HM Treasury Discussion paper on non-bank lending: January 2010

The ABI's Response

Introduction

The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

ABI members, purely on account of their insurance funds, had some £750bn of fixed income assets under management at the end of 2008 (See Appendix I). As institutional investors they also manage fixed income assets on behalf of third parties. The mandates for these latter funds may vary considerably from those of insurance funds where matching assets and liabilities is often a key criteria.

The ABI welcomes the opportunity to respond to HM Treasury's Discussion paper on non-bank lending.

Executive Summary

We believe the suggestions put forward in this paper could contribute to the diversification of corporate funding. However, this additional funding would be at the margin from current non-bank lending markets, absent certain changes. Insurers for example would be constrained, for both commercial and regulatory reasons, in expanding greatly in the target market identified in the paper.

Changes in credit assessment and monitoring practices could help to keep costs low and thereby potentially improve access to new borrowers. Credit ratings would not necessarily be appropriate for all these new borrowers. Standardisation of reporting, documentation and credit-scoring (as a possible alternative to credit rating) should be encouraged. However, such changes would have to be acceptable to market participants and in particular those who set or influence fund mandates.

Corporate transparency to non-bank lenders, even if it remains outside the public domain, has to be at least at the level of public listed companies. New borrowers must adapt to the markets and engage with their new investor base.

Corporates will require appropriate transparency in the pricing of loans so that they can properly assess the overall competitiveness of bank and non-bank loans.

Investors are driven by risk-adjusted reward. UK fixed interest investors, including insurers, generally look for wide, deep and liquid markets though some funds are more capable of adopting a buy and hold strategy. Some corporates in the target market, either by size of issue or lack of frequency, would not be attractive as individual borrowers. This argues for a collective approach either through pooling, securitisation (requiring an originator, most likely a bank) or an officially-supported agency akin to KfW (which itself can be part funded by non-bank lenders). Other innovations in the fixed income markets in terms of technology (electronic trading) and trading structures and products should, over the long term, cumulatively improve the depth and liquidity of all the debt markets.

The current characteristics of the non-bank loan markets and high yield bond markets limit them to the small number of investors who have the expertise to operate effectively in these markets

General Comments

We broadly support the analysis which underpins the paper and the questions that it poses. In particular we endorse the comment in Paragraph 1.3 and emphasise our view that the question of the supply of capital to the UK economy, across the spectrum from equity to debt, should be the subject of holistic review.

With respect to some of the underlying themes which provide context to the paper we would comment as follows. Whilst diversifying funding sources could potentially reduce the impact of financial shocks this will be limited. Recent events have shown that contagion and contamination can influence financial markets to move in a synchronised fashion. Moreover in times of stress when regulators may constrain banking activities other regulated entities, such as insurers, may be subject to similar regulatory pressure. Nonetheless diversification of funding sources, combined with other factors should encourage a more competitive environment. One of the other factors will be the need for behavioural change on the part of market participants particularly in respect of their attitudes to transparency. We cover this point below.

Our working assumption for analysing the paper is that the target market is for companies that would broadly fall in the FTSE 350. Fundamental to our analysis is the objective of ABI members, in the interests of their clients, of efficient capital markets as a key to long term sustainable value creation. In this respect markets (and asset allocation) have to be seen in their regional, if not global, as well as national context. A number of themes follow from and are connected to this.

ABI fund managers have an interest in wide, deep and liquid financial markets which serve the mandates set by the internal insurance funds and external clients. The parameters of these mandates, in particular benchmark indices and performance criteria constrain fund managers' asset allocation. For external clients, such as pension funds, investment advisors can play an important role in setting the parameters. For internal funds regulations are a limiting factor for insurers-current quantative restrictions will change significantly with the implementation of Solvency II. Whether internal or external clients, valuation and pricing will be important features of the the mandates and consequently all funds will be concerned with the volatility and liquidity of their assets. Liquidity is linked to size of issue. Thus while insurers' matched funds, with their long term liabilities, might seem the natural home for illiquid assets their capacity in this respect is heavily constrained for both commercial and regulatory reasons.

Trust and confidence are essential to successful markets. Transparency is one of the keys to establishing trust and confidence.

Accessing the debt markets for those borrowers who hitherto have relied solely on bank lending will require cultural adaptation to meet the requirements of their new investor base. In particular borrowers will have to adjust to the transparency levels to meet the disclosure requirements of the non-bank lending markets and engage with their investors on a basis appropriate to their level of activity in those markets. Corporate management will have to invest in developing these new relationships. Old, or new, relationships with banks still remain important.

In the primary debt, or new issue markets, banks play an important intermediation role which itself requires transparency. Key to effective markets is that banks properly manage the potential conflicts of interest that can arise. Banks both arrange public debt issues for borrowers, also frequently lend to the same borrower and, in some cases, advise such borrowers in financial restructurings should they run into difficulties.

In addition to this principle issue, there are a number of technical aspects to consider in respect of bank intermediation. Borrowers new to the public debt markets or infrequent users, may encounter difficulty in assessing that the costs of debt raising are competitive.

For investors a key issue is the allocation of participation in borrowers' new issues. This is largely controlled by the banks, in collaboration to some degree with the issuers. Investors will wish to see that allocation is appropriate and transparent.

