued as low duration notes under a Medium Term Note (MTN) programme. The difference is that these are often separately negotiated and not issued on standard terms as with ECPs.

Commercial Paper constitutes a negotiable unsecured promissory note. The notes are issued under a programme with maturities of between 1 and 365 days. Facilities are uncommitted and issued on a discount basis without interest being paid on the paper[25].

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13 Sarwal (n 62) 121.

14 Sarwal notes that the first issue was by a non-US company which could raise funds from investors in Europe more easily than in the US domestic market. The second issue was by a sovereign borrower which was offered competitive financing provided that it could issue a marketable security rather than a loan. (n) 121 – 122.

15 A NIF is a medium term programme under which a borrower can issue short term securities in its own name with underwriting banks either purchasing any unsold notes or providing standby credit. NIFs were issued in denominations of over 500,000 dollars and had maturities of between five and seven years, with notes being issued on a revolving basis.

16 The first RUF was in 1982. This provides for the separation of the underwriting and sale with a sole placing agent (placing the notes) and a separate underwriting group purchasing any residual notes or extending loans in an equivalent value. A tender panel was subsequently introduced in 1983 to provide a back-stop facility with member banks bidding for notes with a specified spread. Continuous tender panels were then developed in 1984 to allow the underwriters to purchase notes from the lead manager up to a specified proportionate amount. Tender panels can be made up of between thirty and sixty member banks. Sarwal (n 62) 122 – 123. [A Tap issue is used with a sole placing agent to allow the borrower to feed paper into the market depending on investor interest, using one or more placing agents.]

17 Dealers compete to place the notes on a best efforts basis, with the competition producing better prices for the issuer.

18 Banks act as agents (rather than principal) in selling the paper and maintaining a secondary market.

19 The issuer sets the interest rate, with underwriters taking up agreed proportions through a continuous tender panel at the agreed (cap) rate.

20 A smaller tender panel is used with an existing high quality client base to take up the issue.

21 The banks bid to place paper as selling opportunities arise.

22 Underwriters are entitled to transfer their commitment subject to borrower approval.

23 The participation fee is for front end management in setting up the facility (0 – 0.20%). Annual or quarterly underwriting fees ($^1/_{32}$% and $^1/_8$%) and commitment fees (0.05% - 0.10%) based on the unutilised facility. A separate utilisation fee may also be charged for large "maximum spreads" (0.05% - 0.20%).

24 The Guidelines were initially issued in April 1999 and then revised under the FSMA 2000.

25 A promissory note is defined as an unconditional promise in writing, signed by the debtor, undertaking to pay a specific sum at a stated time. Bills of Exchange Act 1882 s . This is distinct from a Bank Bill (or Bankers' Acceptance) as it only binds

The distinction between the Euronotes and Commercial Paper is nevertheless unclear and would generally appear simply to be dependent on the nature of the underlying issue programme. Commercial Paper is generally unsupported, although there is also no underwriting commitment under an NIF as distinct from a Committed RUF.[26]

The Commercial Paper market originated in the US in the early nineteenth century to allow companies to borrow funds across state lines[27]. Sterling Commercial Paper (SCP) could not be issued in the UK until April 1986 as this was considered to amount to deposit taking, requiring authorisation under the Banking Act 1979 (and then 87). Financial institutions could only issue London Certificates of Deposit or CDs before then. Regulations then permitted the issuance of SCP provided that the issuer was listed and had minimum net assets of twenty-five million pounds. The paper must be issued in minimum denominations of one hundred thousand pounds and mature between 8 and 364 days (subsequently extended to five years). Standard issue procedures have been produced by the British Bankers' Association. Japanese Commercial Paper (Yen or Euroyen CP) was introduced on 20 November 1987[28].

