NÁRODNÁ BANKA SLOVENSKA

BANK CREDIT AGREEMENTS ACCORDING TO ENGLISH LAW

2nd Part

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Continued from Issue 8/2006

Introduction

In the first part of this study we focused our attention on explaining the current status of English bank credit agreements in Slovakia, as well as on a definition of the bank under the English law, together with a brief description of the basic sources of English banking law. The reader was also informed about the principal mechanism of bank lending in the United Kingdom. The second and final part of the study will be dedicated to the basic classification of English bank credit agreements into consumers' loans and the commercial loans with a special emphasis on syndicated loans. Finally, the study will also outline very briefly the institution of lending participation.

1. Bank lending to natural persons

Lending to individuals has been in the UK regulated by the 1974 Consumer Credit Act (hereinafter referred to as "the Act"). While drafting this statute, lawmakers tried to protect the bank's natural-person customer (hereinafter "customer" or "borrower") in relation to the creditor, and they entrenched in the Act many rights that the customer and the prospective borrower had even before any agreement has been signed. Under the Consumer Credit Act, a customer may within a stipulated period terminate any agreement concluded with a bank if a situation stipulated in the Act arises. This right does not apply, however, in the case of a "loan secured over land" or where the agreement is signed at the creditor's place of business or at other places stipulated by the Act. The customer does, anyway, retain the right to terminate the agreement in cast the agreement has been concluded as a distance contract without the personal contact between the bank and the customer. An interesting feature of the statutory regulation of this situation proved to be the clause stating that a credit agreement will not be judged as a distance contract if the customer, even prior to concluding this agreement, has visited the bank in order to consult with one of its employees.

But as Ellinger et al. point out, in practice it is very rare that the customer terminates a credit agreement against the will of the creditor, since it is usually much more favourable for the borrower to accept the conditions stipulated by the bank in the agreement than to acquire the credit from other sources. Generally speaking, the customer usually requests the creditor to extend the loan repayment period. The Consumer Credit Act also supports the customer in many other ways, for example by giving the Treasury the power to regulate the general frame of loans (credit agreements) provided to individuals in the United Kingdom. The aforementioned entitlements have served as a basis for elaborating the very strictly observed and detailed conditions for lending to individuals (hereinafter "Conditions"), according to which the creditor is required to furnish the customer or prospective borrower with "pre-agreement" information in a precisely stipulated form before the agreement is concluded. Otherwise the agreement will be unenforceable without a special court order.

In addition, the Conditions impose on the creditor a requirement to include in the credit agreement terms and information defined later in the Conditions. In the preamble of the agreement there must be a statement that the agreement has been drawn up in accordance with the Consumer Credit Act and also a statement informing the borrower of his rights arising under this Act etc. The information which a credit agreement must contain includes key financial information on the loan (the setting of the loan amount, the

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[1] A distance contract will probably be concluded through an intermediary.

[2] Ellinger, E.P. et al.: Ellinger's Modern Banking Law p. 713 (cited as Modern Banking Law).

[3] Consumer Credit (Agreements) Regulations 1983; Consumer Credit (Disclosure of Information) Regulations 2004.

[4] In practice, however, the "pre-agreement information" is usually provided to the prospective borrower only when the credit agreement is submitted for signing, i.e. just before it is concluded.

[5] Previously in the United Kingdom, credit agreements between banks and natural persons were concluded in a more informal way. An informal "offer letter", setting out the principal provisions of the credit agreement was sent to the customer, and after the customer signed it and returned it to the bank, the credit agreement was concluded. Now all credit agreements between banks and natural persons must be concluded in accordance with the Consumer Credit Act, which stipulates among other things that a credit agreement must include all the contractual terms and conditions.