A key factor in successful markets is that participants have trust in terms of legal certainty and market conventions. An important element is documentation. The ABI together with other investors groups (BVI of Germany, the IMA and NAPF) will shortly be publishing proposals to provide for standard covenants in investment grade loan documentation (see Appendix 2). These proposals are offered as a means of improving market efficiency and can be seen as analogous to the documentation standards of the Loan Market Association (for bank loans) and the recent initiative (for investment grade debt instruments) of the Credit Roundtable in the USA. The proposals also contain elements which should facilitate the role of the Trustees whose abilities to proactively safeguard investors' interests are somewhat circumscribed by current market practices, as reflected in documentation.

Market practices impact significantly on the attractiveness of non-bank lending. In the mid 2000s this was given particular attention by the Bondholder Dialogue in which market participants, including ABI, addressed some of the conventions of the new issues market.

The financial crisis, particularly from autumn 2008, has severely hampered the best practice recommendations flowing from the Bondholder Dialogue. However, the Dialogue demonstrated the impact that mutual self interest could generate amongst market participants. It is this type of change that would benefit from the encouragement of HM Treasury.

Questions for Investors

Credit assessment and monitoring questions

1.Q. Do you consider any of the following to act as a barrier to companies obtaining public credit ratings, and which are the most significant:

a) cost;

b) businesses' concern about revealing information (particularly in circumstances of a difficult trading environment); and/or

c) other (please provide more information)?

1.A. a)There is a perception that this is the case but the evidence is largely anecdotal. Clearly companies hitherto reliant on bank lending will be faced with an explicit additional cost for an initial rating and subsequent monitoring under the issuer pays model.

b) Again we believe this to be the case but there is little factual evidence. We understand that such information would generally be available to companies' banks.

c) Unfamiliarity with the requirements of the debt market given the reliance, hitherto, on bank finance.

Widening company access to non-bank lending providers requires appropriate credit analysis and monitoring capacity. Company research from third parties, particularly investment banks, has reduced. The intended market of this paper, on the other hand, probably represents the intensive end of the credit analysis spectrum.

Ratings from credit rating agencies provide part of the solution. Potentially software which allows the standardisation of financial data and its manipulation for credit scoring and economic model building could reduce analysis and monitoring costs. There are for example a number of z-score systems providers. Whoever provides the credit analysis and monitoring, standardisation of reporting ,documentation and credit scoring could help to keep costs low.

However, if the task falls to investors a number of implications follow. Investors will need to invest in resources, human and otherwise, for an increase in market size which is likely to be relatively small. These costs would have to be covered in the pricing offered to these new borrowers. It is debatable whether this is an economically efficient solution. Non-bank lenders, who would be replicating (or replacing) capacity in the banks, effectively offer only one service to companies, debt instruments, from which they must defray all their costs. Banks offer a number of services including lending and have an infrastructure which gives them an insight into corporate credit status and performance and a wider base over which to defray costs.

The larger ABI members all have inhouse credit analysis expertise. Public credit ratings are not essential to this limited group of institutional investors but they obviously welcome them as one source of information in their investment decision-making.

We would have some concern at the prospect of official encouragement of credit ratings for corporate borrowers given the issues that have arisen with the hard wiring of credit ratings in the financial services sector. Whilst, recent problems apart, the record of rating agencies has been good in the corporate sector, institutional investors would nevertheless have concerns about the agencies' tendency to kneejerk reactions to specific events. Institutional investors look to stability of ratings through the economic cycle.

Insurers have less leeway where they manage money for third parties, such as pension funds. The mandates from these clients will, depending on the nature of the fund, often specify benchmarks with assets at or above a particular rating level, usually investment grade. In the context of pension funds the role of investment consultants is important in the specification criteria adopted in mandates.

Whether internal or external funds the adoption of new means of credit analysis and monitoring such as credit scoring would have to meet the approval of those who set the fund mandates

2.Q. Would lowering the cost of credible credit measurement processes in the UK encourage more:

a) businesses to issue more non-bank debt; and

b) more non-bank investors to buy UK corporate debt?

2.A. a) Possibly but other changes in business culture might be more important, such as providing sufficient disclosure to and actively engaging with debt providers, as well as changes in market structure.

b) Potentially but difficult to assess. The corporate debt market in the UK is largely institutional and these investors are well-acquainted with the market and have clear requirements laid down in their mandates. It is difficult to see from where additional players of size would come.

Corporate transparency questions

6.Q. Would improved quality of corporate transparency increase your appetite for corporate debt significantly, and result in a wider range of companies? If so what type of additional transparency might be important?

6.A. Fixed income investors would welcome wider deeper markets. The benchmark for disclosure is the statutory reporting for listed companies. It is worth noting here that ABI members do not support the differential reporting requirements under the Transparency Directive resulting from the current €50,000 wholesale issue limit in the Prospectus Directive.

The disclosure issue is all the more important when bearing in mind that an increase in non-bank lending will, in part, imply an increase in corporate borrowers who have only a sporadic requirement and will therefore not be regular users of the market with all the familiarity that that would entail.

7.Q. Do the potential costs of greater transparency, whether regulatory or otherwise, deter firms from seeking non-bank finance?

7.A. This may be so in certain cases.

8.Q. If companies made more information available <u>about loan covenants</u> (the terms under which loan was made):

a) would it increase investor appetite for corporate debt; and/or

b) would it reduce existing and future debt holders' expected default risk?