The separate market in Euro Commercial Paper (ECP) began in 1985. These are generally denominated in US dollars, with minimum denominations of one hundred thousand pounds and maturities of between 2 and 365 days. Settlement is effected either through Euroclear or Clearstream. ECP programmes may either operate through a single note, universal notes or grid notes[29]. Global Commercial Paper (GCP) may also be issued, which allows the borrower either to draw on the Euro or the US Commercial Paper market.

Commercial Paper is distinct from Euronotes in that it is not underwritten. The paper is issued under a programme but can be exercised within hours rather than days. Maturities can vary between 7 and 365 days (rather than have fixed maturities). Settlement is same day rather than seven days for Euronotes. Smaller denominations or US dollar one hundred thousand are typical, rather than minimum US dollar five hundred thousand for Euronotes.

Commercial Paper is issued under a dealer or programme agreement. Separate issuing and paying agency agreements, a deed of covenant, deed of guarantee and an information memorandum are used. Standard forms are available from the Euronote Association. The dealer or programme agreement will specify the issue procedures and timetable to be used. This will include standard representations, warranties and indemnities and restrictions on non-authorised sales. The issuer will deliver pre-signed notes to the paying agent. The notes are completed by the agent who authenticates them before issue. The purchase amount and redemption funds on maturity are also paid through the agent bank. The deed of covenant obliges the issuer to pay account holders in the event that the global note is not replaced by definitive notes. A deed is used to allow note holders to enforce the obligation without having been party to the initial document. A separate deed of guarantee may also be used in particular cases[30].

Commercial Paper is generally treated as a negotiable instrument as a matter of market practice.[31] SCP was permitted under the Banking Act 1979 (Exempt Transactions) (Amendment) Regulations 1986 (SI 1986 No 769). This followed a notice issued by the Bank of England on 29 April 1986. SCP is open to corporate entities complying with minimum listing and net asset rules. Banks and building societies are expected to continue to issue CDs rather than SCPs.

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the issuer and not the drawee or accepting bank. The paper is also not tied to any specific trade transaction as with a bankers' acceptance.

26 Beaumont N Bankson and Lee, *Euro Notes* ( ) ch7 cited in Tennekoon (n 23) 437 (n) 3. Contrast Penn (n) para 10.01. Sarwal simply comments that the differences between Euronotes and paper are essentially mechanical and that the debt instrument is the same in each case. Sarwal (n 62) 124.

On Commercial Paper, see Heller (ed), *Euro Commercial Paper* (Euro Money Publications 1988); Felix (ed), *Commercial Paper* (Euro Money Publications 1987). See also Tennekoon (n 23) ch 23 and 24; and Penn (n) ch 10. See also Penn, "Sterling Commercial Paper" [1986] *BFLR* 195 – 209; Johnson and Keslar, "Here Comes Euro CP" (1985) *Euro Money Corporate Finance*; Goodall, "Offers of Commercial Paper in the UK" (April 1984) *IFLR* 15; and Bullock, "Euro Notes and Euro Commercial Paper" Butterworth 1987

27 Banks were prohibited from expanding across states under the McFadden Act which caused credit problems in less wealthy states. Companies would then raise funds through commercial paper and bankers' acceptances in other states. The market was initially used by industrial and commercial companies, although subsequently by consumer finance companies in the 1920s and then by holding companies, foreign companies, banks and sovereign borrowers. Sarwal (n 62) 79. The paper is exempt from SEC registration and disclosure, provided it matures between 2 and 270 days. Some paper is letter of credit backed.

28 Minimum denominations are set at Yen one hundred million with maturities between 1 and 6 months. Issues are placed through dealers (rather than directly with investors) although they are free from withholding tax. Issues may be underwritten by banks or securities houses and non-Japanese borrowers may use the market from January 1988. Sarwal (n 62) 83.

29 The programme may be represented by a single global note with transfers being effected by book entry. Separately printed universal notes may be used, with their own serial numbers, although these will still be held by the depository unless a specific investor calls for delivery. The global note may also have a grid printed on the back which the grid agent can use to record entries and transfer. Sarwal (n 62) 81 – 83.