[6] A creditor bank is required to send the borrower a similar notification where, for example, the creditor is declared bankrupt or where the creditor repudiates the credit agreement.

agreement duration, the repayment conditions) arranged in separate parts of the agreement, other financial information (total price of the loan, method of interest's calculation, interests rate etc.), and other basic information, such as a possible security of the loan, default etc. Where the creditor and borrower amend the original credit agreement, the situation becomes considerably more complicated and the extent of the agreement has to be widened, since there are more and more terms and conditions which must be included in accordance with the Consumer Credit Act and the Conditions. For example, where the borrower sells shares used to secure the loan and replaces them with other shares; or, if the loan is secured by real estate, the Act requires the bank to follow a special procedure when concluding the credit agreement with the individual, including in particular the forwarding of a draft of the agreement in order to give the borrower a period of 7 days "reflection" over the whole financial transaction.

In addition, the Act partially regulates the cases of borrower's arrears – where the borrower defaults (i.e. breaches his contractual obligations), the bank is required to notify the borrower at least 7 days in advance of its decision to declare the loan immediately due or to implement other default consequences. The creditor's formal notification must also include a separate notice to the borrower that any further proceedings by creditor against the borrower will be stopped upon the payment of the entire amount due in accordance with the credit agreement. The creditor is also required to inform the borrower of his right to petition a court for an extension of the deadline for repayment of the amount due in the event that the borrower has a difficulty in making the loan repayment.

2. Syndicated loans

2.1 Nature of a syndicate

A typical syndicated loan in English banking may be described as a traditional, large commercial loan. A specific feature of the syndicated loan is usually the larger number of creditor banks – a "syndicate" (at least two banks) – which provide separate loans to the borrower, and also that the sum of the loans provided by the creditor banks (the total loan) and the loans made separately to the borrower by the creditor banks are subject in law to a single credit agreement. For a bank in the position of a future creditor, a syndicated loan is advantageous where the bank is not interested in financing the entire credit itself, or where it is averse to undertaking the credit risk attached to providing the loan in the requested amount. Logically, the final amount of the loan, along with the purpose for which it is provided, will influence the syndicate's size, i.e. the number of participating creditor banks. The syndicated loan is always provided on the basis of a mandate granted by the borrower to one bank, or a group of banks, as the arranging bank. The role of the arranging bank has been described as to draw up an information memorandum (basic information about the borrower and about the loan) and then to offer it to other banks – the potential creditors. The arranging bank may also be a creditor of the borrower by providing a separate part of the loan. The arranging bank is then required, like any future creditor (syndicate member), to evaluate its own credit risk and to agree on all the provisions of the credit agreement with the prospective borrower, including the conditions and methods of securing the loan. With the credit agreement's conclusion, the direct contractual relationship will be established between the borrower and creditor – the syndicate members.

In accordance with the credit agreement, another creditor bank – the agent, is tasked with coordinating the individual creditor banks and also with administering the supervision of the loan as well as with some organizational matters (e.g. the delivery and receipt of written materials or the calculation of interest if there is a variable interest rate, etc.). In practice, the syndicate usually entrusts the agent with other additional tasks, such as obtaining the borrower's financial statements or, in an emergency, the authorization to declare the loan immediately due upon the borrower's default. Although the agent is expected to act in the favour of the syndicate – i.e. to act with the due diligence and the professional competence, the agent's liability towards the syndicate is all but excluded under the credit agreement, except where the agent acts with gross negligence or deliberately misuses its powers under the agreement.[11]

2.2 Contractual conditions and the legal basis for a syndicated loan

In the recent banking practice in the UK the necessary documentation typically used in the processing of syndicated loans was partially formalized and standardized. The basic principles of syndicated loan agreements in

[7] On syndicated loans, see Wood, P.: International Loans, Bonds and Securities Regulation; London, Butterworths, 1995.

[9] The contractual obligations of the agent and arranging bank are distinct, and both roles may be carried out by a single creditor bank (i.e. the role of arranging bank and agent). Among standard banks, however, these roles are usually performed by two creditor banks.

[10] There are in practice long-term disputes over how best to establish the Agent's obligation to monitor with due care the borrower's fulfilment of the contractual obligations. At present, many credit agreements neither include nor presume such obligation, and the agent is therefore required to monitor the borrower's cooperation only upon the direct order of the syndicate.

