

Client Update

Pan-European Private Placement Initiatives Gain Momentum

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In Europe, the US private placement market is often referred to as the traditional private placement market, as it is a longstanding and established market for investment-grade rated companies to access long-term debt. One of the key features that has made the US private placement (USPP) so successful is the level of standardization of the USPP documentation. The model form note purchase agreement developed and promulgated by the American College of Investment Counsel (ACIC) significantly contributed to the growth of that market and became the industry standard for private placement transactions.

In contrast, in Europe the private placement markets developed locally, mostly limited to certain regional markets such as the UK, France, Germany and The Netherlands. European market participants have often argued that one of the key barriers to the development of a pan-European private placement (PEPP) market was the lack of standardized documentation.

Recent initiatives in Europe are now trying to overcome these obstacles and to create a stronger PEPP market through standardization of private placement documentation and guidance on common market standards and best practices.

In January 2015, the Loan Market Association (LMA) introduced English law standardized private placement documentation based on the LMA standard form investment grade syndicated loan agreement. At the same time, a French financial industry initiative called the Euro PP Working Group published French law standardized private placement documentation.

In February 2015, the Pan-European Private Placement Working Group (PEPP Working Group) issued the Pan-European Private Placement Guide (PEPP Guide) providing a framework and guidance for PEPP transactions. The PEPP Working Group is an umbrella European initiative led by the International Capital Market Association (ICMA) that also includes the Association for Financial Markets in Europe (AFME), the European Private Placement Association (EU PPA), the

French Euro Private Placement (Euro PP) Working Group, the Loan Market Association (LMA), TheCityUK and The Investment Association.

In addition, the LMA responded to increasing international interest in the German *Schuldschein*, a unique German law debt instrument combining features of a syndicated loan and a corporate bond, and issued in 2014 the *Schuldscheindarlehen – LMA Product Guide (Schuldschein Guide)*.

The LMA, the Euro PP Working Group, the PEPP Working Group and ICMA have been coordinating their initiatives and their respective efforts are intended to complement each other. The organizations hope that the new documentation will help develop the PEPP market and will offer a competitive alternative to the USPP model documentation. The newly-developed PEPP market aims at a wider European issuer base, including medium-sized companies with a cross-over credit profile, but also larger corporates that have typically relied on bank financing, but are interested in diversifying their funding base.

The presumption is that the new documentation will attract more European issuers and investors to the private placement market since it is more familiar to them and subject to jurisdictions that they feel more comfortable with.

This client update briefly describes the various new forms of European PP documentation and compares some of their features to the USPP documentation.

LMA DOCUMENTATION

The LMA private placement documentation consists of standard forms of: (i) a facility agreement, (ii) a subscription agreement, (iii) a term sheet, and (iv) a confidentiality agreement. In addition, the LMA issued a user guide providing guidance on the key terms of the standard forms.

Main Features

For the sake of familiarity, the LMA decided to base the facility agreement and the subscription agreement largely on the standard form LMA syndicated facility agreement. Consequently, the new forms include most of the usual provisions of the standard form LMA syndicated facility agreement, except for agency and arranger provisions. This is because the LMA presumed that no agents and arrangers will be required in a private placement transaction.

The LMA documentation assumes that the debt will not be listed or cleared and that it will be unsecured, although it may be guaranteed by affiliates of the borrower/issuer. Further, the documentation does not provide for any

independent credit rating requirement, but it assumes that the borrower/issuer will be an investment grade equivalent.

The debt under the LMA documentation is generally transferable, but the documentation provides optional wording to require prior consultation with, or the consent of, the borrower/issuer for transfers. However, it is presumed that private placement investors will mainly invest on a buy-and-hold basis.

The LMA private placement documents are governed by English law and assume that the borrower/issuer and investors are located in England and Wales. Nevertheless, the LMA points out that the documentation is drafted in such a way as to be easily adaptable to other jurisdictions.

Key Differences to USPP Documentation

A number of provisions of the new LMA documentation deviate from the ACIC model forms and the USPP market standards, including:

- Option to structure the transaction not only as a note issuance but also as a loan.
- Option of floating rate interest (with LIBOR or EURIBOR as a benchmark), while the predominant market practice for USPP and ACIC model forms usually provides for fixed interest.
- Increased costs protection provisions, a typical feature of the LMA facility documentation that is somewhat unusual in context of USPP.
- Placeholder for a most favored lender covenant (the LMA expects that such covenant will be requested by investors, as it is often the case in a USPP, although not contained in the ACIC model forms).
- No language or even placeholder for the so-called “anti-Cookson” protection, a feature of the ACIC model forms that gives investors protection in case the issuer subsequently grants liens securing the primary credit facility.
- Unlike the ACIC model forms, the LMA documentation provides for a change of control put right/prepayment option.
- A number of other topics for which the ACIC model forms usually provide some proposed wording, such as make-whole amount or

prepayment fee, are intentionally left blank for negotiations between the parties.