30 Wood (n 26) paras 9.32 – 36.

31 Tennekoon (n 23) 439; and Penn, Shea and Arora (n) para 10.16 and 10.34.

Commercial Paper will, in practice, not constitute promissory notes for the purposes of s83 of the Bills of Exchange Act 1882 as they are not unconditional (containing purchase restrictions) and do not contain a promise to pay a sum certain in money (due to the effects of withholding tax and grossing up). Commercial Paper is generally treated as constituting a debenture for the purposes of the Companies Act 1985[32]

Account holders of the notes are not "holders" under English Law and can therefore not enforce any payment obligations against the issuer directly. The issuer is required to issue definitive notes in the event of a default which replace the global note held with the depository although this may cause difficulties in practice. A deed of covenant by way of deed poll is accordingly entered into by the issuer which creates enforceable promises to pay by the issuer in favour of each account holder in the event of the global note becoming void.[33]

(9) Certificates of Deposit (CDs)

Certificates of Deposit are transferable certificates or securities evidencing an underlying deposit of funds with a bank. CDs are generally issued in accordance with the EDA's Guidelines on Certificates of Deposit on the London Market – Market Guidelines (November 1999).

London CDs are issued by regulated institutions in the UK, issued and payable in the UK and defined to trade primarily in the London market. Non-London CDs are issued by non-authorised institutions, including principally non-BBA banks. These must be labelled 'non-London ', satisfy the BBA's 'Standards for London Good Delivery ', not breech the FSMA and state the location of the issuing branch, where interest and redemption proceeds will be paid and whether a UK issuing or paying agent is employed. Separate Overseas Domestic CDs may also be issued, although these are not covered by the standard terms set out in the Guidelines.

(10) Multi Option Funding Facility (MOFF)

Multi Option Funding Facilities (MOFFs) allow borrowers to draw funds down under one or more credit structures or arrangements. This extends the NIF by including additional funding options. The first MOFF was first granted to a sovereign entity in 1984[34]. One of the key advantages, apart from draw-down flexibility, is being able to obtain funds in different currencies, including those that may not be available with a Euronote.

MOFFs tend to operate as short MTNs with durations between five and seven years. An MOFF is distinct from a multiple loan facility as it includes a Euronote component with additional committed and uncommitted facilities (including Commercial Paper). [A Borrower's Option for Notes and Underwritten Standby (BONUS) can be regarded as being a specific type of MOFF[35]. MOFFs are also known as Multiple Component Facilities (MCFs) or Multi Option Facilities (MOFFs).

Typical facilities include:

(i) Short Term Advances (in more than one currency)[36];
(ii) Swing Line Facilities[37];
(iii) Commercial Paper or Euro Commercial Paper;
(iv) Bankers' Acceptances[38];
(v) Medium Term Notes (MTNs).

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32 s 744 CA 1985; *Edmonds -v- Blaina Furnaces Co* (1887) 36 Ch D 215; and *Levy -v- Abercorris Slate and Slab Co* (1888) 37 Ch D 260. Penn para 10.3]

33 Tennekoon (n 23) 446 – 448; Penn (n) para 10.14; and Wood (n 26) para 9.36.

34 MOFFs were subsequently used by UK and French corporate entities during 1987 and subsequently. Sarwal (n 62) 133. Such facilities tend to only be provided by the largest banks with the capacity to place the funds in each of the sub-markets involved.

35 This includes an uncommitted note placement facility with a US commercial paper programme and a committed standby credit facility. Sarwal (n 62) 131.

36 The advances option allows the borrower to draw down funds directly in one or more currencies without the need for the underwriting banks to purchase notes.

37 Temporary is provided either to cover the period when separate advances are being arranged or while the borrower is switching between options. The Swing Line Facilities can be drawn down at short notice.

38 Funds are made available against discounted eligible bank bills (acceptances) although this must be covered by a self liquidating asset. Sarwal (n 62) 131.