[11] By 1999, the Loan Market Association (LMA) together with other financial associations had already drawn up recommended forms for primary credit documentation – Recommended forms for a multicurrency term facility agreement and Recommended forms for a multicurrency revolving agreement. These were updated in 2001 and again in 2005.

regard to the contractual rights and obligations of the syndicate members may be divided as follows:

1. Each creditor bank provides a separate partial loan, in the amount stipulated in the credit agreement, for a period agreed in advance – "the commitment period".

2. The contractual rights and obligations of each creditor bank are severable from the contractual obligations of the other creditor banks. In practice, therefore, the non-fulfilment of contractual obligations by one creditor bank does not release the other creditor banks from their undertaking to duly fulfil all obligations in accordance with the credit agreement. It should not be forgotten that each partial loan is separate and the borrower's undertaking to repay it is made to the specific creditor bank. A similar rule has been applied to the exercise of the creditor rights of the syndicate members. Other elements typically include the agreed procedure to be followed by all creditor banks in matters, stipulated in the agreement, on which decisions are taken by the "majority" creditor banks – the banks which provide the largest partial loans within the overall loan amount. Consequently, the "minority" creditor banks have no other option but to accept the decision of the "majority".

English and American legal experts have long been at odds over the definition of the common legal basis for syndicates, since some court cases in the US and the UK have resulted in divergent and legally binding judicial opinions. There is contention over the question whether a syndicate may be at all considered as a consortium (association) or whether a mutual relationship between banks under a syndicated credit agreement (in addition to the mutual relationship between the arranging bank and the other creditor banks) is a purely contractual relationship based on a credit agreement.[14] On this issue, we tend to incline towards the legal opinion based on the Partnership Act of 1890. As Ellinger et al.[15] point out; a partnership (consortium) is determined by this law as "a relationship in which the parties are conducting business together in order to make a profit". A loan syndicate is not a partnership since the syndicate members are not dividing the net profit between themselves.

An institution often mentioned in regard to syndicated loans is "the loan participation". It must be realized that a syndicated loan under no condition may be identified with the loan participation.[16] The syndicated loan is provided by several banks as a single large loan through partial, separate loans, under the legal umbrella of one, typically extensive credit agreement. In the loan participation, the parties to the credit agreement are the borrower and only one "leading" bank, which subsequently – for any various reasons (e.g. insufficient time to form a syndicate) – sells a part of its creditor rights to other banks, the participants. The principal methods of the loan participation are an assignment, a novation, a participation in the risk, and a sub-participation. In practice, the assignment is the most commonly used, since under the English law only the assignment constitutes a genuine sale. Nevertheless, even with the other methods the lead bank is designated as the "seller" and the participant as "the buyer".

3. Conclusion

While finishing the classification and the description of English credit agreements, we should look at one more interesting detail, related more to the overall form of the legal terminology and consequently to both the text and content of English credit agreements. From the preamble to an English credit agreement /as well as any other bank agreement subject to the English law/ it must be quite clear that in terms of linguistic style and rhetoric - notwithstanding their frequently stressed international character – such contracts still remain genuinely "English". And as a proper product of the English law, they contain typical expressions, which simply can't be found in the precise language of he civil law – this style may be characterized as very brief and formally concise with, to put it fair and square, no words wasted. Quite contrary, in English legal language one often comes across a typically colourful "multi-word" expression. Phrases commonly used in English legal practice include "in any way" (disliked in banking circles), "when however", "however" and "from time to time", which one would search in vain to find in precisely formulated German or Czech credit agreements, even if they were enlarged a hundred times.

The outlined differences between contracts drafted under the Anglo-Saxon legal system and contracts drafted under the law of the principal representatives of the civil law system are not an attempt just to deliberately liven up the legal terminology. These differences have been our important legal legacy – a valuable inheritance from once a proud European legal nobility – as well as the result of the completely distinct development of two fascinating legal cultures that produced undeniably unique and sophisticated legal systems affecting the whole of human society – Anglo-Saxon law and civil law.

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[12] The theory of the syndicate as a purely contractual relationship between creditor banks based on a credit agreement is being upheld in the United States. On the other hand, many court decisions are also tending towards the theory of the syndicate under a consortium.

[13] Modern Banking Law, ref. 3, p. 719.