Banking & Finance Update

AUSTRALIA'S GLOBAL
LAW FIRM

August 2013

Welcome

Welcome to the August issue of the Banking & Finance Update

In this issue we discuss some of corporate Australia's most favoured funding options including syndicated and club facilities as well as the opportunities for Australian companies to raise US denominated debt via the Term Loan B and High Yield markets. Our team will explain key features of each and highlight some of the advantages and disadvantages that each financing approach presents.

Our tax group will also discuss the application of new laws that are designed to limit the extraction of profits from Australia at low tax costs.

We hope you enjoy this edition.

Paul Jenkins
Partner
paul.jenkins
@ashurst.com

Martin Coleman
Partner
martin.coleman
@ashurst.com

Contents

Welcome	1
Most favoured arrangements: a trend towards club financings	2
Syndicated Finance – a primer	4
Transfer pricing	7
Accessing the US Capital Markets	9

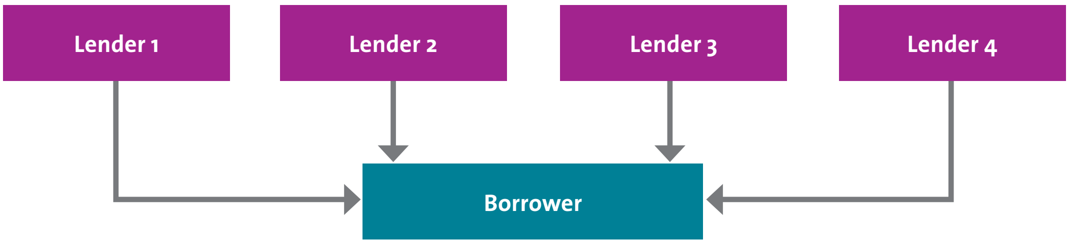
Most favoured arrangements: a trend towards club financings

What you need to know

With the uncertainty in the global economy continuing, many borrowers are using their relationships with banks to seek more competitive sources of funding by way of bilateral or club loans.

What is a club loan?

A club loan is a form of multi-bank financing whereby several banks lend to the same borrower on materially the same terms (other than pricing), but there is no bank syndicate or facility agent, and the financing is usually self-arranged by the borrower.



A borrower may opt for a club structure where it considers that it can obtain cheaper pricing and/or more favourable terms by individually negotiating with each financier. As pricing is not uniform, there may be competitive pressures on the financiers to agree to more favourable terms for the borrower.

A key distinction between a syndicated financing and a club financing is that a club financing does not involve an agent acting as an intermediary between the borrower and the financiers. Instead, the borrower in a club deals directly and independently with each financier.

Typical structure

While there are a few different ways in which a club loan can be structured, the most common structure we've seen recently is as follows:

- **Common Terms Deed:** All the financiers and the borrower (and any guarantors) enter into a Common Terms Deed, which contains the provisions that are common to all financiers, such as definitions, representations and warranties, undertakings, reporting obligations, financial covenants, events of default, review events etc. The document may contain a "most favoured nations" clause to prevent the borrower giving more favourable security and terms (other than in relation to pricing and the mechanics of the loan) to other financiers in the club.
- **Separate, bilateral agreements:** In addition, there will be separate, shorter facility agreements for each financier which deals with the mechanics of providing the loan and sensitive, commercial terms (eg fees and pricing).
- **Common security:** If the facilities are secured, common security is usually held by a security trustee for the benefit of all the financiers. Depending on the deal, the security may only be enforced by a decision of the majority of financiers or alternatively an individual lender may be able to trigger enforcement. Ordinarily, each club financier would rank *pari passu* in terms of payment rights under the security.

Advantages and disadvantages of a club financing

from a borrower's perspective some advantages and disadvantages of a club financing structure are:

Advantages

- **Pricing:** Pricing in a club financing should be better for the borrower. The margin in a syndicated loan usually ends up with the highest price of the syndicate members (ie the price required to get the last dollar in the door), whereas with a club loan the borrower can accept each bank's separate offer and take advantage of lower prices.
- **Terms and conditions:** Given the direct relationship between the borrower and the financiers, and the fact that the financiers act independently, a strong borrower may be able to seek more favourable terms and conditions (eg financial covenants and other undertakings) in a club financing.
- **Flexibility on drawings, repayments and exiting a financier:** A club financing may not require the borrower to drawdown from, and repay, each financier at the same time. As such, the borrower may have the flexibility to drawdown the cheapest debt first and fully repay, and cancel the commitment of, one financier earlier than another. This may be useful for a borrower where it no longer wishes for a particular financier to be involved going forward. From a financier's perspective, a club loan may provide more flexibility on the ability to offer different products.
- **Reduced administration costs:** As a club financing does not have a facility agent or, generally, an arranger appointed, the borrower will not incur additional administration fees which are paid to those finance parties (however, see "No agent" below).
- **Diversification:** A club facility (as opposed to a single bank deal) will allow a borrower to maintain relationships with multiple banks, which can provide competitive tension, but may also provide benefits in terms of maintaining diversity in bank relationships.

Disadvantages

- **Approvals:** If the borrower needs to seek any consents or waivers, depending on the structure of the deal, it may not have the benefit of a "majority financier" regime and instead will need to seek individual consents and waivers from each financier.
- **Enforcement:** Unless the structure has been "dressed up" as a syndicated loan with a majority financier voting regime, each financier may have a veto right and may be able to individually take action upon the occurrence of an event of default.
- **No agent:** While the borrower may benefit from not paying any agency fees in a club financing, the borrower may incur additional costs in directly dealing with all the financiers (rather than dealing directly with an agent who would usually liaise with the financiers). This may include higher internal costs, and higher external legal costs for the financiers, because there is generally no agent or documentation bank to coordinate the dealings with the financiers' counsel.


Gaelan Cooney
Partner
gaelan.cooney
@ashurst.com


Marina Tinning
Senior Associate
marina.tinning
@ashurst.com

Syndicated Finance – a primer

What you need to know

Syndicated financing – a mechanism for multiple financial institutions (including more recently, credit funds) to provide financial accommodation to a borrower via a "facility agent" – is a technology rather akin to the internet. Its strength extends back barely past the 1990s, but it is now ubiquitous, a necessary utility, a novelty turned into the commonplace. Multi-lender corporate and property financings, leveraged and acquisition financings, project and infrastructure financings: all such transactions are commonly built upon the rock of a syndicated financing structure.