8.A. a) Yes if the question is posed in the sense of debt providers knowing the terms on which banks, i.e. other creditors, are lending to an issuer, so that they are better able to assess and price the risk.

b) Better assess the default risk (see above) not necessarily reduce it.

Loan pricing transparency questions

10.Q. Is loan pricing transparency also important for non-bank lenders? If so, why?

10.A. It should be noted that investors will recognise that pricing transparency of bank loans will not necessarily reflect the full commercial relationship between the borrower and banks in situations where banks are able to cross sell other services. The opaqueness of cost structure of different lenders will present borrowers with difficulties of comparison and is not conclucive to a level playing field between lenders.

Preferences of UK investors, questions

12.Q. What factors influence non-bank investor (including overseas investor) appetite for UK corporate debt?

12.A. Ultimately investors are driven by the risk-adjusted reward. The UK market provides access to financial assets in Sterling and other currencies in varying degrees of width and depth. One factor that could influence investors is the re-opening of the securitisation market based on a CLO/CDO (synthetic or cash) structure. An originator, generally a bank, would pool corporate loans and sell tranches with varying degrees of subordination to non-bank investors. Cash CDO/CLOs would provide both funding and capital relief and synthetic partial capital relief to the bank. Another variation to the collective approach is the collective fund which combines investor interests. One example is the UK Companies Financing Fund established by M&G.

13.Q. What role might guarantor entities play in guaranteeing debt issued by UK companies?

13.A. Potentially useful depending on the circumstances but investors may take the view that best practice is to consider guarantees as make weight. Financial guarantees, as provided by monoline insurers, might provide one type of mechanism. However, the recent experience of monolines in respect of securitisation has illustrated the type of difficulties that can be encountered with this model.

14.Q. How could secondary bond market activity be improved?

14.A. This is a complex issue. Currently debt markets are essentially OTC. For such markets to function liquidity providers are required. The recent financial crises saw banks, in their guise as dealer brokers, withdraw capital from this function reducing broking to largely an agency or matched basis. This severely hampered the functioning of the secondary market. However, in recent months liquidity has improved somewhat, but OTC markets remain susceptible to this type of risk, i.e. withdrawal of liquidity by market makers.

A longer term amelioration to the liquidity issue may lie in technological innovation, encouraged by the authorities, which would allow the electronic linking of various pools of liquidity. This may also require cultural change bearing in mind that during the recent financial crisis there was a reversion to voice broking.

France has announced plans for a European bond trading platform and post-trade information system for Euro denominated bonds. Further details are expected in March.

At the retail level the LSE has opened an electronic order book, based on the Italian model. The retail market is of particular interest to the European Commission. ABI members would be concerned at untoward official encouragement of retail bond markets given the greater diversification risks investors face (compared with equities).

The technological changes identified above will, in the long run, improve the efficiency of the bond markets but not significantly impact on the target market identified in this paper.

Non-bank loan market questions

15.Q. Are the barriers discussed above relevant in limiting less large firms' ability to issue loans to non-bank investors (including overseas investors)? If so, which are likely to be the most significant? Are there other factors?

16.Q To what extent might loan market infrastructure be improved? What costs might be involved?

15/16.A. A number of insurers, including members of ABI, are members of the Loan Market Association (LMA) and will be responding to these questions in detail through that route.

High yield bond market questions

17.Q. What factors determine the currency of issuance? Is demand for high yield bonds higher in foreign currency? How is currency risk managed?

17.A. In considering these questions in this section it should be remembered that many institutional investors (annuity funds, pension schemes) are looking for longer maturity than the 7 years typical in the high yield market. Size of issuance, and hence liquidity, are also issues given that many companies that might tap these markets are private or in family ownership. Even if companies, of whatever complexion, tap these markets they still need banking relationships and in particular working capital facilities so bond investors are likely to be faced with structural subordination issues. Companies issuing into the markets will have to meet the tight covenant requirements derived from North American experience which, for example, restrict dividends. However, the more stringent documentation standards provide some reassurance to investors.

The high yield markets developed in North America and, with the advent of the Euro, in Europe. There is insufficient demand in Sterling to foster a large competitive market, a self-perpetuating situation as investors opt for the wider deeper markets in US Dollars and Euro. As the Sterling market lacks depth, and hence liquidity, buy and hold investors tend to dominate.

For insurers high yield asset are expensive from a solvency perspective and likely to become more so under Solvency II.

18.Q. How far might the following be constraints in the growth of UK high yield bond markets:

a) Market infrastructure (if so which aspects);

b) Investor preference and constraints (including overseas investors);

c) Cost of monitoring; and/or

d) Other factors?

18.A. a) See comments above.

b) Client mandates are important. Sterling high yield are off benchmark in many clients mandates; European investors are said to be particularly index sensitive. The small size of the market does not attract US investors. Sterling is irrelevant to Euro-based private retail investors.

c) The initial work on issue is equivalent to the Investment Grade market. Some (not all) investors require quarterly reporting. Tapping this market requires issuers to engage and enter into periodic dialogue with their new investor base.

19.Q. In the past significant share of high yield bond market activity has been corporate buyout focused. How could the high yield bond market be developed as a source of primary funding?

