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NINTH EDITION

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PREFACE

This ninth edition of *The Lending and Secured Finance Review* contains contributions from leading practitioners in 15 different countries, and I would like to thank each of the contributors for taking the time to share their expertise on the developments in the corporate lending and secured finance markets in their respective jurisdictions, and on the challenges and opportunities facing market participants. I would also like to thank our publishers without whom this review would not have been possible.

I hope that the commentary that follows will serve as a useful source for practitioners and other readers.

Azadeh Nassiri
Slaughter and May
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June 2023

Chapter 3

ENGLAND AND WALES

Azadeh Nassiri, Kathrine Meloni and Rhiannon Singleton[1]

I OVERVIEW

i Market conditions

After the high levels of activity seen in the EMEA loan markets in 2021, 2022 was a difficult year, as the invasion of Ukraine triggered volatile macroeconomic conditions. Rising prices and interest rates inevitably caused turbulence in the loan markets, with both investment grade and leveraged lending transaction volumes dropping significantly. Bank lending saw a particular slowdown, as banks focused on clearing deals already in the market. The decrease in traditional bank lending was, to a degree, offset by the direct lending markets, which saw significant levels of activity; however, overall, there was still a slowdown in transaction volumes, particularly at the larger end of the scale (over €1 billion).

In recent years, the transition from LIBOR to risk-free rates (RFRs) has been a key discussion point on transactions. However, at the end of January 2022, the deadline for the publication of most LIBOR currencies passed. LIBOR rates for key US dollar tenors are due to be published until mid-2023, but these are intended for legacy use only and no new loans should be using US dollar LIBOR. The bulk of the loan market now uses the RFR terms in the new Loan Market Association (LMA) recommended forms of facility agreement, which uses RFRs from day one as the reference point.

Environment, social and governance (ESG) transactions continued to dominate in 2022, with most corporate refinancings for working capital facilities now including ESG metrics, particularly in the investment grade market. 2022 also saw an increase in the inclusion of ESG provisions in leveraged facilities and event-driven financings, as both sponsors and lenders increasingly focus on ESG objectives as part of their internal strategies. Sustainability-linked loans, which link the pricing of a facility to ESG objectives (without directing the use of proceeds to those objectives), are the most commonly seen throughout all markets.

ii Market participants and documentary developments

A mixture of participants remain active in the English-law loan market. Traditional banks continue to play an important and active role in the loan market, and remain dominant in investment-grade lending. In other sectors, particularly in the leveraged, real estate and infrastructure finance markets, alternative credit providers such as direct lending

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funds and institutional investors (collateralised loan obligations (CLOs), finance and insurance companies, hedge, high-yield and distressed funds, and loan mutual funds) are more prominent.

Most English-law syndicated loan transactions use the LMA recommended forms as a starting point for negotiations. In addition to various types of facility agreements and ancillary documentation for the investment-grade market (the investment grade agreements) and leveraged lending (the leveraged finance documentation), the LMA collection comprises multiple templates for more specialist products, including real estate finance, developing markets lending and pre-export finance. The LMA's suite of RFR documentation is now widely used within the market. These topics and related documentation are discussed in Section II.

II LEGAL AND REGULATORY DEVELOPMENTS

Managing the steady flow of legal and regulatory changes remains an ongoing challenge for loan market participants. Some of the topics outlined below have been a feature of loan documentation discussions for some time. In some cases, sufficient consensus has emerged to enable them to be addressed in the LMA templates, leaving only points of detail to be negotiated. Where there remain diverging views, the contractual treatment must be agreed on a transaction-by-transaction basis.

i Sustainable finance

Sustainable investing is an important driver for many financial institutions, which, over the past few years, has fuelled an increase in ESG-linked lending. Sustainable loans look to align terms to the borrower's performance against an agreed set of ESG-related performance targets. For example, the margin on an ESG facility may adjust depending on whether those targets are met (upwards or downwards).

This is to be contrasted with green or social lending, which focuses on the use of proceeds, with a requirement that they are used to invest in green or social projects within pre-agreed parameters. Verification is also required for green and social loans, to assess the merits of the particular project for which the funding is intended.

To assist the development and standardisation of the sustainable lending market, the LMA has produced the following documents:

a the Green Loan Principles (GLPs), comprising voluntary recommended guidelines that seek to promote consistency and integrity in the development of the green loan market by clarifying the criteria for which a loan may be categorised as green. To aid consistency with the green bond market, the GLPs build on and refer to the Green Bond Principles published by the International Capital Markets Association (ICMA);

b the Sustainability Linked Loan Principles (SLLPs), which provide a framework for lending to incentivise the borrower's achievement of predetermined sustainability performance targets (SPTs). Similarly to the GLPs, the SLLPs are intended to promote consistency within the sustainability-linked market, covering topics such as setting the SPTs as well as reporting and review of the borrower's performance against those SPTs;

c the Social Loan Principles (SLPs), which provide a framework for market standards and guidance for social loans, where the proceeds of the loan are used for predetermined social projects, building on the Social Bond Principles published by the ICMA. The

SLPs cover topics such as the use of proceeds and process of evaluation and selection of social projects, together with guidance on the monitoring and reporting on the project and proceeds of the loan; and

d most recently, in May 2023, the LMA published model provisions for sustainability-linked loans for inclusion in LMA loan documentation.

Alongside each set of principles, the LMA has also published guidance notes to aid interpretation of the principles in the market. The LMA continues to take a very active role in the development of the market, providing regular updates to the principles and guidance to reflect developing market practice. Sustainability-linked financing in particular continued to grow in the UK throughout 2022, both in the context of investment-grade corporate working capital facilities and, increasingly, in the leveraged loan market (including some event-driven financings).

ii Pension Schemes Act 2021

Defined benefit (DB) pension liabilities have received renewed focus in corporate and financing transactions since the enactment of the Pensions Schemes Act 2021 (PSA). The PSA is intended to strengthen the powers of the UK Pensions Regulator to intervene in corporate activities that threaten DB pension scheme benefits and recoveries (referred to as the 'moral hazard' regime).

The moral hazard regime was introduced by the Pensions Act 2004, which granted powers to the Pensions Regulator to protect the position of DB pension schemes by requiring employers to provide additional support to schemes in certain circumstances. These powers allow the Pensions Regulator to issue contribution notices (CNs) and financial support directions (FSDs) to either the scheme employer or a person associated or connected[2] with the scheme employer. FSDs are more general in nature and permit the UK Pensions Regulator to require employers to provide additional financial support for the pension scheme's obligations where the Regulator believes it is reasonable to do so. CNs focus on specific actions (or failures to act) that have negatively affected the DB pension scheme.

The PSA has further strengthened the Pensions Regulator's powers by introducing new grounds for the issuance of both CNs and FSDs, as well as the introduction of new criminal and civil penalties for misconduct in relation to a DB scheme.

Since the 2004 Act has been in force, DB scheme issues have routinely formed part of the due diligence and credit risk assessment for financing transactions, together with liaising with the scheme trustees (where appropriate) to determine the extent of any additional support required to mitigate the impact of the transaction on the scheme. While due diligence plays a key role in assessing the existence of any actual or potential DB scheme liabilities, contractual protections, by way of representations or undertakings regarding the existence of and liabilities associated with a DB scheme, together with undertakings relating to compliance with the DB scheme obligations and provision of information to the lenders, are also often seen. For some transactions, receipt of a CN or FSD may trigger an event of default, or obtaining clearance from the Pensions Regulator may be a condition precedent.

The changes introduced by the PSA have resulted in an increased focus on the above provisions and the structuring of financing arrangements. Those involved in restructuring

2 The definitions of connected and associated are extremely broad, potentially extending much further than the corporate group.

transactions are likely to pay particularly close attention to the PSA's new provisions: early engagement with pension trustees and detailed preparation and professional advice will all be required to minimise the risk of potential liability.

iii National Security and Investment Act 2021

The National Security and Investment Act 2021 (NSIA) came into force in January 2022. The NSIA allows the government to intervene in business transactions in specified sectors, including acquisitions and the grant of security, which might reasonably raise national security concerns. Acquisitions in these sensitive sectors designated in the NSIA require clearance from the UK government to proceed, which will need to be factored into the offer timetable. Transactions outside those designated sectors may also be affected. There is also a voluntary clearance procedure that may be followed in cases where there is concern that the transaction could be 'called in' by the UK government pursuant to the terms of the PSA after the event.

Where a transaction falls within the scope of the NSIA, obtaining clearance will need to be factored into the proposed timetable. Lenders may request specific contractual protections, such as making clearance a condition precedent to funding.

iv Economic Crime (Transparency and Enforcement) Act 2022

The Economic Crime (Transparency and Enforcement) Act 2022 (ECA) came into effect in August 2022. It aims to increase transparency of ownership of property in the UK by overseas entities by requiring details of beneficial owners to be disclosed. The ECA does this by establishing a new register, the Register of Overseas Entities (Overseas Register), which requires overseas entities that already own (or subsequently acquire) property in the UK to disclose details of their beneficial ownership.

Overseas entities that own – or intend to acquire - a qualifying estate in England and Wales (being a freehold estate, or a leasehold estate granted for a term of more than seven years) must apply to Companies House to be registered on the Overseas Register and provide verified information about their beneficial owners. Failure to register in advance of acquiring a qualifying estate has, from September 2022, meant that an application to register title at the Land Registry in relation to the land in question will be rejected. This has implications for secured lending transactions as it could affect the ability of a lender to register its security at the Land Registry.

The ECA also has retrospective application, requiring overseas entities that acquired a qualifying estate on or after 1 January 1999 to apply to be included on the Overseas Register, with a six-month transitional period from 1 August 2022 to complete their retrospective registration. Additionally, where an overseas entity disposed of a qualifying estate between 28 February 2022 and the end of the transitional period, that entity must provide details of its beneficial ownership immediately prior to the disposal.

Once registered on the Overseas Register, the entity receives a unique overseas entity ID, which must be given to the Land Registry whenever that entity wishes to register title to (or a disposal of) a qualifying estate. The ECA includes an obligation to update the information on the Overseas Register at least annually (or confirm there is no change).

Penalties for a failure to register (or to comply with the updating requirement) include restrictions on registering title, or dispositions of title (which includes the registration of a grant of a charge), at the Land Registry.

Where the security package for a facility includes the grant of security over qualifying real estate by an overseas entity, lenders will need to ensure that the overseas entity has complied with the requirements of the ECA and has an up-to-date registration. Otherwise, there may be implications for the registration of that security (particularly legal mortgages) and, potentially, complications on enforcement. Contractual protections, by way of conditions precedent and representations relating to ongoing compliance, may be required.

III TAX CONSIDERATIONS

i UK withholding tax

Payments of interest by a UK borrower or UK branch of a foreign borrower, or that otherwise have a UK source and that are made on a loan that is capable of being outstanding for more than one year, are subject to UK withholding tax, currently at a rate of 20 per cent, unless an exemption applies. The UK tax regime provides for lenders to receive interest payments free of UK withholding tax if they are UK banks or UK branches of overseas banks that bring that interest into account for UK corporation tax purposes, UK tax-paying companies or partnerships, or UK building societies.

Lenders that are tax-resident outside the United Kingdom may also receive interest payments free of withholding tax if they qualify under a double tax treaty with the United Kingdom (treaty lenders' in LMA terminology). As well as satisfying the conditions in the applicable treaty, directions must be obtained from HM Revenue and Customs (HMRC) stating that the borrower can pay interest without deducting tax. The introduction, in September 2010, of HMRC's double taxation treaty passport scheme (DTTPS) has, where applicable, improved the time frames within which such directions can be obtained, but there remains a greater risk of withholding tax arising in the case of treaty lenders than in the case of UK lenders (unless the borrower is a strong credit and has been able to limit its gross-up obligation such that it does not apply if clearance is not obtained).

The scope of the DTTPS has since been extended such that for loans entered into on or after 6 April 2017, the parties no longer need to be corporates. Assuming the relevant conditions are satisfied, it can now be used if the UK borrower is an individual, a partnership or a charity or if a treaty lender is a sovereign wealth fund, pension fund, partnership or other tax-transparent entity, provided in the last case that the beneficial owners of the interest are entitled to the same treaty benefits under the same treaty.

The treatment of UK withholding tax risk in loan documentation is well settled and reflected in the LMA's English-law templates. In summary, the borrower is obliged to gross up the amount payable to the lenders should the borrower be required to deduct tax from such payments, provided the recipient lender was a qualifying lender on the date of the agreement. The effect is to limit the circumstances in which the borrower might become obliged to deduct tax and gross up any payment to a lender to a change in law that results in a 'day-1 qualifying lender' ceasing to be exempt from UK withholding tax.

ii Stamp and documentary taxes

No UK stamp or documentary taxes generally apply to loan, security or loan trading documentation where a security trustee structure is used (assuming the loan is not considered to have equity-like characteristics).

iii FATCA

The conclusion of intergovernmental agreements between the United States and a number of countries, including the United Kingdom and most of Europe, has had the effect of largely eliminating the risk of FATCA withholding for financial institutions within the scope of those agreements.

In 2012, the LMA produced a series of riders for use with its facility documentation to allocate the risk of FATCA compliance and any tax deductions as agreed, which have since been updated a number of times. Rider 3, which entitles all parties to withhold as required, but imposes no gross-up or indemnity obligation on the borrower, has become the standard way of dealing with FATCA risk in loan documentation in Europe, regardless of whether the borrower group includes a US entity or has US-source income.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Types of security interests

Secured lending transactions typically involve a combination of security interests. Security can be taken over all asset classes and the choice of security interest depends on the nature of the asset and its importance in the context of the security package.

Under English law, there are four types of consensual security: pledge, contractual lien, mortgage and charge.

Pledges and contractual liens

A pledge is created through transfer of possession, where the pledgee has the power to sell the secured assets and to use the proceeds of sale to discharge the secured obligation. By contrast, under a contractual lien the lienee merely has a passive right of retention until the secured obligation has been performed.

The distinction between a pledge and a contractual lien is, however, of very limited practical importance in most corporate financing transactions as both are possessory security interests (and so the company will not be able to continue to use the asset) and they cannot be used for future property.

Mortgages

Mortgages involve the transfer of title to the asset in question to the lender by way of security, with a right to the transfer back of the mortgaged property when the secured obligation has been satisfied. A mortgage is legal or equitable depending on whether legal or equitable title is transferred.[3] The form of transfer will depend on the nature of the asset in question and so, for example, mortgages over a chose in action (e.g., claims or receivables) involve the assignment of rights by way of security.

The steps required to transfer legal title to an asset and to create security by way of legal mortgage add a layer of complexity that may not be required at the outset of the transaction

3 An equitable mortgage arises either where the necessary requirements for a legal mortgage have not been met or where there is an agreement to create a legal mortgage. In practice, the distinction between legal and equitable mortgages, which is of relevance when determining priority rights, is reasonably straightforward to establish.

(see further below). In general, only freehold property, significant items of tangible movable property, aircraft and ships are the subjects of legal mortgages. In relation to other types of assets, equitable security is created and the secured creditor relies on contractual further assurance clauses and a security power of attorney to facilitate the transfer of legal title upon the security becoming enforceable.

Charges

A charge involves an agreement by the chargor that certain of its property be charged as security for an obligation. It entails no transfer of title or possession to the chargee.

In practice, there is little to distinguish a charge from an equitable mortgage, as enforcement rights such as a power to take possession, sell the secured assets and appoint a receiver are routinely included in documents creating charges.[4] The more significant distinction is between fixed and floating charges.

Broadly, a fixed charge attaches to a specific asset and restricts the chargor from dealing with (e.g., disposing of) that asset. A floating charge generally attaches to a class of assets, and the chargor is permitted to deal with those assets in the ordinary course of business without the consent of the chargee pending an event that causes the charge to 'crystallise'. A typical floating charge will comprise the entirety of the borrower's assets, whether existing or future, and whether tangible or intangible.

The main consequence of the characterisation of a charge relates to the ranking of payments on insolvency. For example, expenses of both liquidations and administrations are paid out of floating charge assets. These costs and expenses can be considerable, and may well exhaust the floating charge assets. A floating charge also ranks behind certain claims of certain preferential creditors (broadly, certain rights of employees and certain amounts owing to HMRC) and, in respect of charges created on or after 15 September 2003, the 'prescribed part', a ring-fenced fund, is also paid out of floating charge assets to unsecured creditors in priority to the floating chargee. Unlike expenses, the priority of employees dismissed promptly following the commencement of insolvency proceedings and the amount of the ring-fenced fund are, generally, reasonably finite (the latter being currently capped at £800,000) and can be roughly calculated in advance by secured lenders.

The other key difference between fixed and floating charges is that the holder of a floating charge that constitutes a qualifying floating charge (broadly, a floating charge relating to the whole or substantially the whole of a company's property) enjoys very privileged appointment rights in an administration. It may appoint an administrator either in court or out-of-court at any time when the charge is enforceable, and is allowed to substitute its own preferred candidate in the place of an administrator proposed to be appointed by any other person.

These consequences have acted as a strong incentive to lenders to draft charge documents, known as debentures, which purportedly create fixed security over as many of the chargor's assets as possible, combined with a sweeper floating charge over all of the assets of the chargor. However, when characterising a charge as fixed or floating, the courts will have regard to the commercial substance of the relationship between the parties. The

4 There are very few situations in practice in which it would be necessary to distinguish between the two. The reason for this is that the priority position of a fixed charge is virtually identical to that of an equitable mortgage, and the registration requirements are the same.

label attached by the parties themselves will be largely irrelevant and, if it is inconsistent with the rights and obligations that the parties have in fact granted one another, the security will be recharacterised.

Common methods of taking security

The typical method of taking security over specific assets and any perfection steps[5] depend on the nature of the asset. For example:

a Real estate: title is transferred to the mortgagee in writing alongside the title deeds if a legal mortgage is to be created. An equitable mortgagee will also generally request delivery of the title deeds.

b Registered shares: a legal mortgagee of shares must be registered as the legal owner, which may have adverse tax and accounting consequences for the lenders. Security is, therefore, often taken by way of equitable mortgage or fixed charge. To facilitate enforcement, the certificates for the shares are usually deposited with the chargee together with signed but undated forms of transfer. The articles of association are amended if necessary to ensure there are no restrictions on transfer in the event of enforcement.

c Intellectual property rights: a legal mortgage or assignment of rights to intellectual property by way of security necessitates an exclusive licence back to the assignor to enable it to continue to use the rights, including a provision for reassignment on discharge of the security. It is, therefore, more common for such rights to be the subject of a charge.

The appropriate method of taking security over claims and receivables such as book debts, bank accounts and cash varies. The key question is whether it is practical to create fixed security. If the intention is to create a fixed charge, the security document will need to contain adequate restrictions on the chargor's ability to deal with both the asset and its proceeds, and those restrictions must be complied with in practice. This generally means that the proceeds of charged receivables must be paid into a blocked account. This may be achievable in relation to certain specific sums (e.g., the proceeds of a disposal that are to be used to prepay the loans). However, companies will need access to at least some of their bank accounts, so fixed security will not be achievable in all cases.

Formalities and registration

Formal requirements for English-law security are minimal. For a variety of reasons, however, it is generally accepted that security documents should be executed as deeds.

Subject to limited exceptions,[6] security interests created by English companies must be registered at Companies House within 21 days of creation, whether over assets in the United Kingdom or abroad and whether created under an English-law security document. If this is not done, the security will be void as against a liquidator, administrator or creditor of the company, and the secured liabilities will become immediately repayable.

5 Under English law, perfection steps (other than registration at Companies House) generally relate to priority, and failure to take such steps does not mean a security interest will be invalid.

6 The main exemption is for interests in shares and financial instruments, cash and credit claims that constitute 'security financial collateral arrangements' under the Financial Collateral Arrangements (No. 2) Regulations 2003. However, this exemption is not generally relied on in practice because of uncertainty as to how to interpret the requirement that the security asset must be within the control of the collateral-taker.

In addition, certain types of assets (e.g., real property, ships, aircraft and certain intellectual property rights) may also be registered, generally for priority purposes, on specialist registers.

Particular challenges

There are no specific categories of asset over which security cannot be granted or over which it is too difficult to create security under English law. However:

a third-party consent may be required to create some types of security over certain leased items (including leasehold real estate), and other contractual rights and receivables, which may be challenging to obtain;

b the limits of the distinction between fixed and floating charges can be uncertain, in particular in its application to cash and receivables; and

c it is not possible to create a legal mortgage of future assets. However, it is possible to create equitable security (equitable mortgage or charge) over future assets. The terms of the security document may require the chargor to take steps to convert the equitable security into a legal mortgage upon acquisition of the relevant asset.

The grant of security is also subject to the legal limitations outlined in Section V.

ii Guarantees and other forms of credit support

Guarantees must be documented in writing and are usually executed as deeds to prevent the guarantor from raising any questions about the existence or adequacy of consideration. Guarantees are the most common form of credit support in both secured and unsecured English-law financings.

The legal limitations outlined in Section V apply equally to the provision of guarantees.

iii Priorities and subordination

Priorities

The general rule under English law is that, as between competing security interests, the first in time normally prevails. However, this is subject in some cases to registration and other exceptions. The rules of priority are complex but might, very broadly, be summarised as follows:

a Where registration at a specialist registry is required, the priority of competing interests is generally determined by the order of registration.

b Registration at Companies House does not directly affect priority. This registration may, however, constitute notice to third parties of the existence of the charge, which may affect the ranking of subsequent security.

c The priority of successive assignments of a debt or other chose in action is governed by a common law rule under which an assignee who takes an assignment without notice of an earlier assignment and is the first to give notice of assignment to the debtor obtains priority over the earlier assignee.

d A legal interest acquired for value and without notice (actual or constructive) of a prior equitable interest will normally rank ahead of the prior equitable interest.

e Special rules apply to floating charges. The grant of a subsequent fixed charge or mortgage takes priority over a floating charge, unless at the time the subsequent security is created the floating charge places restrictions on the creation of further encumbrances (in the form of a negative pledge, which is customarily included in English-law financing documents) and the subsequent holder has notice of the restriction. For this reason, a note of the negative pledge is included in the particulars of the charge that are registered at Companies House, the intention being that anyone who searches the register will thereby acquire actual notice of the restriction. Registration at Companies House may also constitute constructive notice.

Ranking and subordination

Subordination in banking transactions is typically effected by the use of structural subordination (where ranking is determined by which company in the group is a debtor (either as a borrower or guarantor) to the junior and senior creditors) and contractual subordination (where creditors contractually agree to the ranking as among themselves). Contractual subordination is generally achieved through the use of an intercreditor or subordination agreement.

Contractual subordination is often coupled with a turnover trust as a fallback to maximise the recoveries of the senior creditors in an insolvency of the debtor. Under a basic trust subordination arrangement, the junior creditor agrees that any money it receives from the debtor in insolvency (e.g., in the event of mandatory insolvency set-off or other mandatory distribution contrary to the intercreditor agreement) will be held on trust for the senior creditors to the extent of the senior debt. If effective, this has the advantage of giving the senior creditors a proprietary claim against the junior creditor, and means the senior creditors will not be exposed to credit risk on the junior creditor.

It is generally agreed that, as a matter of English law, contractual subordination should be enforceable as between the contracting parties.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

i Limitations on validity and enforceability of guarantees and security

The key issues when considering the validity and enforceability of guarantees and security are capacity and corporate benefit, financial assistance rules and the clawback risks that may arise in insolvency. These issues, which are discussed below, are frequently of theoretical concern only and are usually able to be dealt with as a practical matter in a typical transaction.

ii Capacity and corporate benefit

To grant valid guarantees and security, the grantor must have the requisite capacity and there must be adequate corporate benefit.

The corporate benefit analysis must be done on a company-by-company basis and any benefit received by other members of the group may not be relevant unless, for example, there is an element of reliance and financial interdependence between the companies. As well as carefully minuting the perceived benefits, if there is any doubt the security provider or guarantor may seek the approval of its shareholders.

iii Financial assistance

The Companies Act 2006 restricts the provision of financial assistance, including security and guarantees, as follows. If the target is an English public company, neither the target nor any of its subsidiaries (public or private) may provide financial assistance for the purpose of the acquisition of the shares of the target or of reducing or discharging a liability incurred therefor; or if the target is a private holding company, no English public subsidiaries of the target may provide financial assistance for this purpose.

A number of exceptions apply, but they are often not relevant in the context of secured lending. In practice, if security and guarantees are required from the target group following the acquisition, the relevant public companies in the target group will be re-registered as private companies before the financial assistance is given.

iv Clawback risks

Under English insolvency laws, the court has wide powers to set aside certain transactions.

Guarantees and security provided by an English company or any foreign company subject to English insolvency proceedings may be at risk of being challenged by the insolvency officer if given within a certain period prior to commencement of liquidation or administration, and if certain other conditions are satisfied.

In the case of a guarantee, the most likely ground for challenge is that it represents a transaction at an undervalue[7] or amounts to a preference.[8] In the case of security, the most likely grounds for challenge are that the transaction constitutes either a preference or a voidable floating charge.[9]

The vulnerability periods differ depending on the ground for challenge and are six months for preferences (two years if the counterparty is a connected person); two years for transactions at an undervalue; and one year for a voidable floating charge claim (two years if the counterparty is a connected person).

v Preferences

For a transaction to be vulnerable as a preference, not only must it have been entered into within the specified period but the company must have been influenced by a desire to produce a preferential effect and must have been insolvent (as defined by statute) at the time of the transaction or become so as a result of entering into it.

vi Transactions at an undervalue

For a transaction to be vulnerable under Section 238 of the IA, it must have been a transaction at an undervalue within the meaning of Section 238(4) of the IA and entered into within the vulnerable period. Further, the company must have been insolvent (as defined by statute) at the time of the transaction or have become so as a result of entering into it. In practice, this ground for challenge is of relatively limited concern in most secured loan transactions because of the good faith defence that is available. This defence applies if it can be shown that the transaction was entered into by the company in good faith and for the purposes of carrying on its business, and at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

7 Section 238 Insolvency Act 1986 (IA).
8 Section 239 IA.
9 Section 245 IA.

vii Avoidance of certain floating charges

Under Section 245 of the IA, a floating charge may be set aside except to the extent of the value given to the company at the same time as or after the creation of the charge. If the parties are not connected, it is a defence if the company was solvent (within the statutory definition) when the charge was created and did not become insolvent as a result of the transaction.

Transactions, including security arrangements, may be vulnerable to challenge on other grounds, including that they offend the common law anti-deprivation principle, which invalidates, as a matter of public policy, any agreement providing for assets belonging to a company to be removed from its estate on insolvency.

viii Legal opinions practice

The practice of delivering legal opinions and the content of those opinions is well established in the English-law loan market. As a condition precedent to funding, lenders require opinions on the capacity and authority of each borrower and guarantor, and on the enforceability of the facility documentation, including any security documents.

The general expectation in loan transactions is that counsel to the creditors will deliver any legal opinions. This is usually the case in domestic transactions. In some circumstances, however, the borrower's counsel will be called on to provide an opinion.

Syndicated loan opinions are typically addressed to the agent and the lenders forming part of the primary syndicate. Sometimes, where primary syndication takes place after the signing date (e.g., in the case of an underwritten acquisition facility), lenders who join the syndicate within a short period of the date of the agreement (e.g., three months) will be permitted to rely on the opinion.

Market practice has for some time been to permit the opinion to be disclosed to, but not relied on by, those who buy participations in the loan (or exposure to participations in the loan) on the secondary market.

No further reliance on or disclosure of the opinion is generally permitted without the opinion-giver's consent.

VI LOAN TRADING

English-law syndicated loan participations are regularly traded, most commonly by way of transfer by novation, assignment or sub-participation.

Novation is the simplest method and involves an outright sale of the participation. All of the seller's rights and obligations in relation to the loan are cancelled and discharged, and are assumed by the buyer.

If a facility is secured in favour of the lender directly, the security will be released on the novation of the lender's participation to a new lender. Security for syndicated facilities is, however, usually created in favour of a security trustee, who is appointed as trustee for the lenders from time to time. Use of a security trustee structure permits lenders to trade their participations without disturbing the security.

An assignment of rights to drawn loan participations (coupled with an assumption of equivalent obligations) is sometimes used as a hybrid method if transfer by novation would disturb security or guarantee arrangements, for example, in relation to certain foreign law-governed arrangements.

The LMA's investment grade facility agreement templates contain a framework to permit trading by novation or assignment, subject to borrower consent unless the transfer is to another lender or an affiliate of an existing lender, or if an event of default is continuing. The LMA templates do not restrict sub-participation or other trading methods such as trust or derivatives arrangements that do not involve a change to the lender of record under the facility agreement. Some borrowers negotiate those restrictions, but in most cases these trades can be effected without borrower consent. These methods of risk transfer should not disturb any security or guarantees provided in favour of the lender of record (or a security trustee acting on its behalf).

VII OTHER ISSUES

There are currently no other issues of note.

VIII OUTLOOK AND CONCLUSIONS

The increase in activity seen at the end of the 2021 had been expected to continue in 2022, buoyed by good liquidity in the markets and relatively benign borrowing conditions. However, the invasion of Ukraine and the resulting volatility meant that the year was challenging for the loan markets. 2023 is also likely to see muted lending conditions; while bank debt capacity is there for the right credits, those lower down the credit spectrum may continue to turn to alternative products, such as direct lending and private funds.

In terms of other issues, the growth in ESG lending is expected to continue across the investment grade and leveraged markets for both working capital and event-driven financings.