EURO PP WORKING GROUP DOCUMENTATION

In 2014, the French Euro PP Working Group in a first step published a Charter for Euro Private Placement (Euro PP Charter) that was intended to provide a non-binding framework of best practices for Euro PP transactions. In January 2015, the Euro PP Working Group further issued two model private placement agreements intended to complete the Euro PP Charter. The Euro PP Working Group is a French financial industry initiative consisting of French financial industry associations representing corporate borrowers, investors and intermediaries.

Similarly to the LMA documentation, the private placement documentation launched by the Euro PP Working Group consists of a loan agreement and a subscription agreement (together with terms and conditions of the bonds).

The loan agreement is drafted for a loan in Euros (single-currency) on a non-revolving and unsecured basis, with a floating interest rate based on EURIBOR and is intended for middle market companies (known in France under the acronym “ETIs”) or small and medium-sized companies.

The subscription agreement is generally drafted for use in the context of an unlisted, unrated, unsecured issue of notes, bearing interest at a fixed rate, in registered form, by a company that has not already issued listed equity or debt securities. Unlike the LMA documentation, the Euro PP documentation follows existing market practice for Euro PP private placements and assumes that the notes will be cleared (through Euroclear France).

Although the Euro PP documentation does not provide for any formal rating requirements, Euro PP issuers traditionally are small and medium-sized companies with credit quality near or equivalent to investment grade.

Unlike the LMA documentation, the Euro PP agreements do not include a most favored lender covenant, although we expect that investors familiar with the USPP market practice will require it. Another major difference to the LMA documentation is that the Euro PP documentation envisages a role for an arranger and an agent and does not include provisions on guarantors.

The Euro PP model documentation is governed by French law, but may be adapted to other jurisdictions. The Euro PP Working Group specifically points

out that the documentation was developed for international use in coordination with LMA and ICMA.

PEPP GUIDE

Following the publication of the LMA private placement documentation and the Euro PP Documentation, the PEPP Working Group published the PEPP Guide in February 2015.

Based on the Euro PP Charter, the PEPP Guide, as the other initiatives, aims at supporting the development of a PEPP market for European companies by providing a framework for common market standards and best practices for PEPP transactions.

The PEPP Guide characterizes a PEPP-compliant transaction as one between borrowers who are medium-sized unrated European and international companies and primarily institutional investors, which aims at a private offering of unlisted senior and unsecured debt in the form of a loan or represented by securities. Furthermore, the PEPP Guide describes the roles of the borrowers, investors, the arrangers (if any), legal counsel and other parties to a PEPP transaction and the key processes of a PEPP transaction.

For the transaction documentation, the PEPP Guide directs borrowers and investors to the LMA and the Euro PP standard documentations which have been coordinated within the PEPP Working Group. In addition, the PEPP Guide provides an indicative information memorandum template and an indicative form of a non-disclosure agreement. In order to facilitate the negotiations of PEPP transactions, the PEPP Guide includes a schedule describing key points to be discussed between borrowers and investors such as financial and information covenants, negative pledge provisions, representations and events of defaults.

GERMAN SCHULDSCHEIN GUIDE

The German market for private placements has been dominated by a long-standing local instrument called *Schuldschein*. From a contractual point of view, a *Schuldschein* loan agreement is a regular bilateral loan agreement. The term “*Schuldschein*” originates from a note, called “*Schuldschein*”, that was traditionally issued in connection with granting a *Schuldschein* loan.

The growing interest of international borrowers and investors in the German *Schuldschein* prompted the LMA in 2014 to publish the *Schuldschein* Guide. The *Schuldschein* Guide is primarily aimed at international borrowers and lenders/investors that are less familiar with this instrument.

The *Schuldschein* Guide outlines the legal framework of the German *Schuldschein*, including its legal nature, parties involved, documentation and placement standards as well as regulatory features. It further gives guidance on key contractual provisions to be negotiated between the borrowers and the lenders/investors.

So far, there is no standardized documentation for the German *Schuldschein* comparable to the US, LMA or Euro PP private placement documentation. Typically, banks arranging a German *Schuldschein* provide their own forms. For the German insurance industry, the German Insurance Industry Association (*Gesamtverband der Deutschen Versicherungswirtschaft e. V. (GDV)*) issued a guide on German *Schuldschein* in 2013 setting out principles to be observed by German insurance companies when granting German *Schuldschein* loans. This guide also includes two German insurance industry compliant model forms of *Schuldschein* loan agreements, one form providing for loans secured by real estate and one form providing for unsecured loans, however, subject to negative pledge provisions.

An essential part of the appeal of the German *Schuldschein* is the simplicity and flexibility of the documentation. A traditional *Schuldschein* loan agreement, which is only a few pages, mainly sets out the principal amount of the loan, interest rate, interest payment dates, repayment, assignment provisions and governing law and jurisdiction. Features usually known from syndicated loan agreements or bond issues such as extensive representations and warranties, covenants, including financial covenants and negative pledge covenants, events of default, early redemption and conditions precedents are rarely used in the traditional documentation as it is embedded in the legal framework of the German Civil Code (*Bürgerliches Gesetzbuch*). However, given the recent internationalization of the German *Schuldschein* market, the documentation tends to include more and more provisions that international market participants would expect in syndicated loan agreements or bond issues.

Unlike notes issued under the US PP purchase agreement or the LMA or Euro PP subscription agreement, the *Schuldschein* does not qualify as a security. The *Schuldschein* typically constitutes a written confirmation by the issuer that it has received certain loans for the purpose of facilitating enforcement of the debt.

Usually, *Schuldschein* loans are unsecured and do not benefit from guarantees. If required by investors, however, they can also be structured as secured or guaranteed loans. There is no formal rating requirement which makes the issuance of a *Schuldschein* an attractive alternative for small companies.

One of the advantages of the traditional German *Schuldschein* for investors is that *Schuldschein* loans typically do not need to be marked-to-market under German accounting and IFRS rules which enables the investors holding a *Schuldschein* loan to avoid P&L volatility. As for other private placement instruments, investors in the German *Schuldschein* also tend to follow a buy-and-hold investment strategy.

SUPPORTING TAX TREATMENT

Currently, private placement investors who are liable to UK corporation tax benefit from an exemption from UK withholding tax on interest payments. In contrast foreign investors face UK withholding tax on interest when investing into private placement instruments issued by a UK issuer. In March 2015 the UK government introduced legislation providing for a new exemption from UK withholding tax for interest on private placements. The exemption will apply to interest payments made pursuant to a “qualifying private placement”. A “qualifying private placement” is an unlisted security, (i) which represents a loan relationship to which a company is a party as a debtor, and (ii) which satisfies certain other, as yet, unspecified conditions. The UK tax authority (HMRC) is in the process of determining these additional requirements, which are expected to include a cap on issue size and restrictions on eligible issuers and investors. The exemption will not be available until these additional conditions have been finalized, which may take some months. HMRC appears to be taking a pragmatic view of the exemption and is attempting to make it work for the identified target users; mid-sized companies and those funding infrastructure projects. To this end, the legislation adopted in March of this year is more favorable than the initial draft legislation published in December 2014 as HMRC has removed both the requirement that the security have a term of at least three years and that it be “issued” (which means that the exemption should now apply to both bonds and loans).

Tax exemptions supporting the development of a PEPP market have also been recently introduced in Italy.

OUTLOOK

The goal of the pan-European private placement initiatives is to expand the potential issuer and investor base for private placements in Europe and to help reduce transaction costs by providing standardized documentation and guidance on market practices.

However, to achieve these goals in a manner comparable to the USPP market, the PEPP market has yet to overcome a number of issues caused by different legal systems, including different tax and regulatory considerations. This issue

has been identified by the European Commission as a major obstacle to the development of a single European capital market. The European Commission therefore views, and supports, the private placement initiatives as part of its Capital Markets Union initiative which aims at establishing a single capital market for Europe.

There is an expectation in the market that the single capital markets initiative of the European Commission, and the recent introduction of tax exemptions for private placements in the UK and Italy, will encourage other European countries to pass similar changes to their tax regimes and other laws in order to support the PEPP market.

One feature of the LMA documentation that may attract more European issuers to the private placement market is that the documentation is easily comparable to issuers familiar with the standard form LMA syndicated facility agreement. Another advantage of the standardized pan-European documentation is that it allows funding in local currencies, eliminating the swap costs associated with USPP. Also, the new PEPP documentation permits structuring of private placement transactions either as a loan or as a note which, in principle, gives borrowers and investors more flexibility than USPP model forms.

In general, the choice of a more familiar law may make the new PEPP documentation more appealing for European issuers and investors. Specifically in a scenario where private placement debt is guaranteed by an issuer's subsidiaries located throughout Europe, the choice of laws, with submission to the courts, of a European country may prove to be a significant advantage to investors as a judgment obtained in a court of a European country can be easily enforced in each other European country under the rules of the Brussels Ia Regulation without the requirement of any exequatur proceedings. In case of judgments obtained from US courts, investors may be required to initiate exequatur proceedings in each country where the relevant subsidiaries are located, facing various rules and procedures for recognition and enforcement of US judgments. In the case of private placement documentation under US law with submission to US courts, investors could even face a situation where judgments of US courts are not recognized at all, requiring a full re-litigation in local courts (e.g., in Austria).

The new PEPP documentation is also expected to help introduce lower-rated issuers to the market. The PEPP market may also become more interesting to corporates in sectors that are facing difficulties obtaining bank funding due to Basel III requirements.

Some market participants believe that the various PEPP initiatives will draw attention of European issuers and investors new to the private placement market not only to the PEPP market, but also to opportunities in the traditional USPP market.

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Please do not hesitate to contact us with any questions.