The basics

Pressure points in the syndicated debt market evolve over time, but the basics remain constant. In a syndicated financing, the lenders will "participate" (through their "facility office") in common loans made to the borrower via a facility agent (typically, a department of the same legal entity as one of the lenders). This is distinct from a club financing, where the club banks will provide separate bilateral loans directly to the borrower (see the separate article in relation to club financings in this Banking and Finance Update).

Where a syndicated financing is secured, the security will be held on trust for the relevant beneficiaries (typically, the lenders, hedge banks, transactional facility providers, and the facility agent and the security trustee themselves, in their personal capacities) by a security trustee (typically a related body corporate of one of the lenders) pursuant to a security trust deed.

The chronology

A typical syndicated financing may walk the following path:

1. **Mandate letter:** A financial institution, or multiple financial institutions, may be mandated to arrange the facility for the borrower.
2. **Commitment letter:** The arranger may also offer to underwrite the facility – that is, committing to providing the entire facility to the extent that it is not able to sell down portions of that facility to other participants – on the terms set out in a term sheet. Those terms should represent a balance between the borrower and the syndications market. A fee will be paid for that underwrite.

   A commitment letter may include provisions relating to:

   a. In an acquisition finance context, a "certain funds" provision will put the financier "on the hook" to provide its commitment, subject to a limited subset of the usual list of conditions precedent, so as to demonstrate (for example, to a vendor) the certain availability of funding.

   b. Market flex: An arranger may seek the flexibility to change the structure, terms and pricing of the facility if necessary for the purposes of successful syndication of the facility.

   c. Clear market: A borrower may be restricted from seeking or incurring debt in a particular debt market for a period, so as to increase the possibility of successful syndication of the facility.
3. **Information memorandum:** The arranger, together with the borrower, will prepare an information memorandum: a marketing document designed to provide prospective financiers with information about the borrower and the facility, including indicative or agreed terms. For larger selldowns, there may be a roadshow.
4. **Formal documentation:** Once commitments have been sourced from syndicate financiers, a facility agreement and all necessary ancillary documentation will be prepared. In the Australian market, while most firms have their own syndicated facility precedent documents, the Asia-Pacific Loan Markets Association's precedent documents – based on the London Loan Markets Association documentation – represent a quasi-market standard for investment grade borrowers. Indeed, negotiations for many syndication facilities these days, including sub-investment grade borrowers, will often be based on skeleton APLMA documents that have been tailored, or commonly invoke APLMA provisions in relation to a number of issues – including market disruption, increased costs clauses, and agency provisions – as a market standard.

Pressure points in syndicated financings

Financier decision-making

Through the course of a facility term, the financiers may need to make several decisions, ranging from ordinary-course confirmations that conditions precedent to first drawdown have been satisfied, through to providing consents and waivers to the borrower, right through to – where the borrower has defaulted – deciding whether to accelerate a loan and instruct the security trustee to enforce the securities.

Financiers and the borrower will need to agree those decisions that require the instructions of all lenders, and those decisions that require only the instructions of the "majority lenders".

Typically, it is only fundamental decisions that will require the instructions of all lenders. These might include:

- approval of conditions precedent prior to first drawdown;
- reductions in pricing;
- increases in, or extensions to, a commitment.

Other decisions will require the instructions of only the "majority lenders", whose instructions will bind the other lenders. The concept of "majority lenders" may be defined by reference to the lenders' commitments or participation in outstanding loans, and the proportion of commitments or participation that will constitute the "majority" in any particular transaction – usually, 50%, 66 2/3% or 75% – will vary, depending on the make-up of the syndicate. Suffice to say, lenders with a large hold in a tight syndicate will customarily seek a definition of "majority lenders" which effectively provides them with a blocking vote (for example, a lender with a 35% hold may seek a "majority lenders" definition of 66 2/3%); lenders with a small hold will customarily seek the percentage of voting power which comprises the "majority lenders" to be higher, so as to maximise the possibility of their vote being required in any decision-making process. From a borrower's perspective, a lower threshold for "majority lenders" is a knife that cuts both ways: that lower threshold may make it easier for consents and waivers to be obtained, but may also make it easier for sufficient instructions for acceleration of a facility or enforcement of security to be obtained.

A facility agreement may provide for a lender to be disenfranchised where it has not responded to a specific amendment or waiver request within a pre-defined period of time: this is known as "snooze-and-lose". Such provisions can be helpful for facility agents in managing unwieldy or large syndicates.

Less commonly, a facility agreement might also allow the borrower to buy out a lender who does not accept a waiver or amendment request: this is known as "yank-the-bank".

Assignment

"Balance sheet management" became a mantra of many banks during the global financial crisis. To preserve their exits, financiers will commonly seek the ability to freely assign their rights and novate their obligations under a syndicated facility agreement without any consent of the obligors being required. Where obligors manage to negotiate a general consent requirement, a facility agreement may nevertheless provide that consent is not required in a number of circumstances, such as where:

- an event of default is continuing;
- the assignment or transfer is to another existing lender or an affiliate; or
- the assignment or transfer is to a securitisation vehicle where the transferring lender remains lender of record.

Borrowers and, on occasion, lenders may have sensitivity around certain categories of persons being able to join the lender syndicate. Borrowers, for example, may seek to limit syndicate membership to their "relationship" banks; lenders may wish to limit syndicate membership to those whose interests are more likely to be aligned to their own. Such drivers may be dealt by a number of different mechanisms, including:

- imposing a minimum-ratings or a regulatory status requirement on proposed new lenders;
- white-lists (of pre-approved new lenders); and
- black-lists (of persons who are prohibited from becoming lenders).

Care should also be taken as to whether the sub-particiation provisions permit restrictions on assignment to be side-stepped. Financiers, including hedge funds and financiers fronting for them, will often look to use those provisions to transfer debt where possible.

Administrative parties

The Agent

The Agent is responsible for administering the syndicated facility on a daily basis. Notably, the Agent will serve as:

- **contact point between the borrower and the lenders:** for example, the Agent will the party that receives drawdown notices from the Borrower;
- **calculation agent:** for example, the Agent will determine the amount in which each lender must participate in a loan, and the base rate for the interest period of a loan;
- **paying agent:** for example, lenders will make their participation available to the Agent, who will then advance the funds to the borrower. Similarly, interest and amortisation payments will be made by the borrower to the Agent, who will then distribute funds on a pro-rata basis to the lenders. One occasional exception to this role, especially in the case of smaller syndicates where the borrower or lenders wish to maintain confidentiality, relates to establishment fees, which may be documented by fee letters, and paid, pursuant to bilateral arrangements between the borrower and each lender.

The Security Trustee

In a secured syndicated financing, the Security Trustee will hold securities on trust for the relevant beneficiaries pursuant to a Security Trust Deed.

While decision-making by the Agent will commonly be on the basis of the instructions of the "Majority Lenders", decision-making by the Security Trustee (including in relation to enforcement) will commonly be on the basis of the instructions of the "Majority Beneficiaries": a broader concept, which will involve consideration of the commitment, participation or other exposures of agreed beneficiaries other than the syndicated lenders, including secured transactional facility providers, hedge banks (in some instances), and the facility agent and the security trustee themselves, in their personal capacities. Careful consideration should be given by the lenders as to which parties are allowed, and by which process such parties are allowed, to become beneficiaries under the Security Trust Deed.

The Security Trustee will customarily be a related body corporate of one of the lenders; in Australia, each of the four major trading banks has a separate related body corporate which commonly plays such a role. In a sole underwriting context where, initially, the security will be held on trust for one lender, the use of a separate body corporate (distinct from that one lender) eliminates the risk of the trust failing where the security trustee and the sole beneficiary would otherwise be one and the same. (There are other structuring solutions that can also deal with this risk.) However, the use of a separate body corporate (which is not an ADI) as security trustee does raise other issues. Notably, under the *Personal Property Securities Act 2009* (Cth), any security interest granted in favour of the non-ADI security trustee over a bank account cannot be automatically perfected by control.

Martin Coleman
Partner
martin.coleman
@ashurst.com

Kenneth Nguyen
Senior Associate
kenneth.nguyen
@ashurst.com

Transfer pricing

What you need to know

Governments around the world are taking steps to defend their tax bases by introducing new measures to prevent the extraction of profits at low tax costs. Against that background, new tax transfer pricing rules in Subdivisions 815-B to 815-D of *Income Tax Assessment Act 1997* apply from 1 July 2013.

The Australian Taxation Office (**ATO**) is likely to focus on the effect of the new rules on entities with international dealings who consistently report losses or lower taxable income than might be expected, given the value of sales or economic contributions to scales made in Australia by the entity or associated entities.

In addition to covering transactions between legal entities, the new rules contain provisions for allocating income and deductions to a permanent establishment (**PE**) of an entity, including a branch. Those rules go some way towards recognising that "dealings" between a PE and other parts of the same entity are to be taken into account in allocating profits to the PE. But there are serious practical difficulties in determining the actual external income and expenses to allocate.

What you need to do

All taxpayers will have to consider the potential effect of the new rules, especially as they apply automatically (ie on a self-assessment basis) and do not depend on the Commissioner making a transfer pricing determination.

The new inter-entity rules

The new inter-entity rules apply if at least one of the entities is a non-resident not operating through an Australian PE or is an Australian resident operating through a foreign PE. No common control or ownership is required. The inter-entity rules also apply for the purpose of calculating the taxable income of an Australian branch of a foreign financial institution if "deemed separate entity" treatment of the branch applies under Part IIIB of *Income Tax Assessment Act 1936*.

The rules are modelled on, but are not identical to, the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* published in 2010 (**OECD TP Guidelines**). Where the new rules do not produce the same result as the OECD TP Guidelines, the new rules will prevail unless overridden by a tax treaty.

In general, the pricing of actual transactions between entities will be tested by applying one or more of the accepted transfer pricing methodologies directly to those transactions. However, if the form of the arrangements between the parties does not reflect the substance of the arrangements, the "arm's length conditions" (essentially, appropriate market prices) are to be established by reference to the substance of the commercial and financial relations between the entities. Furthermore, if independent entities acting at arm's length would not have entered into the actual relations, the "arm's length conditions" are to be established by reference to:

- the commercial and financial relations that independent entities would have entered into, or
- if independent entities would not have entered into any commercial or financial arrangements, "an absence of commercial or financial relations". In this case, the relevant "arm's length conditions" (broadly, the appropriate prices) would self-evidently be nil.

These reconstruction provisions have the potential to result in radical adjustments in determining an entity's taxable income. We expect that many transfer pricing disputes in future will involve a question as to whether or not actual transactions are to be reconstructed or disregarded entirely, before the arm's length pricing test is applied. For example, if a taxpayer consistently reports losses the ATO might argue that independent entities would not have entered into the actual commercial and financial arrangements, and so the results of the actual arrangements should be compared with the results of not entering into any arrangements or entering into different arrangements.

There is also the potential for dispute over the transfer pricing method that should be used to determine the "arm's length conditions" (essentially, appropriate market prices). Unlike the OECD TP Guidelines, the new provisions do not give clear priority to transactional methods (for example, the comparable uncontrolled price, or **CUP**) method over profit-based methods (ie methods which aim to determine prices in a manner which appropriately splits the overall profits from an economic activity conducted by two or more related enterprises).

Nevertheless, there is a strong argument that the preference given by the OECD TP Guidelines to transactional methods should be respected in the application of the new rules. On that basis, it should be possible to justify the pricing of transactions in most cases by reference to a CUP if a reliable CUP can be found for the transaction, and reliable adjustments can be made to take account of differences between the circumstances surrounding the reference data and the circumstances in which the actual transaction was entered into.

The new profit attribution rules for PEs

New rules for attributing profits to PEs (including branches) adopt the principles set out in the 2010 OECD Report *Attribution of Profits to Permanent Establishments* (**OECD PE Report**) but they specifically stop short of deeming internal "dealings" between a PE and other parts of the enterprise to be equivalent to legal transactions.

In broad terms, the rules require that intra-entity dealings be identified in accordance with the OECD PE Report and then priced in accordance with the OECD TP Guidelines, but the results must then be translated, in a manner not dealt with in the new rules, into allocations of actual income and actual expenses to the PE. In many cases, particularly in the context of banking operations, it will not be possible to identify specific items of income and expense to attribute to a branch as a result of an internal dealing.

The Board of Taxation recently reported to Government on the advantages and disadvantages of adopting the authorised OECD approach (**AOA**) to the attribution of profits to PEs. Under the AOA, dealings between PEs and other parts of the same enterprise are in general treated in the same way as transactions with third parties. The Government has not yet announced its response to the Board's report. Should the AOA be adopted, the financial results of internal dealings will generally be treated as items of income and expense. This will resolve many of the difficulties that arise in applying the new profit attribution rules.

Ian Fullerton
Consultant
ian.fullerton
@ashurst.com

Accessing the US Capital Markets

Term Loan B's and High Yield Bonds

The Current Climate

The past eighteen months has seen a rally in the US "Term Loan B" ("TLB") and high yield bond ("HYB") markets driven by a combination of inter-related factors: US investors' search for yield in the face of declining interest rates, an increased focus by investors on TLB and HYB as an attractive investment, an increased allocation by traditional HYB investors of their portfolios in TLB's as a means to hedge against the prospect of rising interest rates, a revived CLO market looking for TLB assets to allocate to portfolios ($55bn of new CLO issuances in 2012 and $38bn in the first half of 2013) and increased competition and over-subscription among investors for TLB syndicate allocations, all squeezing pricing further in the borrower's favor.

The concern as to the impending 2013/14 wall of maturity for leveraged loans is waning (an average pace of $30bn of refinancings per month during 2012) and borrowers are finding investors with a renewed appetite for more aggressive financings such as dividend recaps. Increased demand from investors has, as in prior cycles, lead to more issuer-friendly financings featuring higher leverage, lower spreads, less or no original issue discount and more flexible covenant packages, with a resurgence of TLB covenant-lite deals.

Opportunities for Australian Corporates

The current climate has opened the door for Australian corporates seeking to raise US Dollar-denominated debt in the US markets in lieu of, or as a supplement to, a concurrent Australian Dollar financing in their home market. The past twelve months has seen a variety of US Dollar TLB and HYB deals including senior unsecured bond offerings from Nufarm Limited (US$325mm), Ausdrill Limited (US$300mm) and BlueScope Steel Limited (US$300mm) and TLB's by Fortescue (US$5bn) and Atlas Iron Ltd. (US$325mm).

While there is a foreign currency exchange risk for a foreign issuer raising debt in another jurisdiction and the cost of hedging exposure may be significant, cheaper pricing on US TLB and HYB may off-set hedging costs. Additionally, a company may benefit from a natural hedge to the extent that it generates revenues in the US which may be sufficient to service the US Dollar debt.

So, assuming that a company is willing to explore this route, the next question is what do US TLB and HYB financings look like and how do they compare as alternative products?

"Increased demand from investors has, as in prior cycles, lead to more issuer- friendly financings featuring higher leverage, lower spreads, less or no original issue discount and more flexible covenant packages, with a resurgence of TLB covenant-lite deals."

Term Loan B's and High Yield Bonds

There are various permutations of TLB and HYB financing structures in the US. An acquisition may be financed through a bank or bond issuance, or a combination of the two. A bond deal may take the form of senior secured or unsecured notes or senior subordinated notes. Such bonds may be issued with "registration rights" or "private for life". A bank financing may take the form of first and second lien facilities, include an amortizing term loan "A" tranche, or take the form of a "uni-tranche" facility. A borrower may need to opt for mezzanine financing or other form of junior debt to supplement its senior debt issuances. A company may have significant inventory and receivables to support and asset-based revolving facility versus a cash flow based alternative and its revolving facility may take priority as a "super senior" tranche. The appropriate structure for a particular issuer will be determined by a combination of factors including anticipated investor demand for specific tranches of debt, the intended use of proceeds, available collateral, the resulting leverage of the issuer, credit ratings and other deal-specific items.

For purposes of this article, we will focus on, non- investment grade financings for companies where a high-yield or term loan financing is a viable option.

What are Term Loan B's and High Yield Bonds?

TLB is a term loan tranche of a bank financing held by institutional (versus traditional banks) with a maturity in the 5-7 year range and nominal amortization of 1% of principal per annum prior to a bullet repayment on final maturity, which as a result, is an attractive investment to investors seeking longer term paper. A TLB loan is often one tranche within senior secured credit facilities comprising term loan and revolving credit facilities. It differs to a term loan "A" tranche, which amortizes in full over the life of the loan and, traditionally held by bank (versus institutional investor) lenders.

HYB are non-investment grade debt securities, referred to as "notes", with a maturity of 5-10 years, issued to institutional investors in either a registered offering subject to the requirement of the *Securities Act 1933* (the "'33 Act") or a private placement in reliance upon available exemptions from registration (typically Rule 144A and Regulation S offerings) under the '33 Act (see "*Taking a Deal to Market*" below). Notes may take the form of senior secured, senior unsecured or senior subordinated (ie: subordinated to certain debt in the capital structure, such as existing bank facilities, but ranking senior to or pari passu with all other debt of the issuer).

The applicable market terms and process of execution differs significantly between a TLB and HYB financing, although there has been a recent convergence in covenant packages (see "*Covenants*" below). Such differences are important factors in a company's decision to undertake a financing comprising of either or both components.

Some Key Differences Between TLB and HYB

	TLB	HYB
Minimum Deal Size	No minimum threshold for a syndicated bank loan – the smaller the size, the fewer number of lenders required to participate.	Threshold amount to undertake a 144A/Reg S offering is generally deemed to be $100-150mm.
Requirement to register with the Securities & Exchange Commission	Not applicable to TLB, since loans are not deemed to be "securities" for purposes of the *Securities Act 1933*.	HYB issued in a registered offering or private placements with registration rights, involve registration procedures required by the '33 Act. The process is generally more time consuming and costly than a TLB financing. See "Taking a Deal to the Market" below.
Interest Rates and Pricing	Floating rate based on LIBOR or the agent's Base Rate (as elected by the margin is often determined by a pricing grid based on agreed leverage ratios offering the borrower a lower margin upon achieving a pre-agreed decreased leverage ratio. Interest is payable at the end of the relevant LIBOR period (ie: 30 days, 3, 6, 9 or 12 month as agreed) or calendar quarters for loans bearing interest at the Base Rate.	Fixed rate coupon payable semi-annually. Some deals may feature a "PIK" (payment-Borrower) plus an applicable margin. The in-kind) toggle feature allowing the issuer to elect to have a portion or all (depending on what portion of the interest rate is available to PIK) of the interest payment added to the outstanding principal balance of the note, instead of paying cash interest for the period.
Voluntary Prepayments and Call Protection	Lenders in bank financings did not traditionally receive the benefit of any protection against early repayment. However, "soft call" provisions began to appear for TLB (not TLA or revolving facilities) circa 2006 to compensate lenders for repricings or refinancings with new loans carrying an overall yield (based on margin and any original issue discount) that is less than the TLB loans being refinanced. The premium is typically 101-2%. Unlike HYB, a "soft-call" is only payable where yield is decreased as a result of a repricing or refinancing.	Note holders typically receive greater protection against repayment by way of call premiums. A note is usually non-callable for a period equal to the halfway point to maturity (ie: a 7 year note may have a 3 year non-call feature) with a premium payable on the principal repaid after expiry of the non-call period. The amount of the premium will decline towards maturity, for example a 7 year note may be non-callable prior to the 3rd anniversary of issuance and repayable at 103% in year 4, 102% in year 5, 101% in year 6 and at par thereafter. The non-call feature is subject to the issuer's ability at any time to repay the principal subject to a "make-whole" payment, which is calculated based on the net present value of future payments owed to the holders through maturity. Electing to repay bonds under the make-whole option is costly and rarely invoked by issuers.
Mandatory Prepayments	A borrower would typically be required to use the net cash proceeds of an asset sale or insurance event, that are not otherwise reinvested within an agreed time frame, to prepay term loans. Term B lenders usually have the ability to refuse acceptance of their share of any payment, in which case, such amount would be retained by the borrower. Term loans also typically include prepayments for excess cash flow, equity issuances and non-permitted debt issuances.	Issuers are required to make offers to holders with net cash proceeds of asset sales and insurance events in excess of an agreed threshold, to the extent not otherwise applied to repay other senior debt or be reinvested in new assets. HYB deals do not include the concept of prepayments from excess cash flow or equity issuances.

	TLB	HYB
Financial Covenants	Typically include financial maintenance covenants (debt to EBITDA, interest or fixed charge coverage ratios) tested on a quarterly basis, unless a "Covenant Lite" loan (see "Covenants" below).	No maintenance covenants in a HYB, which instead includes covenants that are "incurrence-based". ie: a financial covenant (either a fixed charge coverage ratio or leverage ratio) is tested only when the issuer is seeking to incur debt, make an investment or restricted payment in excess of pre-agreed baskets.
Change of Control	A change of control is structured as an event of default, giving the majority lenders the ability to accelerate the loans and demand repayment. A change of control therefore typically triggers a refinancing of the existing credit facilities.	Different to a credit facility, in that a change of control is structured as a put right for the holders with a 1% premium. Therefore, upon a change of control, the HYB would remain in place unless a holder elects to be repaid at 101% of its outstanding principal.
Events of Default	Generally more restrictive than compared to a HYB. Affirmative covenant breaches typically have the benefit of a 20-30 day grace period, with no grace periods for negative covenant breaches and agreed $ thresholds for other categories of default including judgments, ERISA and environmental liabilities. Lenders may call a cross-default for other material debt upon (i) a payment default and (ii) other non-payment defaults with the expiration of applicable grace periods. Lenders do not have to wait for the other material debt to have been accelerated.	HYB default provisions are relatively more lenient than those for a TLB credit agreement. Breaches of significant covenants may have a 30 day grace period, extending to 60 days for less significant covenants. HYB contain cross-acceleration (versus cross default) giving the holders the ability to call a default only where a default under other material debt has resulted in the lenders of such material debt deciding to accelerate.
Acceleration	Upon an Event of Default, lenders holding 50.1% of loans may instruct the agent to accelerate the loans.	Holders of at least 25% of the bonds may instruct the trustee to accelerate the bonds following an Event of Default.
Amendments	Amendments are possible and are managed through the administrative agent. The process and timing of gathering consents will depend on the size of the syndicate.	HYB deals are typically not amended after issuance since the procedure (a "consent solicitation") can be costly and time consuming involving the engagement of a solicitation agent (ie: there is no administrative agent to manage the noteholders) and payment of consent fees. This is one reason for why HYB covenants traditionally offered greater flexibility compared to bank financings.
Replacement of Lenders/Holders	A TLB would typically include a "yank-a-bank" provision giving the borrower the right to force individual lenders out of the syndicate (through a transfer of its loans to an existing or new lender) (i) if a lender is a hold-out lender in a vote requiring unanimous consent and a majority threshold has been reached and (ii) if a lender asserts its rights to compensation under the increased costs or tax gross-up provision.	No equivalent in a HYB deal giving the issuer the ability to force holders to sell their notes.

	TLB	HYB
Debt Buy-Backs	Credit facilities typically include a restriction on the ability of the borrower or affiliates from acquiring loans from lenders on the basis that (i) the borrower should not be able to influence any voting within the syndicate and (ii) lenders should receive all payments from the borrower on a pro rata basis, without individual lenders being able to receive payment ahead of or disproportionately to other lenders (whether through a sale of the loans or otherwise). It is now common for credit agreements to include provisions permitting the borrower to purchase loans from lenders at a price less than par via modified dutch-auction procedures, as an alternative to prepaying loans at par under the optional prepayment provision. Loans purchased are deemed to be immediately cancelled. Affiliates of the borrower (such as the sponsor/equity investors) may also be permitted to become lenders, but subject to limitations as to voting rights and participation in lender meetings.	There are typically no documentary restrictions (other than applicable securities laws) around the ability of the issuer or its affiliates to purchase the issuer's notes in the open market from individual bondholders.
Inspection Rights for Lenders	A typical feature of a credit facility is to permit the lenders visitation and inspection rights of the borrower's properties, books and records. Usually limited outside of a default to a few visits per annum and acting through the Agent on behalf of the lenders.	No equivalent right for noteholders.

Taking a Deal to the Market

The process by which a company would raise debt through either a high yield issuance or a syndicated term loan differs significantly, in large part due to the fact that bonds are debt "securities" falling under the ambit of the '33 Act, while bank loans are not deemed to constitute securities.

High Yield Bond issuances

Pursuant to the '33 Act, an offering of securities is required to either be conducted as a "registered offering" or rely on one of the available exemptions to registration, resulting in what is referred to as a "private placement".

Private placements are typically consummated under the exemptions available under Rule 144A or Regulation S. A Rule 144A offering permits the investment bank acting as the initial purchaser of the bonds to resell the bonds to an unlimited number of qualified institutional buyers ("QIB's") being large institutional investors with at least$100 million of assets comprising securities. Regulation S provides an exemption for offerings of securities conducted outside of the US and is not limited to sales to sophisticated investors, such as QIB's. A company will often conduct a private placement under a combination of both 144A and Regulation S exemptions, which will result in the bonds being sold to QIB's within the US and other investors outside of the US.

Year-to-date, 2013 has seen in excess of $90 billion of covie-lite loan issuances, representing more than 50% of the overall US TLB market for 2013 (data according to S&P Capital IQ/LCD).

Registered offerings vs. private placements

- Time & Cost: the registration process takes additional time and cost to complete, since requires SEC review of the offering memorandum ("OM"). This is not necessary for a private placement.
- SEC Reporting: registration of bonds triggers an ongoing requirement that the issuer reports to the SEC, including disclosure of its financial statements, on a quarterly and annual basis.
- Transferability: securities issued in a private placement are restricted and subject (i) in the case of 144A bonds, minimum holding periods before they are freely transferable to the market and (ii) in the case of Regulation S bonds, resale only in reliance on Regulation S to non-US persons. This limitation is often addressed in providing purchasers with registration rights.

An issuer may be required (based on investor demand) to grant "registration rights" to holders, permitting holders (typically within an agreed period after issuance and subject to other conditions) to request that the issuer register bonds issued in a private placement with the SEC and thereby become freely transferrable. This is an important feature for investors since it provides the purchased bonds with enhanced liquidity, which can result in better pricing of the bonds for the issuer. However, registration results in the requirement for the issuer to report to the SEC.

Term loan B financings

Since bank loans are not deemed to be securities for purposes of the '33 Act, they are not subject to the same requirements or limitations as to disclosure and transferability. The speed at which a bank financing may be consummated is dictated by the extent of the syndication required to find lenders to advance funds. In practice, this may require lender presentations similar to a road show conducted as part of a high yield offering together with a prospectus (a "bank book") that, due to disclosure requirements for a HYB offering, is less extensive than the OM in a HYB offering.

Committed Financings

One of the key differences between a term loan and high yield financing is the fact that a term loan may, typically in the context of a financing supporting an acquisition, be "committed" or underwritten by the arranging bank(s), whereas a high yield deal would not. A committed bank financing would enable a corporate borrower to engage one or more banks to provide a financing commitment on pre-agreed pricing and terms, subject in the case of a syndicated financing, to the ability of those banks to "flex" the pricing and certain terms within agreed parameters, in order to ensure that the arranging banks can syndicate the deal into the market.

In the immediate aftermath of the credit crisis banks were cautious in providing commitments that could not be syndicated. However, as the market continues to improve and syndication confidence has returned (and currently oversubscribed), committed financings have returned to the arena.

In a high yield financing an investment bank is engaged to either place or underwrite (as an initial purchaser) the notes and the market "prices" the bonds, which takes place close to or contemporaneously with closing of the transaction. Where a high yield bond issuance forms part of a financing, and a committed financing is required (ie: an acquisition scenario), the company would seek a committed bridging loan that would be drawn in the event that it is not possible to consummate a high yield offering within the required time frame or at the desired price. Such bridge loans are typically set with a 365 day maturity and an increasing interest rate serving as an incentive to the company to attempt to issue the bonds and refinance the bridge loan, at the earliest possible time.

Covenants

Covenant packages for bank facilities comprising term loans, versus those for high yield deals, traditionally differed in that the latter do not contain financial maintenance covenants. A term loan facility would include a quarterly compliance test of leverage (Debt: EBITDA), interest coverage (EBITDA: interest expense) and/or fixed charge coverage (EBITDA: fixed charges (including debt service, tax and other fixed expenses)), calculated using a 10-30% cushion to the financial model agreed with the banks. The restrictive covenants in a bank financing would limit the ability for the borrower to incur debt, make investments, pay dividends, etc., other than a prescribed set of baskets permitting certain actions to be taken and usually subject to $ caps.

Conversely, high yield covenants are "incurrence-based" by nature, meaning that a financial covenant (typically either a 2:1 fixed charge coverage ratio or an agreed leverage ratio) would only be tested if the issuer wanted to consummate certain actions, such as incur additional debt. Provided that the issuer satisfied the covenant on a pro forma basis (ie: after giving effect to the intended action), it could incur the debt, etc. without restriction. In the event that the issuer could not satisfy the covenant test, it would need to rely upon an agreed set of baskets permitting certain limited actions to be taken irrespective of whether the covenant test could be met.

This differs to a bank financing in that while a borrower may have a debt covenant basket permitting it to incur additional debt up to, say $5 million, the pending quarterly financial maintenance covenant test would dictate whether there was any room to incur additional debt under that $5 million basket without tripping a default.

Covenant lite

The past decade has seen an evolution in the TLB market, principally with the emergence of "covie-lite" deals. Such deals are "lite" in their absence of financial maintenance covenant testing and emerged in circa 2005, driven by private equity sponsors financing LBO activity and accepted by institutional investors who were competing for syndicate allocations and willing to accept a lesser degree of control over a borrower. From the viewpoint of a borrower, a large syndicate of lenders with a broad profile of investor-types, including banks, hedge funds, pension funds and vulture funds, may have divergent interests and prove to be a challenging group to coordinate in a covenant breach or work-out scenario. A covie-lite approach therefore works well from a borrower's perspective to reduce lender involvement when it is experiencing a period of financial strain.

An immediate effect of the credit crisis was to eliminate new covie-lite deals and in some cases, refinancings saw the addition of maintenance covenants. However, covie- lite deals re-appeared in 2012 as confidence in the credit markets improved and are enjoying a resurgence in 2013. Year-to-date, 2013 has seen in excess of $90 billion of covie-lite loan issuances, representing more than 50% of the overall US TLB market for 2013 (data according to S&P Capital IQ/LCD). This, in turn, has been reflected in the CLO market, where newly issued CLOs in 2013 are allowing for a greater percentage of portfolios to be made up of covie-lite loans.

However, not all covie-lite deals are free of maintenance covenants. A variation frequently seen in recent years is to include a financial maintenance covenant, tested quarterly, but where a default may only be called by the revolving facility lenders. This formulation provides a means of appeasing banks as revolving lenders, who are naturally uncomfortable in funding a new advance into a scenario of deteriorating EBITDA, whilst also giving the borrower the benefit of a covie-lite approach for the TLB tranche and limiting the number of lenders it will need to negotiate with in a downside scenario.

The convergence of covenants

Setting maintenance covenants aside, a covie-lite TLB and a HY deal may still differ in their approach to restricting activities of an issuer. For example, while a HY deal might test the ability to incur debt based on meeting a pro forma 2:1 fixed charge coverage ratio, a typical TLB might permit additional debt up to a specified $ cap, or perhaps, a pro form a maximum leverage test.

Where a company's debt capital structure comprises both a senior secured TLB financing and existing (or the ability to issue future) HYB, that company may find itself with two different sets of covenants, different capacities to take certain action and different accounting definitions used in formulating Consolidated Net Income, EBITDA, etc. To the extent that the bank credit facility negative covenants are more restrictive than those of the HYB indenture, the company would not be able to fully access the flexibility offered by the HY bonds, while the bank credit facilities remain outstanding.

This, combined with the additional time and effort on the part of the company to monitor compliance with two covenant regimes, makes it important to attempt to align the covenant packages between a TLB credit agreement and a HYB indenture as closely as possible.

The past few years has seen a trend of convergence in negative covenant packages between TLB and HYB deals, in that borrowers of TLB have been obtaining covenant terms more similar to, and in some cases, identical to, those available in a HYB issuance. Again, the extent of this convergence for a particular deal will be dependant upon various factors including investor demand for the TLB, the issuer or debt credit rating and whether a HYB features as part of the capital structure. The presence of an asset-based revolving credit facility (an "ABL") in the capital structure may further constrain covenant flexibility offered by the HY and TLB tranches. The lenders of an ABL are, typically, commercial banks who adopt a more conservative approach and outlook than institutional investors in a HYB or TLB deal. A borrower will likely experience greater resistance from a syndicate of ABL lenders in its efforts to obtain one uniform set of covenants to apply across all facilities.

Restricted subsidiaries

In a typical HY bond deal the Issuer and its Restricted Subsidiaries are subject to the covenants, while Unrestricted Subsidiaries are not. This concept is now frequently seen in TLB deals, where Borrowers are offered similar flexibility as in a HY deal.

An "Unrestricted Subsidiary" is a subsidiary designated as such by the Issuer and consequentially, (i) is not subject to the covenants and is thereby not limited in its ability to conduct business, including incurring debt, making investments and divesting of assets and (ii) is not required to guarantee the HY notes.

In exchange for this flexibility, (i) the net income and EBITDA generated by an Unrestricted Subsidiary is not counted in the Issuer's consolidated net income or EBITDA, which impacts ability to meet the fixed charge coverage and leverage ratio tests and (ii) the Issuer and its Restricted Subsidiaries are limited in their ability to make investments in, or make loans and payments to, Unrestricted Subsidiaries. Designating a subsidiary as "Unrestricted" equates to making an investment in that subsidiary, and is therefore subject to the Issuer having capacity under its Investments covenant to make the designation.

A covenant would typically include a specific basket for investments in Unrestricted Subsidiaries up to an amount determined by the greater of $χ and χ% of total assets. Investments through designating Unrestricted Subsidiaries over and above that basket amount, would be made in reliance on the "Building Basket" generally available to the Issuer for investments and restricted payments (see "*Restricted Payments*" below).

An Unrestricted Subsidiary can be re-designated as Restricted and brought back into the group, though this is often limited to one iteration in order to prevent abuses of the mechanism to bypass or satisfy the fixed charge coverage or leverage ratio tests.

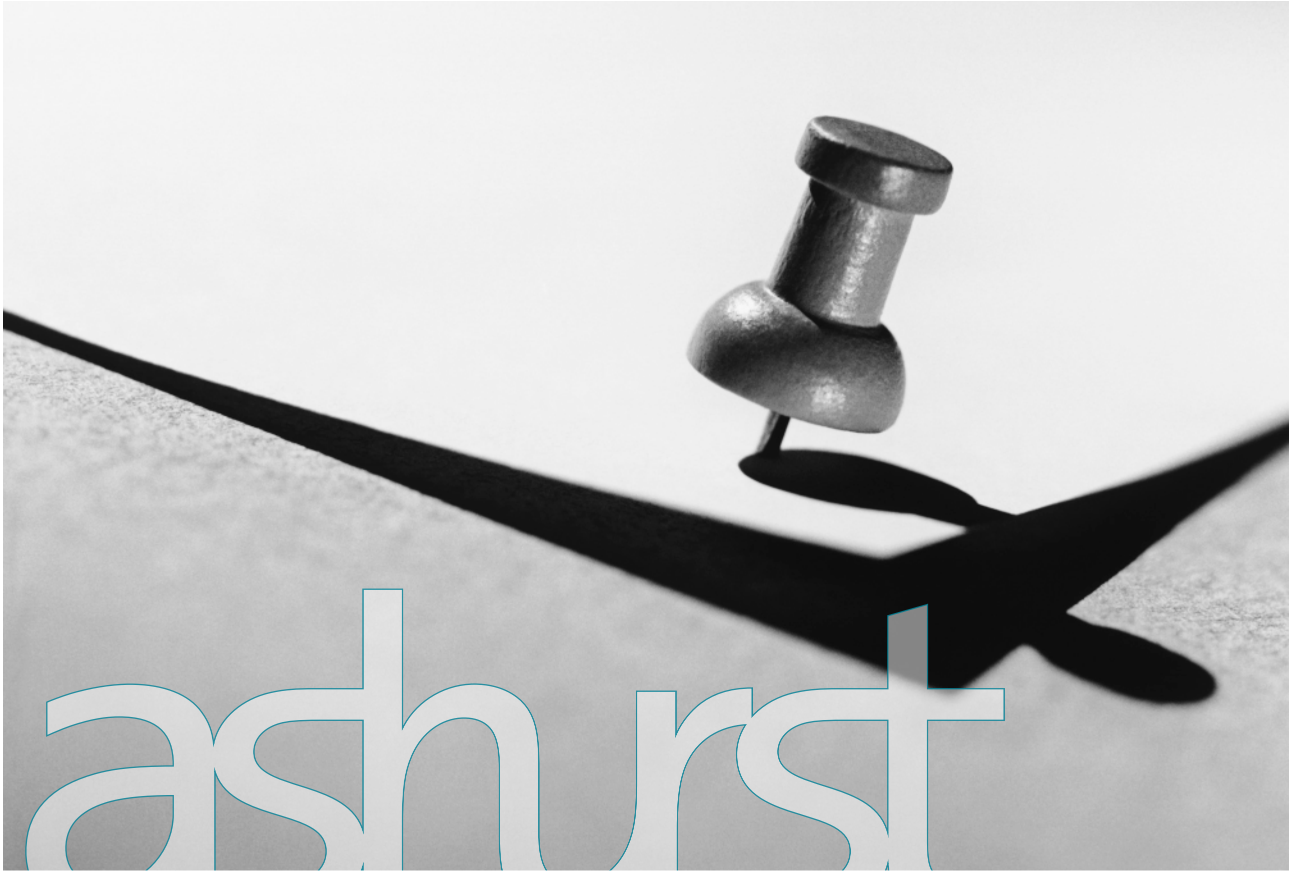
"The past few years has seen a trend of convergence in negative covenant packages between TLB and HYB deals, in that borrowers of TLB have been obtaining covenant terms more similar to, and in some cases, identical to, those available in a HYB issuance."

Covenant Comparison

The table below summarizes certain key covenants in HYB and TLB financings. While the nature of a covenant package for a particular financing will be determined by various deal-specific factors, this illustrates the type of flexibility that is currently being seen in the market and how the prevalence of covie-lite TLB's is resulting in a convergence with HYB deals.

Covenant	HYB	TLB
Debt	Issuer will have the ability to incur additional debt subject to meeting a pro forma 2.00:1.00 fixed charge coverage ratio test or a specified leverage ratio test (ie: the "incurrence test"). Additionally there will be agreed carve-outs ("baskets") for specific categories of debt (capital leases, etc.) available to the issuer irrespective of whether the incurrence test can be met at such time.	Traditionally, additional debt was subject to a $ cap, but has evolved to offer greater flexibility. For example, a borrower may incur additional debt subject to pro form a compliance with a leverage test based on any of total debt, senior debt (ie: not limiting the borrower's ability to incur additional junior debt) or senior secured debt (ie: not limiting the borrower's ability to incur additional senior unsecured or junior debt). If the TLB is issued as part of a financing comprising a HYB deal, it may obtain the ability to incur debt based on the same 2.00:1.00 fixed charge coverage test. TLB lenders may require that additional debt is issued with a maturity outside of the TLB (and control the borrower's ability to prepay such debt, to the extent issued as junior debt, through the Restricted Payments covenant – see below).
Liens	The extent to which the granting of liens over assets is restricted depends upon whether the HYB are senior secured, senior unsecured or senior subordinated. Senior subordinated HYB typically permit liens, provided that the issuer does not grant liens to secure other subordinated debt. Senior unsecured HYB would permit other debt to be secured by liens to the extent that the issuer secure the HYB on an "equal and ratable" basis. Senior secured notes would have a more restrictive covenant limiting the issuer's ability to grant additional liens, subject to a pro forma secured leverage test.	TLB lenders are always focused on the issue of sharing collateral with other creditors of the Borrower and the ability to incur additional secured debt is typically restrictive. Traditionally a $ cap, but a movement towards permitting liens based on a senior secured leverage test (but a tighter test than that for incurring debt) or permitting the Borrower to secure additional debt but only in the form of 2nd liens on the TLB lenders' collateral Permitted 2nd lien financings would be subject to a pre-agreed form of intercreditor agreement that would be attached to the TLB credit agreement. Permitted 2nd lien financings are generally formulated as "silent seconds" ie: subordinated with as few rights as possible.

Covenant	HYB	TLB
Restricted payments (ability to make dividends, redeem equity, prepay other debt or make investments)	An Issuer may make Restricted Payments using either (i) its "Building Basket" or (ii) prescribed permitted baskets. The Building Basket concept is a basket amount available to the Issuer to consummate certain actions, including Restricted Payments and investments, that grows over time based on 50% of Consolidated Net Income accumulated from the closing date through the relevant date, plus other items such as additional equity contributed to the Issuer. The other prescribed permitted baskets, may for example, include a general basket based on either a $ cap or the greater of a $ cap and a % of total assets (to allow the $ cap to grow commensurate with the size of the Issuer group).	Lenders are always focused on the ability of a Borrower to leak cash out of the credit group via dividends or repayments of junior debt, etc. A Borrower would traditionally have limited capacity to make such Restricted Payments (and may be limited to a nominal $ cap general basket). TLB deals have evolved towards a HY approach in (i) permitting the Borrower to use "Retained Excess Cash Flow" (ie: the portion of Excess Cash Flow in any fiscal year that is not required to be applied by the Borrower to prepay loans under the excess cash flow mandatory prepayment provision) or (ii) a similar building basket, typically called the "Available Amount" based on 50% of accumulated Consolidated Net Income and other items as per a HY formulation. One difference here to a HY approach is that a Borrower's ability to use the Available Amount may also be subject to meeting a pro forma leverage ratio test and/or liquidity test (ie: minimum cash and revolving facility availability).
Asset sales	Rather than restrict the issuer's ability to dispose of assets, the covenant is intended to direct what the issuer does with the proceeds. Issuer would be permitted to dispose of assets (in addition to other specific baskets) provided that the sale is at fair market value and at least 75% of sale proceeds comprise of cash. Net cash proceeds not applied by the Issuer to other senior debt (ie: mandatory prepayments under a bank facility) or reinvested in other assets, are deemed "Excess Proceeds". When Excess Proceeds exceed a specified threshold amount, the Issuer is required to make an offer to the holders to repurchase HY Notes using such Excess Proceeds. The Issuer would retain Excess Proceeds where holders elect not to accept the offer.	Traditionally, Borrowers would only be permitted to dispose of assets in sales outside of the ordinary course of business up to a limited $ amount per fiscal year or over the life of the loan. Net cash proceeds of those sales would be subject to a mandatory prepayment, subject to the Borrower's ability to re-invest the proceeds within a specified period of time (typically 180-365 days). Some recent TLB deals have seen a movement towards a HY approach permitting unlimited asset sales subject to fair market value and 75% cash proceeds conditions. Lenders may be comfortable with this approach where the proceeds are applied to de-lever and pay down the loans.



Conclusion

The recent slate of Australian corporates looking to the US to raise debt financing was initiated as a result of constrained regional demand and more competitive pricing terms offered by US investors. However, we may be seeing the emergence of a permanent feature in the global capital markets landscape, where non-US companies might routinely consider a US financing among its range of financing options. The US possesses a deep bench of institutional investors that has recently demonstrated an appetite for term loan B and high yield bond issuances by both Australian and European companies and the trend appears to be continuing. Of course, a variety of deal and company-specific factors will determine whether a US syndicated loan or private placement is feasible for a particular transaction. We are always happy to work with our clients and answer any questions related to a potential US financing.

Key Contacts

Damian Ridealgh
Partner, New York
damien.ridealgh
@ashurst.com

Rich Davis
Partner, Washington, DC
rich.davis
@ashurst.com

Ashurst Australia contact details

Adelaide	Tanya Denning	+61 8 8112 1009
Brisbane	David Mason	+61 7 3259 7430
	Jock O'Shea	+61 7 3259 7309
Canberra	John Clark	+61 2 6234 4060
Melbourne	Martin Coleman	+61 3 9679 3538
	John Field	+61 3 9679 3312
	Jamie Ng	+61 3 9679 3753
	Bruce Whittaker	+61 3 9679 3212
Perth	Gaelan Cooney	+61 8 9366 8000
	Rebecca Field	+61 8 9366 8017
	Andrea Rezos	+61 8 9366 8043
Sydney	Paul Jenkins	+61 2 9258 6336
	Doo-Soon Choi	+61 2 9258 6681
	Simon Irvine	+61 2 9258 5869
	Brenton Key	+61 2 9258 6776
	Timothy Lipscombe	+61 2 9258 6145
	David Mason	+61 2 9258 6104
	Robert Ritchie	+61 2 9258 6036
	Steve Smith	+61 2 9258 6182
	Graeme Tucker	+61 2 9258 6773
	Shawn Wytenburg	+61 2 9258 6046