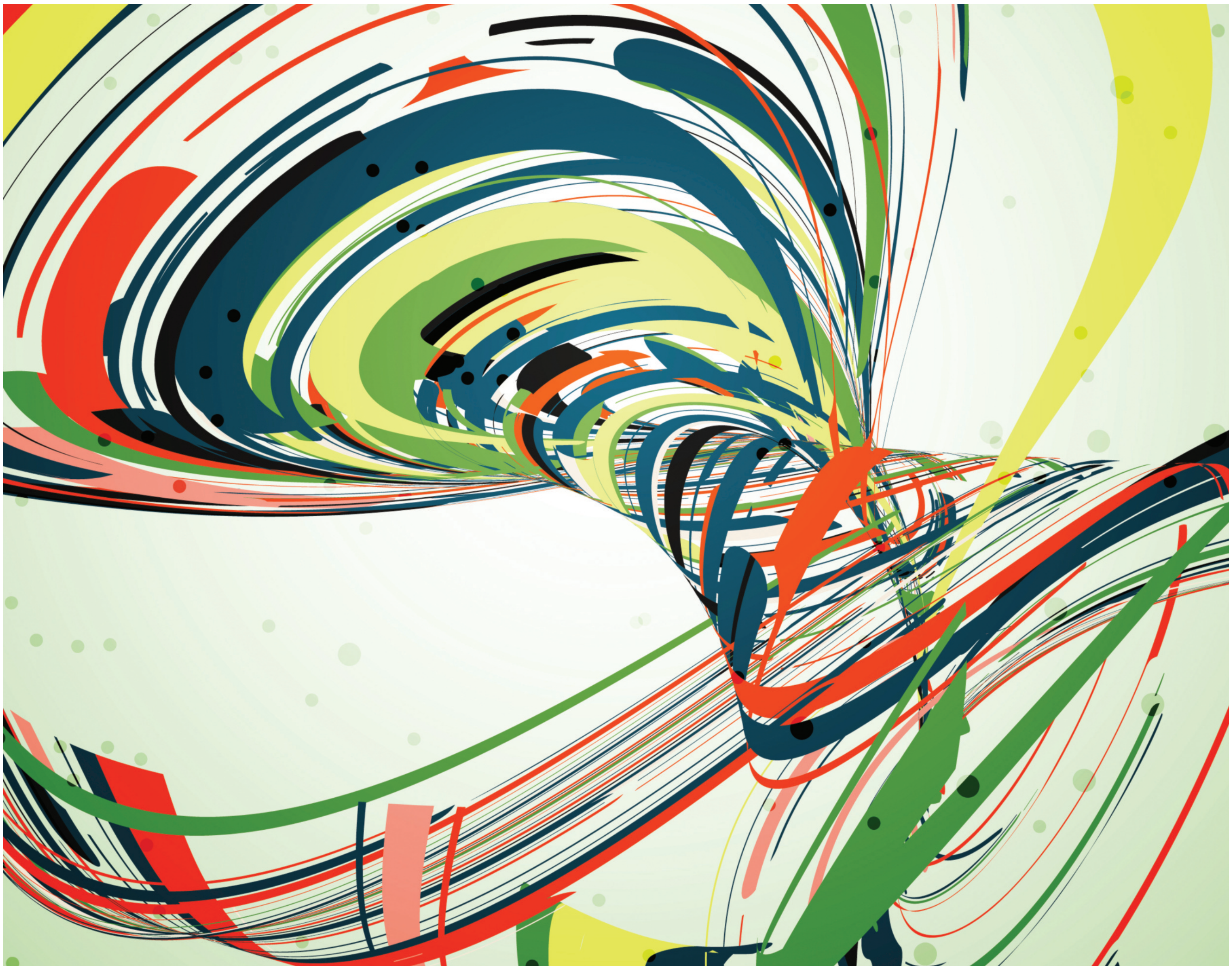

Cross-border Financing Report

UK
Sam Hamilton and Fergus O'Domhnaill, Latham & Watkins

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SECTION 1: MARKET OVERVIEW

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1.1 Please provide an overview of the market and environment for cross-border financing in your jurisdiction.