SALE AND REPURCHASE

G A WALKER

The alternative to either a retention of title or lease is to include a repurchase provision. This involves the sale of an asset subject to a right to subsequently purchase under a single agreement. This includes simple sale and repurchase agreements (possibly involvement a separate third party finance house or other credit provider), security sale and repurchases (repos) and stock lending. Under a simple arrangement, the buyer purchases goods with payment being made by instalment subject to the right of the seller to repurchase and set-off the unpaid balance on the original purchase price against the repurchase price. This will not constitute a security as the buyer has no right of redemption and the goods are recovered by repurchase and not through enforcement[1]. The transaction may be treated as a security where there is an obligation to repurchase[2]. The first party may sell assets to a finance house subject to an agreement to resell them to the debtor after a period with the resell price including an interest margin[3].

https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/1997/the-first-year-of-the-gilt-repo-market.pdf?la=en&hash=E624E6CFBE1BB7D7165A3A2353BA6A3049BC4A8C

Securities Repos

A repo generally involves a spot sale of specific securities with a simultaneous forward repurchase on a subsequent date at a pre-determined price. Repos are principally used in the money market especially by central banks although they can be used in connection with all other types of bonds and securities. Repos are used by central banks in converting open market operations, global money markets and by market makers in specific securities as well as other counter parties[4].

The first repo was by the US Federal Reserve in 1918[5]. The modern market nevertheless developed in the 1990s including with the UK gilt repo market opening in January 1996[6]. The US domestic market is now in excess of US$1 trillion with international repo transactions approaching £500bn[7]. Repos are most commonly used for central bank purposes, providing liquidity in other markets, reducing counter party risk, hedging and generating additional returns[8].

A standard repo (classic or "repo trade") involves the immediate sale of an asset subject to an undertaking to repurchase the asset (or an equivalent asset) at the maturity date for a price including repo interest[9]. This contract is entered into on a trade date with the sale to take place on a value or settlement date. The settlement price is calculated having regard to the trade rather than value or settlement date. The collateral may either be specific (identified) or general (referred to as a general collateral (or GC) trade). The settlement price for government securities is sometimes referred to as the "dirty price" which is the specific value of the security above its nominal issue price on the trade date. (The clean price is the market value.) A margin or haircut may be required (which ranges between 2% to 50% of the collateral value). If coupons are paid on the security, this is referred to as the manufactured dividend which is paid on the coupon value date. [In addition to classic repos, repo transactions include reverse repo[10], a sell/buy-back[11], a tri-party repo[12], hold in custody repo[13], safekeeping repo[14], borrow/loan versus cash repo[15], bonds borrowed/collateral pledged repo[16], cross-currency repo[17] or other more innovative new products such as a four-party repo, floating-rate repo, flex repo or collateral swap[18]

Standard repo contracts are governed by the Global Master Repurchase Agreement (GMRA) produced by the Bond Market Association (BMA)[19] and the International Capital Markets Association (ICMA)[20]. The UK government gilt market also uses the GMRA with a special addendum[21]. The GMRA was revised in 1995 and then reissued in 2000. The GMRA applies with regard to repos, buy/sell-backs and agency trades. The GMRA is governed by English Law although the BMA has also issued a separate 1996 Master Repurchase Agreement (MRA) governed by New York Law. Other forms are used in particular domestic markets although these include the same general provisions. The GMRA generally operates on the basis of establishing a master agreement[22] structure including provisions with regard to title transfer[23], netting[24], margin payment[25],withholding[26], set-off[27] and termination[28].

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1 Goode (n) 414.

2 *Curtain Dreams Plc v Churchill Merchanting Ltd* [1990] BCC 341.

3 Wood explains this in terms of the original seller's call option and the original buyer's put option. In the event of the debtor's insolvency, the buyer will exercise the call option and resell as owner claiming any short Title finance between the resell price and the option re-purchase price as damages. Wood (n) para.1.5.
[On reservation of title, Gerard McCormack, *Reservation of Title* (2 ed 1995); and Sally Wheeler, *Retention of Title Clauses* (1992).]