19.A. Issuance in 2009, in the USA in particular, and the beginning of 2010 for both North America and Europe may indicate a trend for issuance as a source of primary funding or refinance.

General questions

20.Q. Do you believe that HM Treasury should be promoting more diverse sources of funding for companies?

20.A. We believe that HM Treasury is best advised to support the efforts of market participants to improve the efficiency of markets and to foster an environment in which innovation and new technological solutions are encouraged.

21.Q. Which of the issues covered in this discussion paper do you believe to be the most significant?

22.Q. Are there any additional significant barriers that should be considered?

21/22.A. See General Comments above.

Appendix 1

ABI MEMBERS WORLDWIDE TOTAL INVESTMENT HOLDINGS: FIXED INTEREST									£m
	BRITISH GOVERNMENT SECURITIES		OTHER PUBLIC SECTOR DEBT SECURITIES	OVERSEAS GOVERNMENT, PROVINCIAL & MUNICIPAL SECURITIES	UNIT TRUSTS	DEBENTURES, LOAN STOCKS, PREFERENCE & GUARANTEED STOCKS & SHARES		LOANS SECURED ON PROPERTY	TOTAL FIXED INTEREST
	INDEX LINKED	NON-INDEX LINKED			FIXED INTEREST	UK	OVERSEAS		
End 2008	53,245	135,042	7,387	80,596	50,379	153,351	221,220	42,214	742,434

Source: ABI
Notes: Investments held on behalf of life and pensions and general insurance funds. Funds managed on behalf of third parties not included.

MODEL COVENANTS IN STERLING AND EURO BOND ISSUES

1. Contents

2. INTRODUCTION

We have been asked to propose language for model negative pledge, change of control, disposals, information and committee expenses provisions (the "**Relevant Provisions**") to be included in investment grade Sterling and Euro bonds.

We have set out below, in relation to each of the Relevant Provisions, a summary of the shortcomings we have identified in the current treatment of those provisions, and our proposals for improvements. In Section 2, we have proposed detailed drafting for the Relevant Provisions. For clarity, the format of the drafting is closer to that seen in bank documents.

We have reviewed the paper entitled "**Improving Covenant Protections in the Investment Grade Bond Market**" dated December 17, 2007, published by The Credit Roundtable, where a similar exercise was carried out in relation to covenants in the NY law bond market (the "**US Model Covenants**"). We have, where relevant, compared the US Model Covenants to our proposals.

We have also considered various issues that have arisen in connection with requests for consents and amendments, and have suggested some specific principles that should be applied.

2.1 Negative Pledge

The principal shortcomings that we have seen in negative pledges, with varying degrees of regularity, are:

(a) the negative pledge only applying to capital markets issues, and not other debt;

(b) no restriction on debt at a subsidiary level, which debt, while not secured, would be structurally senior to the bonds;

(c) the negative pledge applying only to some Group Companies, such as "Material" or "Restricted" Subsidiaries;

(d) the negative pledge applying only to certain assets;

(e) the Issuer being able to grant security to another creditor if it is given for the Bonds "equally and ratably";

(f) "standard" carve-outs being drafted in such a way that the protection of the negative pledge is watered down to a greater extent than perhaps anticipated.

To address these shortcomings, we have drafted the negative pledge:

(i) to apply to all financial indebtedness;

(ii) to include restrictions on debt that, while not secured, is structurally senior because it is borrowed or guaranteed by subsidiaries of the Issuer (and we have thus recast the provision as a "**Restrictions on Priority Borrowings**");

(iii) to apply to all Group Companies;

(iv) to apply to all types of assets of whatever value;

(v) not to include security being granted on an "equal and ratable" basis;

(vi) to include sale and leasebacks within its scope.

We have included any marked to market liabilities under any derivative contracts in the definition of "Borrowings". While it would be very unusual to see those liabilities included in "Debt" for the purposes of any gearing test, it seems reasonable to limit the ability of the Issuer to give security for those liabilities, or to incur them on a structurally senior basis.

We have included a list of possible standard carve-outs. While recognising that these will need to be tailored to the particular Issuer, we think it would be useful to standardise the language to ensure, so far as possible, that the intended protection is actually achieved. The list includes, subject to limitations where appropriate:

(i) a basket by reference to a fixed amount or a percentage of tangible net worth or net tangible assets;

(ii) debt of after-acquired companies;

(iii) debt to finance acquisitions, construction or improvements secured only on the assets acquired;

(iv) existing debt;

(v) refinancing debt;

(vi) intercompany debt.

The US Model Covenants broadly address the same principal shortcomings as those we have identified, but we have proposed a somewhat more detailed approach to the standard carve-outs.

2.2 Change of Control

The three principal shortcomings in existing issues are:

(a) there is often no Change of Control provision;

(b) where there is, the provision does not always include a sale of all or substantially all the assets as a trigger (nor do the covenants contain a restriction on disposals);

(c) where there is, and the Change of Control has to be linked to a ratings downgrade, the way in which the provisions are drafted is often unworkable in practice due to: timing requirements; requirements that rating agencies do or say something that they will not, in practice, do or say; failure adequately to address the problems with unrated securities; or a combination of the above.