Despite the economic uncertainty surrounding Brexit, given London's undiminished role as a centre for debt finance markets in the UK remain open for business with healthy levels of debt issuance occurring so far in 2018 (following a bumper year of issuance in 2017), fuelled by the low interest rate environment and quantitative easing of recent years. Buyouts, recapitalisations and refinancings make up the majority of market activity in UK and European financing markets, with a surge in M&A activity supporting market volume this year.

In sponsor-related financing activity in 2018, the negotiating dynamic started the year in favour of sponsors and shifted marginally in favour of lenders and investors during the summer months as pricing and documentation was flexed wider on a number of deals for the first time since early 2016, due in part to an increase in the size and number of deals going to market this year (see Section 2.2). Overall, it is a borrower's market with negotiation dynamics shifting based on market conditions and we expect to see further opportunistic financings implemented over the course of the fourth quarter in 2018.

1.2 Have there been interesting changes in the structure of the banking sector in your jurisdiction?

Direct lenders remain popular both with yield hungry institutional investors looking to deploy capital and borrowers who wish to utilise the distinctive features of direct lending (including more straightforward financing structures and fewer lenders) and who prefer to avoid the risks involved in tapping the syndicated markets. Direct

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Sam has experience working at all levels of finance capital structures, including senior debt, mezzanine debt, unitranche debt, first/second lien financings, PIK debt, vendor loans, dividend recapitalisations, asset-backed loans, margin loans, post-IPO facilities, bridge facilities, high-yield bonds, and restructurings.

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lending fund sizes have increased exponentially over recent years and we expect private debt will continue to feature strongly across capital structures in lower to mid-market financings (and even on occasion in the larger deals where well-established direct lenders are involved). Although direct lending deals typically finance groups with EBITDA at or below the €30 million ($35 million approximately) mark, even smaller deals have experienced movement on documentation terms and lending standards due in part to increased competition amongst direct lenders.

SECTION 2: FINANCING STRUCTURES

2.1 What have been the key trends or developments in your jurisdiction over the past 12 months in terms of financing structures, deal drivers and the way borrowers and creditors are participating in the market?

Despite investor pushback over the summer of 2018, European documentation terms include levels of flexibility and innovation that are perhaps the most borrower friendly the debt markets have seen to date. Covenant erosion in European financings remains a common theme in 2018, with the vast majority of deals eschewing maintenance covenants in favour of incurrence and leverage based covenant-lite financing. Default rates remain at historical lows (and are expected to remain low given the lack of covenants in a large proportion of recent debt issuances, which would otherwise function as early warning signals in debt documentation).

2.2 Briefly outline some recent notable transactions involving your jurisdiction, highlighting any interesting aspects in their structures and what they might mean for the market.

In 2017, the number of sponsor-backed cross-border acquisition financings tapping syndicated loan markets in both the EU and US surged to over €100 billion, driven primarily by large M&A deals which require significant levels of financing. So far, 2018 is no different and volumes are currently on track to exceed the heights reached in 2017. One such recent example is the financing backing Carlyle and GIC's buyout of Azko Nobel Speciality Chemicals, which involved €7.3 billion (equivalent) of debt financing. The ability to tap more than one market (often using both loans and bonds) is possible in part due to the convergence of documentation terms over recent years, so that the gap between the EU and US market terms is no longer as distinct. In addition, borrowers/issuers with significant dollar and euro cash flow streams are a natural fit for such deals.