4 The repo market includes central banks, investment banks, securities houses, retail and commercial banks and building societies. Investors include fund managers, insurance companies and pension funds, investment funds, hedge funds, local authorities and corporate treasuries within large companies. The market also includes various inter-dealer brokers and money brokers. These include Cantor Fitzgerald, Prebon Yamane, Garban Icap, Tullett & Tokyo and Tradition.

5 Moorad Choudhry, *An Introduction to Repo Markets* (Securities and Investment Institute 3 ed 2006) 2.

6 (n).

7 Daily outstanding volume in international repos was between £440bn and £450bn in 2006. Choudhry (n) 2. 50% of daily settlement activity in non-US government bonds worldwide is in repos. Choudhry refers to the repo as the most important financial instrument in the world after the basic cash equity and bond products. (n)5.

8 The main advantages of repos are: (a) providing a flexible and secure instrument for increasing or reducing the total amount of funds in the financial system through open market operations; (b) providing liquidity in bond, equity and derivatives markets; (c) managing positions including, in particular, covering short positions (contracting to sell securities that the seller does not own); (d) reduce counter party risk through provision of collateral security; (e) provision of funds at lower interest rates with collateral cover; (f) generate additional funds for securities holders through repo trading; (g) create additional investment vehicle for investors with surplus funds.

9 Repo interest is commonly calculated on the basis of the relevant 30-day repo rate with a 365-day calendar year. Repo interest is then the cash price multiplied by the repo rate and the term divided by 365.

10 A reverse repo simply involves the purchase and subsequent resale of the security. All repos include a reverse repo depending upon from which counter party's perspective the transaction is considered.

11 A sell/buy-back involves an outright sale on the value date with at-the-spot price and a repurchase of the bond for a value at the forward price. The repo rate is not expressly used but implied in the difference between spot and forward prices. These will also be adjusted to incorporate any coupons paid during term.

12 Tri-party repos use a third party custodian (such as Euroclear or Clearstream as well as J P Morgan Chase or Bank of New York) to hold the collateral in a separate tri-party account. The dealing bank can adjust the composition of the collateral on a continuous basis subject only to the custodian confirming that the underlying trades are fully collateralised. Tri-parties are used for non-government instruments including eurobonds, structured finance or other more innovative products.

13 A "hold in custody" (or "trust me") repo is used in the US to allow the dealing bank to hold the collateral in its own segregated account on behalf of the investor. The purpose is to allow collateral substitutions without actual transfers and settlement costs. The difficult is that the investor has to rely on the goodwill and credit-standing of the dealer.

14 A safekeeping repo is similar to a hold in custody repo with the repo seller holding the collateral in safekeeping on behalf of the cash lender.

15 This is a standard delivery versus payment (DVP) repo although legal title does not pass with only a security interest being created.

16 This involves the exchange of securities against specific collateral with no cash transfer but incorporating a transaction fee. This is a form of stock lending (n).

17 Repos may involve cash or securities in different currencies although additional care has to be taken with regard to daylight exposure, marking to market and contract validity and enforceability.

18 A four-party repo uses two custodians. Floating rather than fixed interest calculation can be provided for especially where the value of the underlying collateral floats. The cash advanced can be adjusted under a flexible or flex repo with the interest payment being adjusted according. A flex repo using mortgage-backed securities (MBS) or other asset-backed securities (ABS) is referred to as a structured repo. A collateral swap involves an exchange of securities with the repo rate being lower where the quality of collateral provided is higher. This is similar to a bond borrowed/collateral pledged structure or other stock lending transaction. Choudhry (n) 14-19.

19 Standard repo documentation was introduced in the US in February 1986. Standard non-US dollar documentation was introduced in November 1992 with the GMRA which was agreed with the ICMA. The BMA was originally set up in [ ] as the Public Securities Association (PSA) [ ].