We therefore propose that a Put Event, entitling the Holders to require the Bonds to be redeemed, be defined as:

(a) a disposal of all or substantially all of the assets of the Group;

(b) any person or group of persons acting in concert acquiring over 50% of the voting shares in the Issuer;

(c) any person or group of persons acting in concert acquiring control of the board of the Issuer, or otherwise acquiring control of its operations.

In order to cater for issues where it is agreed that there should be a requirement for a ratings downgrade for a Put Event to be triggered, we have proposed language that could be included to allow for the concept, but which avoids the potential problems inherent in showing causation.

We have also proposed a covenant restricting disposals. This would apply at a lower level than "all or substantially all of the assets", and the interface between the disposals covenant and the Put Event would need to be considered. If a disposals covenant is included, a disposal of all or substantially all of the assets would be both an Event of Default and Put Event.

2.3 Information

The following may be considered useful (in each case to be posted on the issuer's website):

(i) annual accounts;

(ii) interim accounts;

(iii) certificate of compliance with all covenants, signed by a director, with annual and interim accounts and on request by the Trustee or 25% of Holders;

(iv) certificate of compliance with financial covenants (if any), from the auditors, with annual accounts;

(v) notification of a potential Event of Default under the Bonds or any other debt documents;

(vi) notification of any material information;

(vii) copies of all bond documents and all other material debt documents, including facility agreements, intercreditor agreements and security documents, and amendments thereto;

(viii) following a potential Event of Default, or if the Trustee or the Required Holders has cause to believe that a potential event of default may have occurred, any information that the Trustee (or any Holder through the Trustee) reasonably requests.

The list is intended to set out the minimum requirement for all bond issues. There may be other specific requirements, such as regular valuations of real property provided as collateral, which would need to be addressed.

Subject to certain exemptions, companies whose shares or debt securities are admitted to trading, and whose Home State is the UK, are obliged to comply with the requirements of DTR 4 of the FSA DTR Rules in relation to the publication of accounts, and a company whose financial instruments are admitted to trading on a regulated market in the UK are obliged to comply with DTR 2 in relation to inside information.

Some Issuers will be obliged to comply with DTR 4 and DTR 2. In an attempt to impose some consistency on the information to be provided, we have proposed that those Issuers who are not providing accounts in compliance with DTR 4 and publishing inside information in compliance with DTR 2 should comply with similar regimes.

DTR 4 requires audited annual accounts within 120 days and semi-annual accounts within 60 days. We propose that all Issuers should comply with those requirements and that timetable. It also requires a detailed management report and responsibility statements with each set of annual and interim accounts. We propose a short-form management report with the annual accounts, but no responsibility statements.

DTR 2 requires the disclosure of certain information that would be likely to have a significant effect on the price of "qualifying investments". We have essentially replicated the requirement (for those Issuers that are not required to comply with DTR 2) by reference to information that would be likely to have a significant effect on the price of the Bonds.

2.4 Holder committees

Following an Event of Default, potential Event of Default, or even an event or circumstance that may give rise to an Event of Default or potential Event of Default, it would be useful for Holders to have access to legal and financial advice at the cost of the Issuer. While the Trustee has the ability to seek such advice at the Issuer's cost, this is not always sufficient to protect the interests of the Holders (who may be looking for advice as to their rights against the Trustee) and it is unusual for issuers voluntarily to agree to meet the costs of a Holder committee.

While there are a number of possibilities as to what costs should be paid, to whom, and in what circumstances, we have proposed reimbursement of reasonable fees of legal and financial advisers, incurred by one Holder committee, following an Event of Default or event that would, with the giving of a notice or certificate, or the making of a determination (as to materiality) be an Event of Default.

2.5 Consents and amendments

There are a number of safeguards that we think should be provided in relation to amendments to economic terms, or for amendments requested in connection with an exchange or tender offer:

(a) the required majority should be set at 90%;

(b) sufficient time should be given to Holders to consider proposals, and to obtain advice - we suggest a minimum of 28 days;

(c) Holders should have access to legal and financial advice, at the cost of the Issuer - we suggest that the expenses of one Committee be met by the Issuer;

(d) the Committee should be entitled to request, and be provided with, such information as it reasonably requests.

We have not suggested specific drafting for these issues.

3. MODEL COVENANTS

3.1 COMMON DEFINITIONS

"**Default**" means an Event of Default or a [Potential Event of Default/any event specified in Condition [ ] (*Events of Default*) which would (with the expiry of a grace period, the giving of notice, the making of any determination or certification under the Trust Deed or these Conditions or any combination of any of the foregoing) be an Event of Default].

"**Disposal**" means any sale, lease, licence, transfer or other disposal, and "**Dispose**" shall be construed accordingly.

"**GAAP**" means generally accepted accounting principles in [ ]/[including IFRS].

"**Group**" means the Company and each of its Subsidiaries for the time being and "**Group Company**" means any of them.

["**IFRS**" means international accounting standards within the meaning of the IAS Regulation 1606/2002 to the extent applicable to the relevant financial statements.]

"**Required Holders**" means Holders of Bonds the aggregate principal amount of which is not less than 25% of the aggregate principal amount of the Bonds.

"**Subsidiary**" means [a subsidiary within the meaning of section 1159 of the Companies Act 2006]/[a subsidiary undertaking within the meaning of section 1162 of the Companies Act 2006]/[ ].

3.2 RESTRICTIONS ON PRIORITY BORROWINGS

[ ].[ ] Restrictions on Priority Borrowings
So long as any of the Bonds remain outstanding, the Issuer shall not, and shall ensure that no other Group Company will, incur or allow to remain outstanding any Priority Borrowings other than Permitted Priority Borrowings.

Definitions

"**Borrowings**" means, at any time, the aggregate outstanding principal, capital or nominal amount (and any fixed or minimum premium payable on prepayment or redemption) of Group Companies in respect of:

(a) moneys borrowed and debit balances at banks or other financial institutions;

(b) any acceptance under any acceptance credit or bill discounting facility (or dematerialised equivalent);

(c) any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

(d) any lease or hire purchase contract which would, in accordance with GAAP, be treated as a finance or capital lease (a "**Finance Lease**");

(e) receivables sold or discounted (other than any receivables to the extent they are sold on a non-recourse basis);

(f) any derivative transaction (and, when calculating the value of that derivative transaction, only the marked to market value shall be taken into account);

(g) any counter-indemnity obligation in respect of a guarantee, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution in respect of an underlying liability of an entity which is not a Group Company which liability would fall within one of the other paragraphs of this definition;

(h) any amount raised by the issue of redeemable shares which are redeemable (other than at the option of the Issuer) before the [*insert final maturity date*] or are otherwise classified as borrowings under GAAP;

(i) any amount raised under any other transaction (including any forward sale or purchase, sale and sale back or sale and leaseback agreement) having the commercial effect of a borrowing or otherwise classified as borrowings under GAAP; and

(j) (without double-counting) the amount of any liability in respect of any guarantee for any of the items referred to in paragraphs (a) to (i) above.

"**Permitted Priority Borrowings**" means:

(a) Permitted Secured Borrowings;

(b) Permitted Subsidiary Borrowings; and

(c) Priority Borrowings not falling within the definitions of Permitted Secured Borrowings or Permitted Subsidiary Borrowings, up to an aggregate amount outstanding of [ ].

"**Permitted Secured Borrowings**" means Secured Borrowings of any Group Company:

(a) under any netting or set-off arrangement entered into in the ordinary course of banking arrangements for netting debit and credit balances;

(b) which becomes a Group Company after the [date of the Trust Deed] where the Secured Borrowings were incurred prior to the date on which that Group Company became a Group Company if those Secured Borrowings:

(i) were not incurred in contemplation of the acquisition of that Group Company; and

(ii) are discharged, or the relevant Security released, within [ ] months of that Group Company becoming a Group Company;

(c) under any Finance Leases up to an aggregate capital value of [ ] (or its equivalent) at any time;

(d) owed to any other Group Company;

(e) [listed in Schedule [ ]/outstanding on the [date of the Trust Deed]];

(f) incurred to finance the acquisition of a Group Company (other than the Issuer or any holding company of the Issuer) or the acquisition, construction or improvement of any assets, if the Secured Borrowings are secured only on the shares in the Group Company or on the assets acquired, constructed or improved, up to an aggregate amount outstanding at any time of [ ];

(g) incurred to refinance any Permitted Secured Borrowings falling within paragraphs [(e) or (f)] of this definition, if the Security securing the new Secured Borrowings is no more extensive than the Security securing the refinanced Permitted Secured Borrowings, and the amount of the new Secured Borrowings is no greater than the refinanced Permitted Secured Borrowings.

"**Permitted Subsidiary Borrowings**" means Borrowings of any Subsidiary of the Issuer:

(a) owed to any other Group Company;

(b) [listed in Schedule [ ]/outstanding on this [date of the Trust Deed];

(c) constituting guarantees of the [Bonds] [or other direct Borrowings of the Issuer ranking pari passu with the Bonds], and which are not Secured Borrowings.

"**Priority Borrowings**" means:

(a) Secured Borrowings; and

(b) Borrowings of any Subsidiary of the Issuer.

"**Secured Borrowings**" means any Borrowings:

(a) which are secured by any Security over any asset of, or shares in, any Group Company;

(b) of the type described in paragraphs (d) or (e) of the definition of "**Borrowings**";

(c) against or with which any credit balances at banks or financial institutions may be set off or combined, in an amount equal to those credit balances.

3.3 CHANGE OF CONTROL

[ ].[ ] Put Events - Option to require redemption or purchase

(a) If a Put Event occurs, each Holder will have the right to require the Issuer to redeem or, at the Issuer's option, purchase or procure the purchase of, that Holder's Bonds in accordance with this Condition [ ] (the "**Put Option**").

(b) Promptly, and in any event within [14] days of a Put Event occurring, the Issuer shall send a Put Event Notice to each Holder, with a copy to the Trustee stating:

(i) that a Put Event has occurred and that the Holder is entitled to require the Issuer to redeem or purchase, or procure the purchase of, that Holder's Bonds at the Redemption Price;

(ii) the Redemption Price, showing the calculation thereof;

(iii) whether the Issuer will redeem, or purchase, or procure the purchase (and, if so, by whom), any Bonds in respect of which the Put Option is exercised;

(iv) the Completion Date, being a date not less than [ ] nor more than [ ] days after the date of the Put Event Notice;

(v) the procedures, consistent with the Trust Deed and these Conditions, to be followed by the Holder in order to have its Bonds redeemed or purchased.

(c) If the Issuer does not send a Put Event Notice in accordance with paragraph (b) above, the Trustee may, and shall if so directed by the Required Holders, send the Put Event Notice.

(d) If a Holder wishes to exercise the Put Option in respect of all or some of its Bonds, it shall do so in accordance with the procedures specified in the Put Event Notice.

(e) On the Completion Date, the Issuer shall pay, or procure the payment of, the Redemption Price for each Bond in respect of which the Put Option has been exercised to the Paying Agent for the account of each relevant Holder.

Definitions

"**Change of Control**" means any person or group of persons acting in concert gains direct or indirect control of the Issuer. For the purposes of this definition:

(a) "**control**" of the Issuer means:

(i) the power (whether by way of ownership of shares, proxy, contract, agency or otherwise) to:

(A) cast, or control the casting of, more than [50]% of the maximum number of votes that might be cast at a general meeting of the Issuer; or

(B) appoint or remove all, or the majority, of the directors or other equivalent officers of the Issuer; or

(C) give directions with respect to the operating and financial policies of the Issuer with which the directors or other equivalent officers of the Parent are obliged to comply; and/or

(ii) the holding beneficially of more than [50]% of the issued share capital of the Issuer (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital).

(b) "**acting in concert**" means, a group of persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate, through the acquisition directly or indirectly of shares in the Issuer by any of them, either directly or indirectly, to obtain or consolidate control of the Issuer.

"**Completion Date**" means the date on which any exercise of the Put Option will be completed, as specified in the relevant Put Event Notice.

"**Put Event**" means:

(a) a [Change of Control/Trigger Event]; or

(b) [the Disposal of all or substantially all of the assets of the Group whether in a single transaction or a series of related transactions, and whether through a Disposal of assets or shares in Group Companies/a breach of Condition [ ](*Restriction on Disposals*)].

"**Put Event Notice**" means a notice sent or to be sent under Condition [ ].[ ] (Put Events-Option to require redemption or purchase) by the Issuer or by the Trustee.

"**Put Option**" has the meaning given in Condition [ ].[ ](a) (Put Events-Option to require redemption or purchase).

"**Rated**" means carrying a rating from [at least two] Rating Agencies of [ ] or better.

"**Rating Agencies**" means Moody's Investors Services Limited, Standard & Poor's Rating Services, a division of The McGraw Hill Companies Inc, and Fitch Ratings Ltd, or any of their respective successors or any [Substitute Rating Agency].

"**Redemption Price**" means, in relation to a Bond, the principal amount of the Bond multiplied by 101%, together with interest accrued up to but excluding the Completion Date.

"**Reference Stock**" means [ ] or such other UK government stock as the Trustee determines to be a benchmark gilt, the maturity of which most closely matches the maturity of the Bonds.

"**Trigger Event**" means:

(a) if, at the time a Change of Control occurs, the Bonds are not Rated, a Change of Control;

(b) if, at the time a Change of Control occurs, the Bonds are Rated, the Bonds ceasing to be Rated on or before the date which is the later of:

(i) [ ] days after the Change of Control; and

(ii) if, before the date specified in sub-paragraph (i) above, one or more Rating Agencies announces that it is reviewing the credit rating of the Bonds, the date on which it announces that [the review has been completed].

"**Valuation Date**" means the second [Business Day] before the date of the Put Event Notice.

3.4 RESTRICTIONS ON DISPOSALS

[ ].[ ] Restrictions on Disposals

(a) So long as any of the Bonds remain outstanding, the Issuer shall not, and shall procure that no other Group Company will, enter into a single transaction or a series of transactions (whether related or not) and whether voluntary or involuntary, to Dispose of any asset, other than a Permitted Disposal, if, on the date of the transaction, the aggregate value of (i) the assets to be Disposed of, when aggregated with the value of all other assets Disposed of [after the date of the Trust Deed/since the later of (A) the date of the Trust Deed and (B) the date falling [3] years prior to the date of the proposed Disposal] by Group Companies, less (ii) Reinvested Proceeds, would exceed [£[ ] (or its equivalent)/[ ]% of [Consolidated Net Worth/Consolidated Asset Value].

(b) For the purposes of paragraph (a) above:

(i) the value of any assets which are or are to be Disposed of shall be the value of those assets (without deduction for any liabilities) included in the most recent audited annual financial statements as at the date of their Disposal or, in the case of an asset which was not taken into account in those financial statements, its book value at the date of its Disposal;

(ii) if any shares in a Group Company are or are to be Disposed of, there shall be deemed to have been or to be a Disposal of the same proportion of the assets of the relevant Group Company and of any of its Subsidiaries as the proportion of the equity share capital of that Group Company in which the Issuer is (directly or indirectly) interested immediately before the Disposal;

(iii) "**Consolidated Asset Value**" means the value of the assets of the Group in the then most recent audited annual financial statements; and

(iv) "**Reinvested Proceeds**" means, at any time, the aggregate amount of the proceeds of any Disposal which have, at that time, been applied to the acquisition [, construction or improvement] of assets comparable or superior as to type, value and quality of the assets Disposed of.

"**Permitted Disposal**" means any Disposal which, except in the case of paragraph (b) below, is on arm's length terms:

(a) of trading stock or cash in the ordinary course of trading of the disposing entity;

(b) of any asset by a Group Company to the Issuer or to a wholly-owned Subsidiary of the Issuer;

(c) of assets (other than receivables) in exchange for other assets comparable or superior as to type, value and quality;

(d) of obsolete or redundant vehicles, plant and equipment for cash;

(e) of cash equivalent investments for cash or in exchange for other cash equivalent investments;

(f) of cash in the payment of dividends;

(g) of cash as consideration for the acquisition of assets.

3.5 INFORMATION

[ ].1 Website

The Issuer shall designate and maintain a website (the "**Website**") and shall supply the Trustee, and any Holder that so requests, with the address of the Website. All information posted on the Website shall be capable of being downloaded and printed by persons with access to the Website.

[ ].2 Financial Statements

(a) So long as any of the Bonds are outstanding, the Issuer shall, unless it is required to comply, and is complying, with DTR 4 of the DTR Rules of the UK Financial Services Authority as set out in their Handbook (the "**DTR Rules**"), post on the Website:

(i) as soon as they are available, but in any event within 120 days after the end of each of its financial years, its audited consolidated financial statements for that financial year;

(ii) as soon as they are available, but in any event within 60 days after the end of the first half of each of its financial years, its consolidated financial statements for that period,

and shall ensure that any such financial statements remain on the Website for at least 5 years.

(b) The Issuer shall procure that each set of financial statements:

(i) includes a balance sheet, profit and loss account and cashflow statement, shall be certified by a director of the Issuer as giving a true and fair view of (in the case of annual financial statements), or fairly representing (in other cases), its financial condition and operations as at the date as at which those financial statements were drawn up and shall be prepared in accordance with GAAP;

(ii) is accompanied by a compliance certificate [setting out (in reasonable detail) computation as to compliance with Condition [ ] (*Financial Covenants*), and] confirming that no Default has occurred.

(c) The Issuer shall procure that each set of annual financial statements is accompanied by:

(i) a management report containing a fair review of the Issuer's business and a description of the principal risks and uncertainties facing the Issuer, and an indication of any important events that have occurred since the end of the financial year; and

(ii) a report by the [Auditors] [confirming compliance with Condition [ ] (*Financial Covenants*)].

(d) [If the Trustee or [any Holder/the Required Holders] wishes to discuss the financial position of any Group Company with the Auditors, the Trustee [or the Holder/required Holders] shall notify the Issuer, stating the questions or issues which they wish to discuss with the Auditors. In this event, the Issuer must ensure that the Auditors are authorised (at the expense of the Issuer):

(i) to discuss the financial position of each Group Company with the Trustee or [Holder/Required Holders] on request from the relevant person; and

(ii) to post any information which the relevant person may reasonably request.]

[ ].4 Information

So long as any of the Bonds remain outstanding, the Issuer shall post the following information on the Website:

(a) a copy of the [*Bond Documents*];

(b) a copy of [all documents relating to any Borrowings falling within paragraphs (a) to (e) of the definition thereof of any Group Company in excess of £[ ] (or its equivalent), including all loan, credit or facility agreements, trust deeds, indentures, agency agreements, guarantees and security documents and documents containing any intercreditor arrangements, and all amendments to those documents];

(c) at the same time as they are dispatched, copies of all documents [dispatched by the Issuer to its shareholders generally (or any class of them) or] dispatched by any Group Company to its creditors generally (or any class of them);

(d) unless it is required to comply, and is complying, with DTR 2 of the DTR Rules, promptly upon becoming aware of it, any information which (i) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of [the Bonds]; (ii) is not generally available; and (iii) would, if generally available, be likely to have a significant effect on the price of [the Bonds] subject to any exemptions that would be available to it under DTR 2;

(e) a notice of any Default (and the steps, if any, being taken to remedy it) promptly upon becoming aware of its occurrence;

(f) promptly upon a request by the Trustee or the Required Holders, a certificate signed by two of its directors or senior officers on its behalf certifying that no Default is continuing (or if a Default is continuing, specifying the Default and the steps, if any, being taken to remedy it);

(g) promptly on request following a Default or if the Trustee [or the Required Holders] has cause to believe that a Default may have occurred, such further information regarding the financial condition, assets and operations of the Group and/or any Group Company (including any requested amplification or explanation of any item in the financial statements or other material provided by the Issuer as [any Holder/the Required Holders] [through the Trustee] may reasonably request.

3.6 Committee Expenses

(a) **Bondholder Committee Expenses**

The Issuer will pay, or reimburse each member of any Holder Committee for, all reasonable fees and expenses of legal and financial advisers to the Holder Committee which have been incurred during a Default Period in connection with determining the rights and available remedies of the Holders and evaluating possible courses of action.

(b) **Definitions**

"**Default Date**" means the date on which a Relevant Default occurs.

"**Default Period**" means any period from (and including) a Default Date to (and including) the date on which all Relevant Defaults have been remedied or waived.

"**Holder Committee**" means any committee of Holders or, if more than one such committee has been constituted, the committee comprising Holders with the highest aggregate nominal amount of Bonds.

"**Relevant Default**" means an Event of Default, or any event specified in Condition [ ] (*Events of Default*) which would (with the giving of notice, the making of any determination or certificate under the Trust Deed or these Conditions or any combination of the foregoing) be an Event of Default.