SECTION 3: LEGISLATION AND POLICY

3.1 Describe the key legislation and regulatory bodies that govern cross-border financing in your jurisdiction.

The Financial Services and Markets Act 2000 (FSMA) regulates the provision of financial services in the UK. A firm needs to be authorised (or exempt from authorisation) by the Financial Conduct Authority (FCA) or the Prudential Regulatory Authority (PRA), the main regulatory bodies, in order to carry out certain regulated activities in the UK. Whilst accepting deposits is a PRA-regulated activity, corporate lending by itself is not a regulated activity. Banks participating in syndicated loans do not need any lending-specific authorisation or licence to participate in loans in the UK (although they will have a range of regulatory permissions relating to the other activities they carry on).

A securities' issue is subject to the Listing Rules administered by the UK Listing Authority (UKLA). Traded securities are subject also to rules of the relevant markets of the London Stock Exchange. The FCA's Prospectus Rules and the EU Prospectus Directive regulate the content of prospectuses. The EU Market Abuse Regime, the UK Criminal Justice Act 1993 and the Financial Services Act 2012 regulate insider dealing. Certain intermediary services relating to securities such as brokerage, placement, and underwriting require regulatory permissions.

Acquisition of UK listed entities is subject to the provisions of the City Code on Takeovers and Mergers, the UK Companies Act 2006, Listing Rules as well as insider dealing prohibitions per above.

The European Central Bank (ECB)'s leveraged lending guidance came into effect in November 2017. It applies to all significant credit institutions supervised by the ECB and defines leveraged lending to mean either a loan with total debt to EBITDA in excess of 4.0x or, a loan where a financial sponsor owns more than 50% of the borrower. The guidance has not tempered the appetite of banks to participate in leveraged loans, with leverage levels routinely exceeding the ECB guidance and banks instead focusing on the ECB's expectation that a leveraged borrower has an adequate repayment capacity, defined as the ability of the borrower to fully amortise the senior secured debt, or repay at least 50% of its total debt within five to seven years.

3.2 Have there been any recent changes to legislation or regulations that may impact the cross-border financing market or availability of funding in your jurisdiction?

Effective January 3 2018, FCA firms cannot use right to act or right of first refusal clauses with respect to future primary market or M&A services. The ban does not extend to bridge loans, provided it meets the characteristics for bridge loans as set out in the FCA policy statement in this regard. In practice, most bridge loans in cross-border financings will meet these requirements.

The UK will exit the EU on March 29 2019. Negotiations on the nature of the UK's post-Brexit relationship with the EU are underway. There is the possibility of a transitional period from March 29 2019 to December 31 2020, during which period the UK will continue to follow EU rules and participate in the single market and the customs union. The UK Parliament enacted the European Union (Withdrawal) Act 2018 on June 26 2018, pursuant to which, if it is operative immediately before exit day, EU law (as it stands upon Brexit) will become part of English law.

A hard Brexit (ie the UK and the EU are unable to negotiate terms of their future relationship), remains a concern for financial institutions. There are also questions on the effect of Brexit (such as a loss of passporting) on continued performance of legacy contracts. Trade and industry bodies have argued that the most efficient solution would be for this issue to be addressed via legislation between the UK and the EU.

Following the comments by the FCA Chairman in July 2017, Libor is expected to be discontinued after 2021. The Bank of England (BoE) has developed the reformed Sterling overnight index average (Sonia), an overnight rate, as an alternative to sterling Libor. However, markets have expressed concerns around the suitability of overnight rates for use with forward-looking term-based asset classes such as loans. The Loan Market Association and the International Capital Markets Association have been working with the BoE and the FCA on alternatives for forward-looking term asset classes. Similar workstreams are underway in other Libor jurisdictions. In the meantime, industry position is to include flexibility in legacy and new contracts via amendment provisions, to address the discontinuation and replacement of Libor in contracts.

Finally, EEA banks participating in non-EEA law governed contracts (which will include English law contracts following Brexit), will be required to include the contractual recognition of a bail-in clause pursuant to article 55 of the EU Bank Recovery and Resolution Directive in those contracts.

3.3 Are there any rules, legislation or policy frameworks under discussion that may impact lenders or borrowers involved in cross-border financing in your jurisdiction? How can market participants prepare?

See above and note that there are no specific restrictions which prevent foreign lenders making loans, benefitting from guarantees or taking security in the UK and no exchange controls which affect the repatriation of capital.

SECTION 4: LOCAL MARKET NORMS

4.1 Are there frequently asked questions from new market entrants or often overlooked areas from parties involved in cross-border financings in your jurisdiction?

Secured lending in the UK typically provides lenders with a defensive secured position at the top of the capital stack. However, structuring and intercreditor issues play a key role in any European cross-border financing. In particular, where debt is both senior and subordinated, borrowed by entities located across multiple jurisdictions, the market approach is to enter into an intercreditor agreement upon closing to attempt to deal contractually with certain issues arising from the lack of any comprehensive cross-border insolvency mechanism in Europe. This will ensure that lenders obtain a security package which protects value and permits the sale of the group as a going concern in the event of a restructuring.

4.2 Please describe any common mistakes or misconceptions that exist about the financing market in your jurisdiction.

UK financing structures generally fall on the creditor friendly side of the spectrum with few surprises for market entrants who are familiar with international financing markets in the US or other common law jurisdictions.

4.3 Are there any classes of assets over which security cannot be taken or regulations specific to your jurisdiction governing the taking of security over certain classes of assets that lenders should be aware of?

The UK has a comprehensive and sophisticated body of law with respect to taking and enforcing security. Essentially there are no classes of assets which cannot be secured (although the choice of security interest may depend on the underlying asset) and the public register for security interests registrable in England and Wales is readily accessible on Companies House (beta.companieshouse.gov.uk), without charge. Despite this, practitioners generally consider certain security interests to be ripe for reform, in particular, the distinction between fixed and floating charges (which, upon insolvency, affects the statutory waterfall for application of liquidation proceeds) could be simplified and clarified by statute.

Where security is provided over financial collateral (such as cash and financial instruments), beneficiaries can disapply certain restrictions on enforcing that security, provided the security qualifies as security financial collateral arrangement under the Financial Collateral Arrangements (No. 2) Regulations 2003.

Note also that cryptocurrencies and similar assets based on distributed ledger technology do not fit neatly into English conflict of law rules; such assets lack an obvious *lex situs* (an applicable law based on location) and the law is still evolving in this area.

4.4 What measures should be taken to best prepare for your local market norms?

It is recommended that foreign lenders or borrowers obtain legal, tax and structuring advice at an early stage to ensure the proposed structure is sound from an investment, acquisition and lending perspective. This will assist investors, borrowers and lenders in identifying any legal, tax, regulatory or other impediments which could adversely affect their commercial objectives.

Associations such as the Loan Market Association (LMA) and the Association for Financial Markets in Europe (AMFE) organise conferences, provide regular market guidance and update market participants on issues of importance of which they need to be aware.

SECTION 5: PRACTICAL LEGAL CONSIDERATIONS

5.1 Briefly explain (i) the typical security package available at closing and (ii) any downstream, upstream and cross-stream guarantees available in your jurisdiction, in each case, with reference to any specific restrictions or limitations.

The typical security package at closing includes security over specific assets such as shares, real estate, bank accounts, IP and receivables, by way of a charge or a mortgage, in addition to all asset security over the business (a floating charge). Perfection steps depend on the nature of the security interest and the type of asset, and range from notices to third parties to registration at asset specific registries. English companies and limited liability partnerships must register security at the UK Companies House within 21 days of creation, failing which it is invalid against liquidators, creditors and administrators of the chargor. There are complex rules dealing with priority of security in an insolvency.

UK companies can give downstream, upstream and cross-stream guarantees provided they can demonstrate corporate benefit to the company (which may be demonstrated in part by providing shareholder resolutions). Directors should also consider solvency and capital reduction issues when approving guarantees.

It is unlawful for a UK public company and its subsidiaries to give financial assistance for acquiring its own shares. It is also unlawful for a UK public company to give financial assistance for acquiring shares in its UK private holding company.

5.2 Are there any specific issues or challenges creditors should be mindful of regarding an insolvency or restructuring situation? Have there been any major judicial changes to the insolvency system (or related judicial decisions) in your jurisdiction recently? How long does an enforcement process typically take?

The UK is generally a creditor-friendly environment and creditors, especially secured creditors, play a large part in any restructuring or insolvency situation. The UK is also a very rescue-focused jurisdiction as evidenced by the fact that there is no express duty on a company to begin insolvency proceedings if it is cash flow or balance sheet insolvent (directors do however need to be mindful of wrongful trading risks). There are currently two powerful rescue/restructuring focused tools available to debtors – schemes of arrangement and company voluntary arrangements (CVAs) – each involving effective cram-down mechanisms so creditors have to be aware of the risk of being forced into a deal if the requisite majority consent to it. The only recourse is to argue prejudice or material irregularity in the case of CVAs or the inherent unfairness of the scheme, for example, because as junior creditors your debt has been wrongly valued. Once in the realm of insolvency, the alternative to full-blown liquidation is a corporate rehabilitation proceeding known as administration.

As a qualifying floating charge holder (as confirmed by the underlying documentation), creditors have the power to appoint an administrator out-of-court and control the process thereafter. Although this route is a potentially powerful way to hold the debtor accountable, the administrator has to respect the statutory waterfall of objectives which is primartily focused on rescuing the business as a going concern.

Security under financial collateral arrangements is not caught by the statutory moratorium that arises upon administration, which generally prevents any steps from being taken to enforce a security interest or to start or continue any legal process except with the consent of the administrator or with the permission of the court. Even those caught by the moratorium will not generally have difficulty enforcing their security; however, courts in the UK are extremely practical and will exercise their discretion commercially when deciding whether or not a sale of assets secured by a fixed charge is consistent with the objective of the administration (and if so, the proceeds of the sale would return to the secured creditor and the latter could prove as an unsecured creditor for any shortfall). Creditors have to be aware that the administrator can dispose of property subject to a floating charge as if it weren't subject to that charge (such creditor maintaining their priority vis-à-vis the proceeds).

Security enforcement may take place promptly (upon instruction of a security trustee) or take slightly longer in formal processes such as administration where the appointed insolvency practitioner aims to achieve the best price reasonably obtainable. However, asset sales by administrators can also occur very quickly (and within a pre-arranged process called a "pre-pack administration", almost instantly upon the appointment of the administrator(s)).

The UK government has very recently (September 2018) announced reforms to the UK's restructuring and insolvency regime aimed at ensuring the survival of businesses. The three main areas of reform are:

- A 28-day stand-alone moratorium so that not only within administration and liquidation but also in the context of out-of-court restructurings, debtors have a breathing space to negotiate with their creditors.
- Prohibition on essential suppliers (over and above those supplying gas, electricity, water and IT services) to rely on termination clauses to stop supplying to a distressed company.
- Creation of a stand-alone cram-down tool, with very similar cram-down functions as the existing scheme and CVA tools.

SECTION 6: OUTLOOK

6.1 What are your market outlook predictions for the next 12 months in cross-border financing in your jurisdiction?

At the time of writing, the UK and the EU are in the midst of Brexit negotiations and therefore predicting the UK market outlook over the next 12 months with any accuracy is challenging. What we can say, however, is that default rates remain exceptionally low, dry powder for private equity firms remains historically high, the supply-demand imbalance in European cross-border financing markets continues unabated and corporates hold healthy levels of cash on balance sheets which is fuelling M&A activity. In addition, interest rates are expected to gradually rise over the coming years so, although there is no immediate maturity wall on the horizon, we would expect corporates and sponsors to continue refinancing debt in order to take advantage of low pricing and flexible financing terms currently available in London and indeed across Europe.

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