20 The two main trade associations in the international bond market were the International Primary Markets Association (IPMA) and the International Secondary Markets Association (ISMA). These were subsequently merged with the creation of the International Capital Markets Association (ICMA) in October 2005. [ ].

21 This includes delivery by value (DBV) within the Central Gilts Office (CGO) settlement managed within CREST (n).

22 The GMRA works in the same manner as ISDA master agreements with the provision of standard terms unless adjusted (in Annex I) with other elections also being required. The master agreement will apply to all repos entered into between the parties subject only to specific confirmation being entered into. The obligations imposed apply equally on both sides in light of the parallel nature of the repo transaction. Additional counter party or product specific annexes may also be used. These include the Netherlands Annex and the South African Annex or the (UK) Gilts Annex or the Equities Annex and Italian Annex. Daniel Franks, "The Global Master Repurchase Agreement" in Choudhry (n) ch.8.

23 The seller maintains an economic interest in the securities although full transfer of legal title is provided for under the GMRA. The purpose is to secure a true sale rather than create a secured loan. The GMRA includes clauses designed to ensure that a true sale takes place and that any re-characterisation by the courts is avoided. All title and interest passes, the seller has no continuing proprietary or legal interest and the buyer may deal with the securities in the ordinary course of its business. Equivalent rather than identical securities may be exchanged on the repurchase although this does not undermine the original transfer of title and only reflects the fungible nature of the asset. As with ISDA master agreements, the TBMA and ICMA have obtained a number of legal opinions from the main financial jurisdictions confirming the validity of the repo transaction provided for under the GMRA in the host country. The EU Financial Collateral Directive 2002/47/EC also specifically requires that Member States ensure that repurchase and other title transfer agreements are specifically recognised.

24 The GMRA takes effect as a master netting agreement with all cash payment and securities delivery obligations in all confirmations carried out under the repo structure being netted out. This applies both with regard to settlement netting and close-out netting. Settlement netting applies with regard to daily currency payments and security exchanges with net rather than gross settlement being provided for. Close-out netting applies in the event of a default with all obligations being accelerated and final payment and delivery obligations netted at that stage. Close-out netting is important in a pre-solvency and post-solvency situation (in particular to avoid cherry-picking by liquidators) as well as for ongoing capital adequacy purposes. Early termination and close-out netting is provided for under the EU Financial Collateral Directive and is supported by specific financial laws in many countries including in the US.

25 The GMRA provides for net margin maintenance payments or alternatively for specific transactions to be margined on a gross basis, re-pricing (following a change in value) or novation. Margin obligations arise where the value of the securities or collateral fluctuates on a daily (or even intra-daily) basis. Payment obligations may vary even where the securities are subject to a "haircut" or discount to reflect their volatility. The margin can be covered by cash or separate collateral.

The UK gilt repo market was set up on 2 January 1996 by the Bank of England. Gilt repos use a separate side agreement based on the GMRA[29]. Dealing in gilts had previously to be carried out through stock exchange money brokers (SEMBs) with stock borrowing and lending through gilt-edged market-makers (GEMMs) using the earlier gilt-edged stock lending agreement (GESLA). The UK gilt repo market was set up with a "Big Bang" in January 1996 following market consultation. All market counter parties can now borrow and lend gilts using the adjusted GMRA and updated GESLA which had been amended in December 1995. A Gilt Repo Code of Best Practice was also produced in anticipation of the new market coming into effect. The market expanded from £50bn in repos and stock lending to £90bn by 2005 with a daily turnover of £22bn. The secured gilt repos now account for over half of all overnight transactions in the sterling money markets. The new market has also increased liquidity and reduced transaction costs[30].

The UK repo market now includes market makers, brokers and end-users. Two-way repo rates are quoted by around 20 firms. These provides rates for GC, specifics and specials for anything up to three months with some longer quotes being available[31]. A number of sterling broking houses also specialise in particular types of repo or maturity bands[32]. These operate under a brokerage agreement (with both sides paying one basis point on GCs and two basis points on specific and special repo contracts). End-users principally include other financial institutions such as banks, building societies and securities houses as well as fund managers, hedge funds and insurance companies as well as overseas central banks and some corporate market participants. Settlement is now effected through CREST following the merger of CREST with the Bank of England Central Gilts Office in 2002. Gilt repo settlement has been available since 2003[33]. A CREST reference price is also produced using GEMM data[34]. UK trading is conducted in accordance with the terms of the Gilt Repo Code of Best Practice issued by the Bank of England in November 1995[35].

Regulation, Accountancy and Taxation

Repo transactions are subject to market risk capital charges as they are held in the bank or security houses' trading books. Repos using approved standard documentation such as the GMRA receive favourable treatment. Documented repos can use the risk weight of the counter party (such as an OECD bank) with the charge being based on the mark-to-market value of the positions held. Lower charges may be available under the revised rules to come into effect under Basel II[36].

[Specific types of sale and repurchase agreements are used in the money and securities markets. These are generally referred to as "repos". Repo trades allow securities to be sold on a spot basis subject to a legal enforceable obligation to repurchase the same (or an equivalent) asset as a later date at a predetermined price. The repurchase price will include accrued interest (referred to as the repo return). Repo markets are treated as part of the money markets as they are essentially used for short borrowing purposes although they operate using securities and capital market instruments as collateral. Repo markets are used by central banks for open market money operations and by other financial institutions for funding or hedging purposes[37].]

Repos are treated as secured loans for accountancy and taxation purposes. Repos are treated as on-balance sheet transactions. Securities are held on the balance sheet of the seller with initial transfers not being treated as a disposal. Cash payments are treated as interest and charged as income. Repo interests constitutes loan interest and is charged on an accruals or time of transaction basis. Different rules apply in other jurisdictions.

(j) Stock Lending

Stock loans or stock or securities lending is used to allow financial institutions to hold and use securities on a short-term basis in return for a fee. This may be used to cover short sales[38] or to permit delivery or settlement on an underlying transaction. The security is lent for an agreed period (or possibly on overnight roll) with the borrower providing collateral in the form of cash or possibly a separate security or basket of securities[39]. Under a stock loan, the security holder retains all right and interest which would otherwise be transferred under a repo. Repos are also principally used for borrowing with the security providing collateral, whereas stock lending is used for security coverage purposes with cash being provided as collateral.

Stock lending is most commonly carried out by pension funds and insurance companies which allow them to generate additional income on their securities portfolios. Investment banks or securities houses will then enter into stock loans to borrow the securities on an open (rolling) or fixed (term) basis. The specific securities to be used are identified generically (such as UK 4% gilt due 2010). The parties will agree the duration, the initial margin (collateral)[40] and the rebate (interest on the cash provided)[41]. The stock borrower will also pay a stock loan fee calculated on the market value of the securities involved[42].

Standard documentation is provided for by the International Stock Lenders Association (OSLA). A separate gilt-edged stock lending agreement (GESLA) was revised in December 1995 with the new UK gilt repo market coming into effect on 2 January 1996[43]. This contains various standard provisions which parallel those set out in the TMA (ICMA GMRA and adjusted GMRA for the UK gilts market).

Repo trading and stock lending may be carried out by the same firm or one firm may specialise in either activity. Historically, some firms have continued only to provide stock lending facilities as the cost of introducing necessary systems to allow them to carry out new repo trading would be considered to be prohibitively expensive. Firms may also consider that they lack the expertise in specific repo related activities including cash reinvestment or managing interest rate risks. Separate taxation and accountancy issues may also be relevant. Other firms may have the ability to stock lend, repo the security obtained and invest the cash separately in the sterling CD market[44].

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26 One of the elections in the GMRA allows parties to withhold payment or delivery in the event of default by the other party. This is referred to as a "flawed asset" provision in practice and was added to the 2000 GMRA. The right is optional in light of the possibility that some countries may re-characterise the repurchase as a form of secured lending. Franks (n) 145.

27 The GMRA also includes an optional set-off provision which allows parties to attempt to net out obligations under separate transactions in addition to under the repo master agreement.

28 Automatic early termination is provided for in the event of insolvency of either party. The purpose is to pre-empt formal insolvency proceedings. This may nevertheless cause difficulties in practice with the non-defaulting party not wishing to lose control over the action taken. The use and value of automatic early termination has to be considered with regard to the particular parties and laws applicable in a specific transaction. Franks (n) 146.

29 The Gilt Repo Legal Agreement is based on a revised version of the 1995 GMRA. This includes specific additional terms and conditions in Part 2 to Annex I. The Bank of England has issued a separate Gilt Repo Code of Best Practice ( ) for use in the UK repo market.

30 Choudhry (n) 70, 72.

31 The main market makers now include Royal Bank of Scotland, Barclays Capital, HSBC, Deutschebank and CIBC. Earlier separate SEMBs such as Gerrard & National and Lazards, Rowe & Pitman have now been absorbed within larger operations.

32 These include Tullett & Tokyo and ICAP.

33 Settlement was originally carried out under the DBV (delivery by value) system with a basket of securities being delivered to the cash lender with settlement at end of day. [DBV allows members to borrow or lend money on an overnight basis against gilt collateral.] Term repo settlement was then introduced in September 2003 using a new RPO facility which avoids the need for large intra-day cash or stock movements. Banks can select a basket of securities including up to 10 separate bonds with further substitution being possible. Repurchase is carried out automatically although specific lines can be closed or current trade rolled-over.

34 This is based on the clean mid-market closing prices (16.15pm) provided by GEMM Association members adjusted to include accrued interest and quoted to five decimal places using £100 nominal stock. Separate reference prices are made available for gilt strips on a yield basis.

35 This requires that market participants ensure that they have adequate systems and controls including necessary internal controls, credit risk control systems, written procedures and accounting and taxation systems. Market professionals are required to confirm that clients are aware of the Code before transacting. Parties are expected to deal under an appropriate legal agreement such as the Gilt Repo Legal Agreement based on the GMRA ( ). Initial margin is based on counter party creditworthiness and associated market risks with net exposures being monitored on a daily basis subsequently. Stock loan and repo transactions are to be identified according to the relevant custodian. Special provisions apply with regard to default and close-out with the non-defaulting party, in particular, being required to do everything possible to ensure that default market values are fair. Bank of England, *Gilt Repo Code of Best Practice* (1995). See also M Choudhry, *The Gilt-Edged Market* (Wiley London 2003).

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37 Section

38 Short selling involves the sale of an asset which a party does not own on the general expectation of being able to purchase it back at a lower price on a subsequent date. Many jurisdictions apply strict rules on short selling such as margin and the US "short sale rule" under Rule 10a-1. Rule 10a-1 requires that the last transaction must be made a price higher than the previous one (uptake) or the last price must have been the same as the previous price and the last price change before that was an increase. A short squeeze (or bear squeeze) refers to the need to close-out a short position due to the inability to continue to borrow the supporting securities with the collateral being returned to the lender.

39 The stock lender generally pays interest on the collateral which is received by the other party in the form of a rebate.

40 This may, for example, be 102% which would cover the full value of the securities to be lent.

41 The rebate is paid by the collateral holder (securities lender).

42 Ten basis points (0.1%) is typical.

43 Section

44 Choudhry (n) 73.

3. INTERNATIONAL LOAN FINANCE — G A WALKER

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 or 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

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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

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]

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

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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).

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 Estoppe l- 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

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]

(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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22 LMA 23.7

23 LMA 23.4 and 23.5 (b)

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

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,*]

[Existing Lender] [New Lender]

By: By:

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

[Agent]

By: