High-Yield Debt 2019

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LEXOLOGY®
Getting The Deal Through

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Simpson Thacher & Bartlett LLP

Lexology Getting The Deal Through is delighted to publish the fourth edition of *High-Yield Debt*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Greece and Russia, and a new article on high-yield debt in China.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Arthur D Robinson, Mark Brod and David Azarkh, of Simpson Thacher & Bartlett LLP, for their continued assistance with this volume.

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Global overview

Arthur D Robinson, Mark Brod and David Azarkh
Simpson Thacher & Bartlett LLP

This year's edition of the *High-Yield Debt* volume in the *Lexology Getting The Deal Through* series is published at a time when conditions in the global high-yield market have been fairly volatile with market windows opening and closing due to a variety of factors. The US market was the most strongly affected by rising interest rates whereas interest rates in Europe remained at their historic low levels. Negative investor sentiment in the US market affected investor sentiment in both Europe and emerging markets. High-yield issuance levels in the United States, Europe and emerging markets all unexpectedly declined in 2018 relative to 2017. The high-yield market essentially shut down for the last two months of 2018 and that lasted into 2019 in part due to the US government shutdown.

Most high-yield indices declined in 2018 and the asset class generated negative returns in 2018 for the first time in a number of years. Volatility in the high-yield and equity markets in the final months of 2018 led to a drastic slowdown with very few deals pricing, starting in October. As 2019 has started off with calmer equity and debt markets, market participants have generally been predicting a modest increase in high-yield volumes in 2019 compared with 2018.

US market conditions in 2018 started off buoyant as strong GDP numbers and a perceived economic boost from lower corporate taxes led to higher issuance levels. As the year went on, however, market sentiment seemed to plateau and then reverse as the United States found itself in potential trade disputes with a number of its largest trading partners and the Federal Reserve continued to raise interest rates in response to strong economic data. Investors began to worry that the US's economy could go into a recession and companies with higher leverage levels could find it difficult to refinance their growing debt balances. In addition, declining oil prices led to increased volatility in the E&P space. Notwithstanding investor handwringing, default rates among issuers in the US high-yield market remained low. Volumes moderated in 2018 as US high-yield investors continued to face competition from the US term loan market for corporate financing activity. In particular, lenders in the US bank market continued to provide second lien acquisition financing with attractive prepayment terms, which enabled some borrowers to complete acquisition financings entirely in the bank market without issuing any high-yield bonds. As this edition goes to press, market sentiment among second lien lenders is reported to have moderated, which high-yield proponents believe will contribute to increased high-yield activity in 2019. At one point in early 2019, close to 50 per cent of all high-yield bond issuances were secured, reflecting a shift from the second lien bank market to high yield.

In Europe, high-yield bonds have continued to be a regular financing option for non-investment grade companies. European bank regulators and the European Commission have generally supported the development of European debt capital markets as a means of diversifying both financing options for companies and credit risk outside the formal banking sector. The European high-yield market continued to be volatile in 2018 as concerns grew about the economic risks of a no-deal Brexit as well as disagreements between the newly elected Italian government and the European commission over Italy's expected budget deficits. European political developments ranging from never-ending EU-UK Brexit negotiations to the continued expansion of anti-EU political parties around Europe have led many participants in the European high-yield market to be cautious about the outlook for the remainder of 2019.

High-yield activity from emerging markets slowed significantly in 2018 as rising US interest rates and a stronger US dollar increased the risk that emerging markets issuers could have difficulty refinancing their US dollar obligations in the year ahead. Both Turkey and Argentina, once considered strong and attractive economies, both encountered significant economic difficulties in 2018, which led to a dramatic fall off in high-yield activity by issuers from these countries. Continued political instability in Venezuela, Turkey and the Middle East limited access for corporate issuers from these markets. In 2018, financings in Brazil remained on hold for the first half of the year while investors waited to see the results of national elections. The second half of 2018 saw low levels of US dollar denominated high-yield issuances, but increased issuances denominated in reais that were targeted principally at Brazilian investors. With US interest-rate hikes on hold for the near-term, conditions for emerging market issuers may be more accommodating in 2019 than they were in 2018.

Some of the finest legal counsel were approached to write on the countries covered in this volume and it is hoped that their insights will prove useful.

High-yield debt in China

Christine Chen, David Liao and Annie Shen
Fangda Partners

Does a high-yield debt market exist in China?

Generally, high-yield debt consists of securities (mainly corporate bonds) rated below BBB, or Baa3, by established international credit rating agencies. Issuers rated below investment grade are considered to have a greater risk of defaulting on interest or principal repayments and, therefore, are generally expected to pay higher coupons to investors.

However, unlike most other debt capital markets, the domestic high-yield debt market in China (which for the purpose of this chapter excludes Hong Kong, Macau and Taiwan) is not well defined. This is because the rating scales used by the Chinese credit rating agencies are not comparable to those of international credit rating agencies, and the Chinese regulations require publicly offered debt securities to have a rating of AA or above. Market statistics suggest that over 90 per cent of bonds fall into only three rating categories: AAA, AA+, and AA. The vast majority of domestic bonds are rated AA or above, which means Chinese credit rating agencies pool bonds with different credit risks into same broad rating categories, raising doubts over the accuracy of Chinese ratings. Recent bond default cases did not imply significant differentials among bonds with different domestic ratings. According to the data compiled by Wind Information, a Chinese financial data provider, the number of domestic bonds default cases surged to 119 in 2018 from 35 default cases in 2017. Most of these issuers were rated AA and above before defaults.

Compared to the domestic market, Chinese issuers are active in issuing debt offshore and have been dominant in Asia's G3 bond market in recent years, providing high volumes of bond products across a range of different ratings and maturities, including high-yield debt. Despite the challenges relating to onshore regulatory requirements and fast-changing market conditions, Chinese issuers' demand for offshore high-yield bond offerings remained high, though volatile, in 2018 and there was a boom of high-yield bond offerings by Chinese real estate developers at the beginning of 2019.

The overall approach of Chinese issuers' offshore high-yield offerings is very similar to that in the high-yield markets in the US or Europe. Nonetheless, differences remain in certain areas, including significant carveouts and exceptions from the basic covenants. Most high-yield bonds issued are typically denominated in US dollars, and governed by New York law. The covenant packages have been modified to adapt to the conditions of the Chinese companies and their needs, driven by factors such as regulatory requirements, the issuers' business in China and the appetite of the market participants.

Overview of China's domestic debt capital markets

The Chinese domestic debt capital markets consist of the interbank bond market and the exchange market (consisting of the Shanghai Stock Exchange and the Shenzhen Stock Exchange). Debt securities offered and traded on different markets are subject to different regulatory regimes, as follows:

- debt securities issued by financial institutions (financial bonds) and primarily offered and traded on the interbank bond market (with limited exceptions) are regulated by China's central bank, the People's Bank of China (PBOC);
- debt securities issued by corporate entities that are not financial institutions and offered and traded on the interbank bond market (debt financing instruments of non-financial enterprises) are regulated by the National Association of Financial Market Institutional Investors (NAFMII), a self-regulatory body under the supervision of the PBOC;
- debt securities offered and traded on the exchange market are regulated by the China Securities Regulation Commission (CSRC); and
- 'enterprise bonds' (bonds issued by corporate entities that are not financial institutions and offered and traded on both the exchange market and the interbank bond market) are regulated by the National Development and Reform Commission (NDRC).

The regulatory approval, registration and offering process

Debt security issuance (regardless of ratings) in China is subject to stringent regulatory approval or registration requirements, as follows:

- the PBOC's approval is required for financial bond offerings;
- registration with NAFMII is required for offerings of debt financing instruments of non-financial enterprises;
- the CSRC's approval is required for public offerings of debt securities on the exchange market, and a post-issuance filing with the Securities Association of China, a self-regulatory body under CSRC's supervision, is required for private placements on the exchange market; and
- the NDRC's approval is required for enterprise bond offerings.

To obtain the respective regulators' approval or registration, the issuer is required to prepare and submit to the regulators the required application documents, with assistance from the lead underwriters. Although the application documents vary for different types of debt securities regulated by different regulators, most of the regulators require, among others, the following documents (regardless of the credit standing of the issuer):

- an application letter or registration report (as applicable);
- the resolutions of the issuer's board of directors or shareholders' meeting;
- the issuer's articles of association and other constitutional documents;
- the offering circular;
- audited financial reports for the past three years and the latest financial period;
- credit rating reports;
- a repayment plan (if applicable);
- legal opinions;
- credit enhancement documentation (if applicable);
- an underwriting agreement; and
- leading underwriters' recommendation letters (if applicable).

After the respective regulators give approval or registration notice (other than for private placements on the exchange market), the offering can be launched. Price enquiries with potential investors are generally permitted. However, in most offerings, pricing is conducted through central bookbuilding (similar to a Dutch auction) or bidding process pursuant to regulatory requirements.

Main participants in China's domestic debt capital markets

In addition to the issuer, the key participants in debt offerings (whether investment grade or high-yield in China's domestic markets) include the following:

- Lead underwriters, which are qualified financial institutions possessing the requisite underwriting licences. Generally, only lead underwriters execute an underwriting agreement with the issuer and have underwriting commitments. Syndicate members act like dealers and do not enter into the underwriting agreement directly with the issuer.
- Auditors, which are qualified accounting firms that have audited the issuer's financial statements.
- Rating agencies, which are qualified credit rating agencies overseen by the Chinese regulators.
- Law firms, which are Chinese law firms possessing the requisite qualifications to advise on the respective debt offerings. The issuer must engage counsel to issue a legal opinion for the application to the respective regulators for approval or registration of the debt offering. Most lead underwriters do not engage counsel to advise them on domestic debt offerings.
- Bond custody and clearing institutions. Debt securities issued on the interbank bond market are registered with, under custody of, and settled and cleared through China Central Depository & Clearing Co, Ltd (CCDC) or Interbank Market Clearing House Co, Ltd (also known as the Shanghai Clearing House). Debt securities issued on the exchange market are registered with, under custody of, and settled and cleared through China Securities Depository and Clearing Corporation Limited (CSDC).
- Post-issuance managers (for debt securities issued on the interbank bond market) or trust managers (for debt securities issued on the exchange market). This role, unlike a trustee or fiscal agent on other markets, is generally taken by the lead underwriter of the debt offering and is expected to monitor the issuer on its performance of ongoing obligations until the maturity of the debt securities.

Investor protection

Covenants package

In other markets, high-yield debt documentation generally contains protective clauses, including significant covenants, in the terms and conditions of the bonds. To protect investors' interests, a high-yield debt issuer is typically requested to make a number of undertakings to ensure that its financial condition, business and assets remain within certain limits, such as limitation on asset sales, incurrence of indebtedness, creation of liens, restricted payments and transactions with affiliates, and covenants on dividends, mergers and certain other covenants. Traditionally, the terms and conditions of debt securities in China's domestic markets have been relatively thin. A covenants package contained in the terms and conditions of high-yield debt securities offered in other markets was rarely seen in China's domestic market until the recent defaults on corporate bonds.

In September 2016, NAFMII released sample investor protection provisions, including cross-default clauses, financial ratio covenants, and change of control put options, for the inclusion in the terms and conditions of debt financing instruments of non-financial enterprises. The triggering of the events listed in these provisions does not necessarily lead to a declaration of default. Rather, a bondholders' meeting must be called to discuss solutions, which could be the early redemption of the bonds, the provision of guarantees or collateral, or a waiver of default.

Bondholders' meetings

A bondholders' meeting is a common investor protection mechanism in China's domestic debt capital markets. Issuers are generally required to include a bondholder meeting provision as part of the terms and conditions of their debt securities. This provision may refer to the relevant rules governing bondholders' meetings, or set forth the procedures for calling bondholders' meetings, the quorum, voting requirements, adjournment, written resolutions and other matters relating to bondholders' meetings.

In 2013, NAFMII released a rule governing bondholders' meetings for debt financing instruments of non-financial enterprises, which provides concrete procedural rules for bondholders' meetings and a descriptive list of triggering events for calling these meetings. The CSRC regulation governing corporate bond offerings on the exchange market also provides a list of triggering events, upon the occurrence of which a bondholders' meeting must be convened.

However, in practice, the effectiveness of bondholders' meetings in protecting investors' rights and interests is questionable. There have been a number of cases where the issuer has refused or failed to implement the resolutions from bondholders' meetings, particularly those requiring the issuer to redeem the bonds early or to provide an additional guarantee or collateral, and investors were left with no redress other than to sue the issuer.

Ongoing disclosure requirements

For debt securities issued in China's domestic market, whether investment grade or high-yield debt, traded on the interbank bond market or the exchange market, the issuers are required to make ongoing disclosure during the life of the debt securities. Ongoing disclosure consists primarily of the following two categories:

- Periodic disclosure, including audited annual financial statements and unaudited interim (in most cases, quarterly) financial statements.
- Disclosure of material events. The NAFMII rule setting out the information disclosure requirements for debt financing instruments of non-financial enterprises specifies 15 types of 'material events' that must be disclosed by the issuer in a timely manner. The CSRC regulation governing corporate bonds traded on the exchange market also requires issuers to disclose 13 types of 'material events' in a timely manner. These material events, the occurance of which may materially and adversely affect the issuer's repayment ability, include (whether in NAFMII's rule or CSRC's rule), among others: material changes to the issuer's business strategies and operating environment; default in the payment of debt; incurrence of significant debt; encumbrance or freezing orders over its material assets; waiver of creditor's rights for significant amount of debt owed by third parties; criminal proceedings or significant investigations against any director, officer or supervisory board member; material legal or arbitral proceedings or regulatory penalties; significant losses exceeding 10 per cent of the issuer's net assets; institution of a bankruptcy or liquidation proceeding; or merger, separation or reduction in registered capital.

Additionally, rating agencies are required to monitor the issuer's credit status during the life of its debt securities and release a follow-on rating report at least annually.

Offshore offering structure

A typical Chinese high-yield issuer has an offshore holding company in the Cayman Islands or Bermuda that may be listed on the Hong Kong stock exchange, has several intermediate companies organised in British Virgin Islands or Hong Kong, and has substantial onshore operations. In recent years, certain Chinese companies listed in the domestic stock exchanges have also entered the offshore high-yield market.

The high-yield bonds issued by Chinese issuers are typically governed by New York law. Key documents in the high-yield offerings include, among others, description of notes in the offering memorandum, indenture, global notes and purchase agreement. Depending on the offering structure, transaction documentation may also include security documents, inter-creditor agreements, escrow agreement, as well as any third-party waivers or consents.

In the process of tapping offshore bonds markets for raising funds, Chinese issuers have adopted various transaction structures that suit their needs under different circumstances. Specifically for high-yield bonds, two transaction structures are most often seen in the current market, that is, the direct issuance of bonds by a Chinese issuer (the direct issuance structure) and the issuance of bonds by an offshore special purpose vehicle with a cross-border guarantee provided by its onshore parent (the cross-border guarantee structure).

With the growing liquidity of the Asian market in recent years, most of the Chinese issuers' high-yield bond offerings are offered in reliance with the exemption under Regulation S of the US Securities Act of 1933, as amended (US Securities Act). This led to a shortened timetable to execute a high-yield transaction. A few years ago when the Asian high-yield bond market was largely driven by US institutional investors, Chinese issuers offering high-yield debt offshore had to conduct their offerings in reliance with Rule 144A under the US Securities Act.

Regulatory approval and registration

Over the past years, the Chinese regulatory authorities have continually amended the relevant regulations in respect of offshore bond offerings by Chinese issuers in response to changing domestic and international economic conditions.

NDRC requirements

Following the promulgation of the Circular on Promoting Reform on the Administration of Filing and Registration of Foreign Debt by Enterprises (the Circular) by the NDRC on 14 September 2015, the case-by-case approval requirement for offshore debt issuance by onshore Chinese companies was replaced by a procedure under which issuers are required to complete pre-issuance registration with the NDRC of offshore bonds with a tenor of more than one year and complete a post-issuance filing with the NDRC within 10 working days after closing.

The NDRC pre-issuance registration and post-issuance filing requirements apply to offshore high-yield bond issuances by onshore Chinese companies, as well as the offshore subsidiaries controlled by onshore Chinese companies and, therefore, would be required under both the direct issuance structure and the cross-border guarantee structure. Except for issuers falling under the jurisdiction of a few provincial and municipal NDRCs specifically designated and authorised by the central NDRC to handle NDRC registration and filing in connection with offshore bonds issuances, Chinese issuers are generally required to complete the pre-issuance registration and post-issuance filing with the central NDRC, either directly or through the local counterpart of the central NDRC. Although it is provided in the Circular that the NDRC will decide to accept pre-issuance registration application within five working days from the date of application, and issue a registration certificate within seven working days from the date of acceptance, the NDRC has discretion to conduct a substantive review of the application to ensure compliance with the eligibility requirements provided in the Circular and this timeline is, in practice, rarely strictly followed by the NDRC. Therefore, registering an offshore bond issuance at an early stage of the transaction is always advisable to ensure certainty in the deal execution.

Depending on certain factors concerning the Chinese regulators, at times it is relatively easy to get approval and at other times it is quite difficult, as NDRC approvals swing between a constrained supply and a supply glut. This has resulted in certain offerings being driven by NDRC approvals more than the issuers' own needs. Once an issuer receives a quota, then in many cases, they want to complete the offering before the expiry date, which may result in a rush to the market before calendar year end. More recently, the NDRC has been granting approvals at a more steady pace.

SAFE registration

Offshore high-yield bond issuances by Chinese companies under either the direct issuance structure or the cross-border guarantee structure are subject to the registration requirement imposed by the State Administration of Foreign Exchange (SAFE).

One issue to note is that a SAFE non-registration put is normally included in the terms of offshore high-yield bonds issued by Chinese issuers, either under the direct issuance structure or the cross-border guarantee structure. If the SAFE registration is not completed by a certain deadline as set forth in the terms of the high-yield bonds, then investors in these bonds would have the right to require the issuer to repurchase the bonds at par plus the accrued interest until, but not including, the date of repurchase.

Direct issuance

According to the Administrative Measures for Foreign Debt Registration issued on 28 April 2013 and its relevant implementation guidelines, Chinese issuers opting for the direct issuance structure shall complete registration with the local SAFE within 15 working days of the execution of the transaction documents that incur foreign debts. The information relating to such bond issuance may also be required to be filed at the local SAFE pursuant to the Circular on Relevant Matters about the Macro-prudential Management of Cross-border Financing in Full Aperture issued by the PBOC, which came into effect on 12 January 2017, if the Chinese issuer is not a real estate developer or local government financing vehicle.

Cross-border guarantee

For offshore high-yield bonds issued under the cross-border guarantee structure, the onshore parent guarantor would be required to register the cross-border guarantee for the high-yield bonds in accordance with the Provisions on the Administration of Foreign Exchange for Cross-Border Security and the Administration of Foreign Exchange for Cross-Border Security Implementation Guidelines promulgated on 19 May 2014 (the Cross-border Guarantee Registration Rules). Under the Cross-Border Guarantee Registration Rules, a Chinese onshore corporate or entity can provide a cross-border guarantee to support debt securities issued by an offshore entity, provided that the Chinese onshore guarantor has a certain equity interest in the offshore issuer, and shall register this cross-border guarantee with a local SAFE within 15 working days after the execution of the guarantee. It generally takes a few months for the local SAFE to complete the registration of the cross-border guarantee.

The Cross-border Guarantee Registration Rules impose restrictions on remitting any proceeds from offshore bond issuances with onshore cross-border guarantees back into China and require the proceeds raised from such issuance to be used outside China for offshore projects verified by the NDRC. However, this restriction has been lifted by the Notice on Improving the Check of Authenticity and

Compliance to Further Promote Foreign Exchange Control issued by SAFE on 26 January 2017. The cross-border guarantee structure has since become increasingly popular with Chinese issuers in the offshore bonds offerings and international financings.

Covenants package

Chinese issuers' high-yield bonds are typically issued with full high-yield covenants. These covenants are originally inherited from US high-yield bonds with carveouts and exceptions that have been evolved over time.

One unique feature of high-yield bonds issued by Chinese issuers is structural subordination. The method to pledge hard assets as collateral is typically not available for Chinese companies who are structuring offshore transactions, because Chinese regulations restrict the shares and assets of onshore operating companies from being pledged as security for offshore debt. Consequently, the shares of offshore intermediate holding companies are pledged instead. Given offshore noteholders' lack of ability to control the onshore Chinese operating companies' assets and revenues, some high-yield bond offerings by these Chinese issuers have omitted share pledges. Similarly, China incorporated onshore entities that possess substantial assets or operations can only act as non-guarantors and may not provide guarantees for the transaction. Offshore noteholders only receive subsidiary guarantees from non-Chinese subsidiaries, which typically account for only a nominal amount of the issuer's assets. This structural subordination greatly limits the noteholder's access to onshore assets and places offshore creditors at a significant disadvantage to onshore lenders in a default situation. As a result, the covenants package is designed to minimise the incurrence of onshore debt that is structurally senior to the offshore high-yield bonds to the extent it is possible.

At the early stage of Chinese issuers' issuing high-yield debt, the covenants package was quite tight. As time goes on and investors are more familiar with these Chinese issuers, there is a general trend towards loosening the covenants package. Meanwhile, due to the business growth in China and the increased complexity of the issuers, many high-yield issuers require substantial flexibility, which has further driven changes in the covenant packages. For example, certain carveouts under the debt covenants were introduced to permit such issuers to incur substantial additional onshore debt through purchase money, trust financing, investment properties and other exceptions tied to a percentage of total assets that grows with the business.

Main participants in Chinese issuers' offshore high-yield offerings

Major participants in Chinese issuers' high-yield debt offerings include issuers, investment banks, legal counsel, auditors, trustees and, depending on the structure, there might be other relevant parties, such as subsidiary guarantors, parent guarantors and collateral and escrow agents.

One feature is that the Chinese issuers' high-yield deals are concentrated in the real estate sector. Chinese real estate developers substantially dominate all the offerings of Chinese issuers' high-yield debt, although, in recent years, some non-real estate developer issuers have come to the market. This concentration is largely relevant to the onshore financing capabilities of Chinese real estate developers. In addition to the general macroeconomic conditions, foreign exchange fluctuations, and investors' yield expectations, Chinese real estate developers' ability to access onshore loan and bond markets are often limited owing to policy concerns and changes in regulatory requirements. Chinese issuers are naturally attracted to the onshore financing market when it is cheaper for them because the proceeds are used to finance onshore projects. For example, during 2015 and the first half of 2016, the Chinese offshore high-yield debt market experienced a slowdown with the liberalisation of the onshore market. However, when the regulations are tightened, Chinese high-yield issuers come back to the offshore market to issue high-yield bonds. As a result, the high-yield offering volume of Chinese real estate companies has been volatile.

Another feature for market participants is that the mix of underwriters and investors for Chinese high-yield bonds has changed significantly in recent years. New players with China-based parents, both underwriters and investors, have entered the market. Investor demand is increasingly coming from the Hong Kong branches or subsidiaries of Chinese banks, insurance firms, securities firms, asset management firms or Chinese companies that have offshore treasury units. Chinese investment banks are competing with global investment banks to win more underwriting business in the Chinese issuers' high-yield debt offerings and they are reasonably successful. Chinese investment banks, such as China International Capital Corporation, China CITIC, Guotai Junan Securities, and Haitong Securities, BOCOM International, ABC International, CCB International, CMB International, Bank of China and China Everbright Bank, have come to feature repeatedly in the high-yield transactions and in the league table. At the early stage, high-yield debt offerings were featured with one or two joint bookrunners, but currently, each deal seems to involve many joint bookrunners combining to form a big syndicate team.

Future opportunities

Despite fluctuations in the past few years, the Chinese high-yield market is still a very sustainable market in terms of volume. The market will continue to broaden, in terms of the structure, type of issuers, and an increased need for US dollar funds driven by the globalisation of Chinese companies. We believe that the onshore debt market would blend more with the offshore market if offshore creditors were able to access onshore collateral.

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

As in many other jurisdictions, securities offerings in Brazil (including high-yield debt securities) are regulated by securities laws, whereas bank loans are regulated by specific banking regulations.

The offering of debt securities in the local market can take a wide range of structures in Brazil depending on specific characteristics of the offering, such as number of investors involved, term of the transaction and registration of the transaction with local securities authorities, among others. Typically, these transactions are implemented either through (i) a public offer duly registered with the Brazilian Securities Commission (CVM) under CVM Instruction No. 400, or (ii) a restricted public offer under CVM Instruction No. 476. See question 6 for more information on the differences between public registered offerings and restricted offerings of debt securities in Brazil.

Typically, offerings of debt securities are implemented through the use of debentures (medium or long-term offerings) or commercial papers (short-term transactions). These instruments are similar to a bond used in international transactions, and are fixed-income debt securities that represent a fraction of a credit held by an investor.

The natural advantage of issuing and offering debt securities, especially in the case of a public offer under CVM Instruction No. 400, is the access to a wide and diverse number of investors, consequently increasing the chances of obtaining longer tenures and lower interest rates when compared with standard bank loans.

On the other hand, in addition to the increased costs of structuring a securities offering in Brazil when compared with bank loans, securities laws and regulations also impose specific liability and disclosure obligations both on issuers and underwriters, which must be carefully reviewed and considered by all involved parties during the structuring of offering procedures.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

There has not been a recent increase of regulation specifically regarding high-yield debt securities, but the CVM is constantly reviewing and detailing the obligations of issuers of securities in general, especially those related to disclosure requirements.

Considering the recent corruption scandals in Brazil, local regulators are currently focusing on know-your-customer and enhanced due diligence practices, and both lenders and underwriters are requiring increased detailed information regarding their clients. Further, in the case of underwriters, higher scrutiny and due diligence questions from high-yield debenture investors themselves are also being observed (with reflections in the representations, covenants and acceleration provisions set forth in the bond documentation).

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

Currently, in light of the high demand for infrastructure financing in the local market, we have seen companies relying on the debt capital markets (local and international) in order to meet their funding needs and requirements. In this regard, issuers that hold infrastructure projects in sectors such as telecoms, transportation and energy (generation, transmission and distribution) have implemented relevant debt offerings over the past years.

Governmental-controlled entities (such as Petrobras, Cemig and the Brazilian Development Bank (BNDES)) have also recently relied on the international bond market for different reasons, such as debt restructuring, funding for local priority projects and extension of term of debt obligations, among others.

It is usual in local transactions (especially those involving project financing) for investors or lenders to request 0a comprehensive collateral package from the issuer or borrower (equity, equipment, real estate, receivables). Even though in past international transactions that was not the case, there have been recent bond offerings (such as those involving entities in the agribusiness sector) in which the issuer agreed to grant the investors guarantees.

Main participants

4 Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

A public offering of debentures typically involves several participants with different roles and it must necessarily involve at least one financial institution duly registered with the Central Bank of Brazil and the CVM to act as underwriter. Usually, local underwriters are licensed to operate as investment banks, brokerage firms or multi-service banks, and their main responsibilities are essentially the same as those in other jurisdictions such as the United States and the United Kingdom. They include:

- structuring the offer and assisting the issuer during all registration processes;
- marketing the securities and assisting the issuer with the interactions with potential investors; and
- reviewing the offer documentation and assuring the completeness and accuracy of the information provided to investors.

For the rendered services, the underwriters usually receive a commission fee calculated as a percentage of the debentures' total issued and subscribed price.

Issuers and underwriters are also assisted by lawyers and accountants during the preparation of the offering documents and the registration process with the CVM, where lawyers usually perform a legal due diligence and provide a legal opinion, and accountants issue a comfort letter regarding the disclosed accounting information of the issuer.

Investors, in turn, are typically represented by a trustee, who is responsible for controlling the flow of information between the issuer and investors, as well as executing all required documents on their behalf. In the case of a secured transaction, the investors are usually assisted by a security agent as well, responsible for the supervision and enforcement of collateral.

Finally, although having rating agencies is not mandatory in public offerings in Brazil, their involvement is usual in high-yield securities offerings, as they play an important role in assessing the issuer's ability to meet its financial obligations under the transaction.

New trends

5 Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Covenant packages may vary depending on the financial situation of the issuer, its envisaged projects and specific industry trends. More recently, however, in view of corruption scandals in Brazil involving bribe payments to government officials, investors and underwriters tend to apply greater scrutiny when reviewing compliance and ethics practices in all industries, but especially those which typically conduct business with public governments and entities.

Although it is a trend not specific to high-yield bonds, but a standard reflected in all corporate transactions during the last few years, we have seen detailed clauses with lengthy representations and warranties regarding compliance practices and standards, as well as increased legal due diligence requirements in relation to agreements involving public companies and governments.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Local securities laws contain provisions on the nature, scope and requirements regarding public offerings, and there is no legal definition as to what constitutes a private placement.

As briefly explained above, there are two modalities of public offerings: (i) public offerings in the broad sense, covered by CVM Instruction No. 400, which require prior registration (of the issuer and the offer itself) with the CVM; and (ii) restricted public offerings, covered by CVM Instruction No. 476. It is not necessary for the latter to be registered with the CVM, as the offering is directed only to a limited number of professional investors.

There is a broad set of rules and regulations governing registered public offerings of securities. These rules not only establish the types of companies that can access the market with these offerings (ie, listed corporations), but also contain provisions related to: (i) procedures for offerings registrations; (ii) minimum documentation involved in any offer; (iii) disclosure requirements and information that must be informed to investors by those involved in the offer; (iv) definition of public offer; and (v) sanctions that may be applied in case of breaches of securities laws, among other things.

In the case of restricted public offerings, it is not necessary for the companies to be registered with the CVM and the offering itself does not need any registration with this authority. Nevertheless, the communication of the offering's characteristics is mandatory. Disclosure material can be prepared, although it is not necessary. Furthermore, restricted public offerings have some limitations, such as the type of investors that may acquire the securities and the number of investors that can participate in the offer (up to 75 investors for selling efforts and no more than 50 may purchase the securities). They are directed only to professional investors, such as investment funds, financial institutions and other institutions authorised to operate by the Central Bank of Brazil, insurance companies, capitalisation companies and investors with investment portfolios exceeding 10 million reais.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

Although there is no clear rule and maturities can vary from one issuance to another, high-yield securities issued in the local market usually have maturities that vary from five to 10 years and might contain optional redemption provisions granted to the issuer.

To assure a yield protection to investors for a significant period, these optional redemption provisions are typically structured with a non-call period, preventing the issuer from redeeming the debentures for a predetermined number of years, and it is uncommon to have exceptions to this non-call period. In addition, where the issuer decides to redeem the debentures after this non-call period, it is usually required to pay investors a premium that decreases during the tenure of the debentures.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

Although public registered offers have more formal processes and regulatory requirements than restricted offers, both procedures tend to follow substantially similar paths for launching, pricing and closing, with the delivery of a disclosure package (which is optional in case of restricted offerings) to investors and roadshow presentations. After the roadshow, the bookbuilding takes place and, based on investors' demand, pricing is finalised together with the execution of the underwriting agreement between the issuer and the underwriters.

Closing usually takes place on the third business day after pricing and is normally preceded by a bring-down due diligence call to confirm there have been no material changes since the execution of the underwriting agreement.

Finally, the majority of the high-yield bonds issued locally have a fixed coupon applied to a floating rate (usually the Certificado de Depósitos Interbancários), and this coupon varies depending on factors that vary from market conditions, investors' aversion to risk and the financial situation of the issuer and its industry prospects.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

High-yield bonds issued locally usually contain an extensive list of financial and negative covenants restricting the issuer's ability to incur additional indebtedness or grant liens. Some examples of these covenants are restrictions on:

- the payment of dividends above the minimum required by law and the issuer's articles of association;
- the sale, lease or disposal of material assets;
- merger or consolidation with other entities;
- change of control;
- cross-default and cross-acceleration; and
- transactions with affiliates.

Most covenants are not limited to the issuer itself, and also include restrictions that shall be observed by its relevant subsidiaries or controlling entities.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

With the recent financial crisis in Brazil and investors' aversion of risk, it is fair to say we have seen a tightening of covenants during the past few years.

These covenants, however, may be extensively negotiated between the issuers and underwriters before launching the offer, and it is uncommon to have covenants renegotiated between launch and pricing.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

Covenants are usually looser or tighter depending on the financial situation of the issuer itself, and not related to its specific industry sector.

In the past few years, however, industries that typically enter into agreements with public entities in Brazil have been subject to tightened scrutiny and covenants due to recent corruption scandals involving government officials.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Changes of control and asset sales are usually negative covenants that, if triggered, will result in an event of default and the standard acceleration of the debt by the issuer.

It is not usual to have specific prepayment requirements or different redemption amounts triggered by a change of control.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

Although this structure exists in some indentures, 'double trigger' change of control provisions are not standard market practice in high-yield debenture issuances, and a mere change of control will typically result in the acceleration of the debt regardless of whether it results in a ratings downgrade.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

No. Customarily, in the securities market, a covenant package is negotiated for the entire tenure of the high-yield debenture, and it is not common to see a crossover covenant package with covenant differences.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

As previously mentioned, the CVM is the entity responsible for issuing securities regulations and overseeing the securities market, and disclosure requirements vary if the offer is a public registered offer or a restricted offer.

Registered public offerings under CVM Instruction No. 400 must contain detailed offering documents with all information needed for investors to analyse the terms and risks of the offering, including a prospectus, which shall be reviewed and authorised by the CVM.

Currently, the CVM has a partnership with ANBIMA, an association of financial and capital markets entities, in order to expedite registered debenture offering procedures. Through this partnership, ANBIMA is responsible for reviewing offering documents and only after ANBIMA is satisfied with the documents they submitted are they subjected to the CVM for its approval of the public offering.

In the case of restricted public offerings, a summarised offering document might be delivered to investors with the main terms and risk factors of the offer, but no CVM registration is required.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

There are no specific limitations on the use of proceeds from and issuance of high-yield securities when compared with standard debt securities.

In both cases, however, the issuer must describe to investors how the proceeds from the offer will be used in its respective indenture.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

High-yield debentures do not contain any specific restrictions precluding investors from investing them.

Nevertheless, as previously discussed in question 6, there are specific regulatory limitations depending on the type of offering. Public registered offers are typically directed to a wide range of individuals, but restricted offers under CVM Instruction No. 476 can only be distributed to professional investors, such as investment funds; financial institutions and other institutions authorised to operate by the Central Bank of Brazil, insurance companies, capitalisation companies and investors with investment portfolios exceeding 10 million reais.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

No, there are no particular closing mechanisms in the Brazilian jurisdiction that an issuer of high-yield securities should be aware of.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

High-yield debenture offerings might have different guarantees among companies of the same group and can include upstream, downstream or cross-stream guarantees.

Typically, this guarantee structure will depend on the credit-risk assessment made by the underwriters and will reflect the financial situation of the issuer itself and the corporate group as a whole, as well as other collateral packages that might be granted to secure the financial obligations resulting from the offer.

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

There are several collateral packages that can be granted to secure high-yield debentures, which typically depend on the industry sector of the issuer as well as the amount of assets that are free of liens.

These packages usually include assignment of receivables, equity pledge agreements, mortgages and security over movable assets, such as equipment.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

There are no specific limitations as to which types of security can be granted to secure high-yield securities or that can be pledged as collateral.

The foreclosure of this security, however, may be limited by different factors depending on the industry and type of security, such as bankruptcy, insolvency, judicial and out-of-court reorganisation proceedings and other laws of general application relating to or affecting the rights of debenture holders, among others.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

As discussed above, the collateral structure will depend on several factors and the credit analysis to be performed on the issuer.

Although there is no legal limitation, cross-lien deals between high-yield debt securities and bank agreements are not common in the Brazilian jurisdiction.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

Typically, the issuer bears all the costs of legal expenses related to the security interests, including the fees to be paid to the underwriters' legal counsel and the registration fees before the relevant registry of deeds and documents. These fees usually comprise:

- the CVM's registration costs (in the case of registered offerings implemented under CVM Instruction No. 400);
- secondary market fees (fees of B3 S.A. – Bolsa, Brasil, Balcão);
- underwriters' fees;
- legal counsel's fees;
- independent auditors' fees; and
- roadshow and marketing costs and expenses.

Security interests

24 How are security interests recorded? Is there a public register?

There is a public register and the general rule is that, in order to be effective against third parties, all security documents must be duly filed and registered with the competent registry of deeds and documents.

Different securities might also have to comply with additional requirements to be fully effective under Brazilian law. Pledges over shares, for instance, have to be registered in the share registry books of the issuer (in case of book-entry shares), whereas pledges over quotas issued by a limited liability company must be registered in its relevant articles of association.

25 How are security interests typically enforced in the high-yield context?

The investors will typically have a security agent responsible for the supervision and enforcement of the collateral in case of default by the issuer. The security agent shall act under the instructions of the investors represented by the trustee, and the enforcement procedure will vary depending on the type of security, but it typically can be exercised either by an out-of-court foreclosure (amicable sale), or an enforcement proceeding.

Under the Brazilian Civil Procedure Code, the investor (represented by the security agent) is entitled to sell the underlying assets of the pledge (amicable sale) provided that the security agreement expressly permits such amicable sale or the amicable sale is otherwise authorised by the issuer under a power of attorney. High-yield security agreements typically contain provisions and powers of attorney allowing the security agent to arrange for judicial or extrajudicial foreclosure of the security and granting powers to transfer, assign or otherwise dispose of the rights related to the collateral. Even though such a procedure is possible in theory, in practice, it is not very common (in many cases because the issuer or guarantor opposes the out-of-court sale).

The most common remedy for the foreclosure of security agreements is the judicial foreclosure proceeding, which follows a specific set of rules and procedures under the Brazilian Civil Procedure Code, starting with the filing of a initial motion requesting the issuer or guarantor to be served with process to pay the matured debt and, in case of default, seizure of the corresponding collateral.

The judicial foreclosure of security, however, tends to be an expensive and time-consuming process, as issuers or guarantors typically oppose the foreclosure with arguments against the enforceability of the main claim or of the security or arguments regarding the event of default. For this reason, it is not unusual for investors to use collateral as leverage to force the issuer or guarantor to renegotiate the original

agreements and avoid the costs and expenses of a prolonged enforcement action instead of foreclosing the collateral immediately after the debt is accelerated.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 | How does high-yield debt rank in relation to other creditor interests?

The Brazilian Civil Code and the Insolvency Act (Law No. 11,101/05) establish specific ranking depending on the type and nature of the underlying debt, but there is no specific category for high-yield debt securities in relation to other standard debt securities.

Depending on whether collateral is granted, as well as the type of collateral, the corresponding high-yield debenture will rank senior when compared to any unsecured loan or debt security of the issuer. In this case, the proceeds from the enforcement of the granted collateral shall first satisfy the financial obligations of the issuer arising from the high-yield debenture.

Regulation of voting and control

27 | Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

Intercreditor arrangements in high-yield debentures vary depending on the corresponding collateral structure, but investors typically require that the debentures rank at least pari passu with other incurred debts by the issuer.

It is not usual, however, to have common collateral shared among high-yield investors and bank lenders (although that may be seen in transactions involving project financing, in which the company may obtain funding from banks – usually the BNDES – and the local debt capital markets).

TAX CONSIDERATIONS

Offsetting of interest payments

28 | May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

No, that is not common in the local market.

Tax rulings

29 | Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, that is not common in the local market.

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

Typically, Finnish high-yield debt is a fixed rate issue with bullet maturity (ie, the entire principal is paid on the final maturity date) whereas bank loans are typically divided into amortising term loan A and non-amortising term loan B. Most of the covenants in high-yield instruments are incurrence-based, which means that the covenants are only tested when the issuer takes an affirmative action, such as incurring new debt. In bank financing, covenants are typically maintenance-based and are automatically tested on agreed testing dates. Therefore, with high-yield debt, the issuer typically has a higher degree of control over the covenants and when they are tested. In short, the benefits of a high-yield bond are bullet maturity and more issuer-friendly covenants. The main disadvantage is that obtaining amendments and waivers from high-yield creditors is more difficult.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

The liquidity and capital requirements of the Basel III and CRD IV packages are increasing the regulatory burden for banks and therefore make lending more challenging.

In addition, new legislation concerning the role of agents entered into force in September 2017. The new legislation clarified the authority and scope of the agent to act on behalf of the bondholders. We believe that the development of regulation is likely to cause high-yield bonds to be even more attractive in the future.

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

The energy, building and construction, and real estate sectors have been particularly active during the past years in various types of bond issuances (the high-yield market stayed quite active in 2018 compared to 2017); however, we saw some acquisition related high-yield issuances as well. Combinations of high-yield bond and super senior working capital facility that share the same security package were more common in 2017 .

The high-yield (or non-investment grade) bond market from a Finnish corporate issuer's perspective can be roughly divided into two separate markets: the European/international high-yield bond market and the domestic/Nordic high-yield bond market, of which the latter is significantly more active. In Finland, in general, the total amount issued under any given bond issue (in a European or international high-yield context) is bigger, the documentation follows international standards and the governing law of the main finance documents is typically New York law (or, in certain cases, English law).

The high-yield issuances governed by Finnish law may vary from close to investment grade credit to junk bond with the majority of issuances in the higher end of the credit spectrum. Depending on the quality of the credit, it may be secured or guaranteed. On average the Finnish high-yield bonds are of higher credit quality compared to the other Nordic markets. At the higher end of the credit spectrum, however, investment grade style documentation is frequently used.

There is growing interest in investing in bonds. Typically, Finnish pension funds have been active investors both on the loan and the bond side, but the investor base has expanded steadily over the past few years. In addition, the Finnish state-owned financing company Finnvera currently has a mandate to invest in bonds.

Main participants

4 Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

Typically, bonds governed by Finnish law are arranged by a bank or financial adviser and are not underwritten. The arranger is responsible for arranging the bond, including pre-sounding of the investors, investor meetings and bookbuilding. The arrangement fee is typically based on the bond proceeds and there might be success fee elements based on the pricing. Generally, the fee varies from 0.5 per cent to 3.5 per cent of the bond proceeds, even though the highest credit quality high-yield issuers may pay fees below that range.

The notes are registered to Finland's central security depository, Euroclear Finland, and, typically, one of the arrangers also acts as issue agent and coordinates the registration of the notes into Euroclear. Out-of-pocket costs are paid by the issuer.

The bondholders are usually represented by an agent and no bondholder is allowed to take any unilateral action against the issuer. There are two established participants in Finland providing agency services: Nordic Trustee and Intertrust. The fee is typically an annual fee and any additional actions, for example bondholders' meeting arrangements, are invoiced separately.

New trends

5 Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

We are likely to see more fallen-angel corporate issuers entering the high-yield space as they are likely to receive relatively light covenant packages. Another interesting discussion topic is whether it remains

necessary to have a proper red-herring listing prospectus for Nordic high-yield bonds or whether lighter documentation would be sufficient for marketing purposes. Many bankers and issuers think that the time it takes to access the markets is too long, because the bonds are usually sold by utilising a red-herring listing prospectus as an offering memorandum. The prevailing shortage in the demand of high-yield bonds has created the trend of covenant packages becoming less restrictive across the wider European market, and the majority of Finnish issuances can be described as 'covenant-lite'.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

The documentation prepared for the purposes of domestic or Nordic issues is usually governed by Finnish law and the bond terms are based on model bond documentation introduced in 2014 by the Confederation of Finnish Industries (EK) and the Advisory Board of Listed Companies (the EK Model Terms). The use of the EK Model Terms is standard in today's domestic/Nordic market and, for the purposes of this type of bond issue, the main question from an issuer's and investor's perspective is whether the credit in question is strong enough to issue under investment grade documentation or whether the EK Model Terms will be required by the relevant investors. In general, strong 'implied BB' credits tend to issue bonds by using investment-grade style documentation, while 'implied B' and below credits tend to use the EK Model Terms. However, the practice among the weaker BB credits is more varied.

The EK Model Terms are used in a variety of different structures, including senior secured bonds, senior unsecured guaranteed bonds and senior unsecured and unguaranteed bonds. The terms included in the EK Model Terms are, in many ways, similar to bond terms in use in other Nordic countries (not least because other Nordic countries were benchmarked in connection with the preparation of the EK Model Terms).

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

The typical maturity of a domestic or Nordic high-yield bond ranges from three to five years. The call structure is standardised in that a non-call period of 24 or 30 months is included, after which a prepayment premium, which decreases with time (eg, every six or 12 months), is applicable in the case of a redemption prior to maturity. However, the higher credit quality high-yield issuers using investment-grade style documentation usually do not have call option structures included in their bonds. High-yield bonds are usually issued at par, although it is not entirely uncommon to see issues with an original issue discount. Other than the discussed call structure and other standard prepayment provisions (such as upon a change of control) no particular yield protection provisions are usually included.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

It is common for domestic high-yield bonds to have fixed interest rates but a few transactions have included a floating rate interest (namely three-month EURIBOR plus margin) with zero floor.

Coupons are typically determined in a bookbuilding process where the arranger takes offers from the investors in respect of margin and amount.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

The main covenants restricting the operation of the debtors vary from transaction to transaction. In corporate issues at the higher end of the non-investment grade spectrum, the main covenants would typically include incurrence-based financial indebtedness and distribution covenants and relatively relaxed negative pledge and disposal restrictions. At the riskier end of the domestic high-yield bond market, the covenants can be extremely restrictive (similar to the ones included in a typical leveraged bank financing), for instance prohibiting, in effect, all additional indebtedness (other than possibly a tap issue and limited working capital financing required by the debtor).

As a main rule, the financial covenants included in a domestic high-yield bond issue are incurrence-based, although it is not unheard of to include maintenance covenants. This inclusion of incurrence-based financial covenants, as opposed to maintenance-based financial covenants, remains one of the main differentiating factors between the domestic high-yield bond market and the bank loan market (where, in the case of the latter, the financial covenants are always maintenance-based). Notwithstanding, in the industry, we are seeing bank loans that include certain incurrence-based covenants, which practice may reach Finland shortly.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

The abundance of liquidity in the financing market has not affected high-yield bond terms, at least not at the lower end of the credit spectrum. One of the reasons for this could be that these debtors (or the reasons for procuring financing) may entail risk to such a degree that rather tight restraints are justifiable and also that these debtors lack an alternative source of funding (such as bank financing). Changes to covenants and other terms of the issue are sometimes seen during the time between launch and pricing with respect to weaker credits. For the stronger credits this is not usually the case. In the current market, the higher quality high-yield issuers get away with covenant-lite documentation and financial covenants are rare.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

The industry sector as such does not have a direct impact on covenant terms. Naturally, certain industry sectors may be more appealing to investors than others but this does not directly impact covenant terms. In general, covenant requirements tend to be tightest in the real estate sector bonds where one would normally expect to see up to three

financial covenants (eg, solvency ratio, secured solvency ratio and interest cover ratio) due to their heavy dependence on funding.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

As a general rule, a change of control always triggers the right of each investor to demand prepayment. Portability is a feature that is not usually included in domestic issues. As regards disposals, the position varies between strict restrictions on disposals or looser restrictions on disposals coupled with an obligation to discharge debt (whether the respective high-yield or some other debt) with the proceeds of disposal (which may be subject to a reinvestment right).

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

Double trigger change of control provisions tied to a ratings downgrade are not included in domestic high-yield bond documentation. It is good to bear in mind, however, that neither domestic bonds, nor the issuers, are usually rated by an international rating agency.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Since domestic issuers or bond issues are not typically rated, there is no established concept of a crossover covenant package for Finnish issuers who are on the verge of being investment grade. One could argue, however, that the larger, non-investment grade corporates that issue unsecured bonds under the EK Model Terms (or investment-grade documentation) have relatively relaxed covenant packages compared to the high-yield proper issuers at the lower end of the ratings spectrum. From this perspective, one could take the view that although there is no concept of a crossover covenant package, these do exist and are in fact quite common. One of the main differences between the covenant packages of the high-yield issuers at the upper end of the credit spectrum compared with the ones at the lower end relates to the incurrence of additional debt, which, in the case of the issuers at the higher end, is tied to the satisfaction of an incurrence test (if any), whereas in the case of the issuers at the lower end incurring additional financial indebtedness may not be permitted at all.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

The Finnish Securities Markets Act (746/2012) as amended is largely aligned with the relevant EU regulation and it applies to securities governed by Finnish law. Domestic bonds are commonly offered so that there is no need to publish a prospectus. However, an information memorandum that describes the issuer and relevant risks is typically included in an offering, and such information memorandum is often used as a template for the prospectus if the bond is listed at a later stage. In the event of a stock exchange listed issuer, the high-yield bonds are usually also listed and sold on the back of a red-herring listing prospectus.

The Finnish Financial Supervisory Authority must approve prospectuses but not information memorandums.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

The bond terms typically set out restrictions for the use of proceeds but otherwise there are no restrictions.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

If an investor is precluded from investing it would likely be as a result of some internal regulations applicable to the investor. In addition, there may be some investor requirements under the Markets in Financial Instruments Directives I and II (Directives 2004/39/EC and 2014/65/EU (MiFID)) that limit to whom the arrangers may sell bonds. Obviously, international sales restrictions, such as exemptions from registration under the applicable US, European and UK legislation, will always need to be followed.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

The settlement mechanism follows the rules and decisions of Euroclear Finland. Certain practicalities can be agreed with the issue agent, Euroclear and the issuer.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

Depending on the credit in question and the corporate structure of the issuer, subsidiary guarantees are sometimes used in connection with high-yield deals. Usually, guarantees are given as directly enforceable guarantees under which the guarantor is liable for the principal debt in the same way as an obligor is personally liable for this debt.

A guarantee is typically issued in separate guarantee documentation and not as part of the high-yield terms and conditions. However, it is usual that the terms and conditions address the need for additional guarantees from material companies in the future.

The upstream guarantees issued by Finnish subsidiaries are typically subject to applicable restrictions set out in the Finnish Companies Act (624/2006) regulating financial assistance and unlawful distribution of assets.

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

The typical security package depends much on the credit, business and corporate structure of the issuer. Often the security package consists of a pledge over the shares in material subsidiaries of the issuer and in the issuer, and certain intragroup receivables, as well as business mortgages.

Limitations

21 | Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

There are no specific limitations for granting security for high-yield securities, although there are general restrictions set out in the Finnish Companies Act. Pursuant to the Act, any legal and other acts of a limited company should be taken for the corporate benefit of the company. The obligations of Finnish companies under the relevant agreements are subject to the requirement of receiving sufficient corporate and commercial benefit from the transactions. If the amount of financial benefit received from a transaction were considered to be insufficient compared with the obligations the company assumes, the transaction could be declared invalid or null and void by a competent court. Further, and without limiting the generality of the foregoing, the enforceability of obligations under any guarantee or security interest granted by a Finnish company could be limited up to the amount of financial benefit received.

In addition, the Finnish Companies Act stipulates that a Finnish limited company may not provide security for the purpose of a third party acquiring shares in the company or its parent company. In practice this means in terms of acquisition financing that a target cannot provide a guarantee or grant security to any third-party lender to the extent the funds borrowed are used towards financing of the acquisition of the shares in the target company (or any direct or indirect parent company of the target). If a company were to breach the aforementioned financial assistance rules, the transaction could be considered null and void or as constituting unlawful distribution of assets. In the latter instance, the recipient of the security could be obliged to return part or all of the assets. Further, criminal sanctions or compensation for damages could be awarded.

Due to these restrictions, subsidiary guarantees and security granted for the high-yield debt is typically subject to limitation language.

Collateral structure

22 | Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

If the bank debt and high-yield debt sit in the same structure with the same ranking or super senior arrangement, it is quite common that there is a shared security package, including an intercreditor agreement reflecting the creditors' agreed debt ranking and distribution of proceeds.

Legal expenses

23 | Who typically bears the costs of legal expenses related to security interests?

Typically, all costs relating to the security are paid by the issuer.

Security interests

24 | How are security interests recorded? Is there a public register?

Business mortgages and real estate mortgages as well as pledges over intellectual property rights are registered in public registers. No public register exists for other types of security interests.

25 | How are security interests typically enforced in the high-yield context?

We have not yet seen security interests being enforced in the high-yield context. However, the likelihood of enforcement is generally dependent on the type of secured asset subject to enforcement.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 | How does high-yield debt rank in relation to other creditor interests?

There are different types of high-yield issuances. The riskier high-yield issuances are typically secured and therefore also in a better position compared to other non-secured creditors.

Without any structural or contractual arrangement, the high-yield debt ranks as any other debt not preferred by law.

There have also been some Finnish high-yield issuers with super senior working capital facilities where the high-yield debt ranks behind the super senior debt in the payment waterfall.

Regulation of voting and control

27 | Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

The international issuances follow international standards. There is no settled market position covering domestic issuances. Voting and control issues may be heavily negotiated depending on the credit and the amount of bank debt in comparison with bond debt. If there is a considerably small amount of bank debt compared to the bond debt, the bond creditors usually control the enforcement process but the bank creditors (if they are in a super senior position) enjoy value protection.

TAX CONSIDERATIONS

Offsetting of interest payments

28 | May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

In general, interest expenses are tax-deductible for corporate tax purposes provided that the securities have been issued for business purposes. However, the deductibility of both related-party and third-party interest expenses is limited. Third party interest expenses have been subject to limitations only as of 2019 and a grandfathering rule excludes certain existing third party loans from the scope of limitations.

Interest expenses may become non-deductible if the net interest expenses exceed 25 per cent of the company's adjusted business profits (ie, taxable business profits adjusted with the aggregate amount of interest costs, depreciations, losses and change in value of financial assets and group contributions received, deducted with the amount of group contributions paid) and if the annual net interest expenses exceed €500,000. Despite these rules, net interest expenses paid to third parties are always deductible up to €3 million.

Deductability of related-party interest expenses is subject to stricter rules than third-party interest expenses. Third-party loans may be deemed related-party loans if a related party pledges a receivable to an unrelated party as security for the loan and the unrelated party provides a loan to another related party, a receivable from a related party is pledged as a security of a loan or the loan from an unrelated party is de

facto a back-to-back loan from a related party. Nevertheless, in certain situations the interest expenses will remain fully deductible if the equity ratio of the company is equal to or higher than the consolidated equity ratio of the group. Regulation allows an indefinite carry forward of non-deductible interest expenses and deduction of these interest expenses, provided that the limitations are not exceeded. The definition of interest is broad and it covers, for example, expenses incurred in connection with financings, guarantee fees and banks' arrangement fees.

There are no special tax considerations for the high-yield market in relation to deductibility of interest expenses.

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

There is no general need for issuers to obtain a tax ruling in connection with the issuance of high-yield bonds. However, full certainty on, for example, deductibility of interest expenses in unconventional structures can be obtained through an advance ruling issued by the tax authorities or a tax authority's preliminary discussion procedure.

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 | Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

The major differences between high-yield bonds and bank loans in France are similar to those in other jurisdictions. Among other elements, there are differing approaches to covenants, repayment terms and amendment mechanics.

High-yield bond covenants are incurrence-based (tested at the time of a transaction only), whereas loan covenants have traditionally been maintenance-based, meaning that they must be respected at all times. Loans have traditionally also required that leverage and interest coverage ratios be respected quarterly and that these ratios tighten over time with a view to the borrower deleveraging.

Even where bond and bank covenants cover the same ground, high-yield bond covenants tend to provide greater flexibility to the issuer than bank loans, for example, by allowing acquisitions as long as the acquirer takes control of the target and by providing baskets that evolve with the growth of the business. This is in part due to the relatively cumbersome process needed to get waivers from bondholders compared with a group of relationship banks in a loan. However, with the expansion of covenant-lite loans (with bond or term loan B covenants) in Europe, the distinctions between bond and loan covenants are blurring.

From the issuer standpoint, however, loans provide significantly greater scope for prepayment without penalty. Bonds have non-call periods during which the issuer can only redeem them by paying a costly make-whole premium or by using the proceeds of certain equity offerings to redeem a portion of the bonds. Floating rate notes, which have shorter non-call periods, can be attractive for issuers seeking faster redemption possibilities, but covenant-lite loans will also be attractive for this type of borrower and are likely to have less onerous prepayment and non-call provisions.

When it comes to waivers and amendments, bonds require a consent solicitation to be made to holders, which must then approve with a simple majority for most matters or a 90 per cent or 100 per cent super majority for certain specified matters generally affecting economic terms. Loans must generally be approved by a two-thirds majority or, for certain matters, a 100 per cent majority. This may be easier in the loan context compared to bonds if a large stake is held by relationship lenders. Some movement towards a 50.1 per cent threshold in the covenant-lite context has also been observed.

Issuing a bond requires a considerable investment of time by the company to prepare a thorough disclosure document and to provide the underwriters and legal advisers with the documentation and information they need to carry out their due diligence exercise. This is particularly true for a first-time issuance, and companies should find that repeat issuances in the market are much faster and less labour-intensive. The due diligence aspect stems from the fact that both issuer and underwriter will be exposed to potential securities law liability for the offer and sale of bonds, unlike for bank debt. Issuing a bond will also bring with it public (or semi-public) reporting requirements, compared with the non-public transmission of information in a bank loan.

Regulation

2 | Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

High-yield bonds are not typically listed on a regulated market in France and are only privately placed with institutional investors, so there has been no recent French regulation that has affected them in particular.

Rules regarding bank loans have not changed much recently, although banking monopoly rules are being relaxed, which will, in particular, allow certain alternative lenders (mainly French funds) to enter the market.

However, stricter rules on the deductibility of interest have affected the attractiveness of leveraged structures in certain circumstances and have affected the structuring of the security packages (see question 28).

Current market activity

3 | Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

France has seen issuers from a wide range of industries coming to the high-yield market as a way to achieve covenant flexibility or to diversify their funding sources. Sponsor transactions are common, but so are companies that are majority-owned by families or individuals. Issuance activity has been relatively busy in recent years, with both new and repeat issuers coming to market, although political uncertainty has generated some volatility.

This period has also seen a number of high-yield issuers carrying out initial public offerings (IPOs), typically using the proceeds to reduce debt. Although high-yield bonds are sometimes seen as more onerous than bank debt because of the reporting and disclosure requirements, these can actually be good preparation for the IPO process and the level of communication that is expected of public companies.

Main participants

4 | Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants in France are the same as in other European markets. Entities such as Citibank, Deutsche Bank, The Bank of New York Mellon and Wilmington Trust that have a track record of acting as New York law trustees act frequently on high-yield transactions as trustees, paying agents and collateral agents. The usual big rating

agencies are also active in the French market, and the ratings process is an important workstream for the issuer, on which the underwriters or financial advisers will provide critical assistance. European and US investment banks that are active in the high-yield market elsewhere in Europe are also present in France. The large French banks are particularly visible given their historical relationships with many issuers.

New trends

5 Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Portability has become a common feature of high-yield bond terms in cases where a sponsor has communicated to bondholders that it is seeking to sell the asset. If this flexibility is provided, it removes the issuer's requirement to carry out a change of control offer at 101 per cent if, at the time of the change of control, the group's leverage is below an agreed level.

An important feature in French transactions continues to be the analysis of what guarantees and security can be provided in respect of the bonds. If French subsidiaries are not receiving the proceeds of the bond offering, through a debt pushdown or otherwise, then corporate benefit concerns can make it very difficult to get upstream guarantee coverage. Where these guarantees are possible, they will be limited to the amount allowed by corporate benefit considerations, which constrains their practical usefulness as credit support (see question 19).

Similarly, there continues to be discussion as to whether the costs of putting in place a double Luxco structure justify the perceived benefits in terms of creditor protection. The presence of two Luxembourg companies above a French company is intended to allow creditors to enforce their pledges granted by the top Luxembourg company over the shares of the lower Luxembourg company and thereby gain the power to control the board of directors of the French company.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

High-yield bonds are generally issued under a New York law indenture and cleared through Euroclear and Clearstream although, in some cases, they may clear through the Depository Trust Company in the US.

Issuers and banks will typically look to recent transactions with similar characteristics (industry, geography, sponsor, size) and seek to agree which of these deals will be the most relevant reference points for the working group and the investor base. Bank feedback about investor reactions to those precedent transactions can then help the working group to adapt the structure and terms of the new transaction to address the needs of the issuer and the market.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

Maturities are typically between five and 10 years, with the non-call period generally lasting two to five years depending on the maturity, although the non-call period can be shorter for floating rate notes and, more rarely, for fixed-rate notes. During the non-call period, the issuer will nevertheless have the option to redeem the bonds by paying a make-whole premium. It is also common to have an option to redeem 35 per cent or 40 per cent of a series of bonds with the proceeds of equity offerings, and in some transactions, the issuer may redeem up to 10 per cent of the bonds at a price of 103 per cent at any time.

Issuers seek to avoid issuing bonds with original issue discount beyond what is considered de minimis for US tax purposes so as not to dissuade US investors.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The launch, pricing and closing process is not substantively different in France from that in other European countries. Following the launch there is a management roadshow in the major European financial capitals and, if there is a Rule 144A placement, in the US too. During the course of the roadshow, indications of investor interest will allow the banks to determine a coupon range, which is then further tested with investors to come up with a firmer range and, finally, the exact pricing proposal that will be agreed with the issuer.

Fixed-rate bonds are more common than floating rate bonds.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

In a typical high-yield bond transaction, there will be covenants limiting the following:

- incurring indebtedness and issuing preferred stock;
- making restricted payments (dividends, repurchases of equity or subordinated debt, minority investments);
- carrying out asset sales;
- incurring liens;
- entering into transactions with affiliates;
- agreeing restrictions on the payment of dividends by subsidiaries; and
- issuing guarantees.

Other covenants relating to security interests will apply to secured bonds, while bonds using an issuing vehicle or a double Luxco structure will have covenants intended to preserve the structure. There will also be an obligation to report to bondholders annually, quarterly and on the occurrence of material events.

There has been some convergence between high-yield and bank covenants in the bank markets particularly, as companies increasingly consider term loan B facilities containing incurrence covenants that are similar to those in bonds, with the addition of one or two maintenance covenants. These facilities provide the operational flexibility of bond covenants with the repayment flexibility of bank debt. In France, the terms of these loans are usually highly tailored to the situation of the particular issuer, unlike in the US where terms are more standardised in an effort to ensure wide syndication.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

Covenants have not been changing significantly, but the gradual long-term trend towards greater issuer flexibility continues, particularly

in sponsor transactions. For example, the ability to make restricted payments subject to a leverage test has become more common. In addition, there has been growing flexibility in some early redemption elements, with shorter non-call periods and options to redeem 10 per cent of a series at 103 per cent. This is of course a sensitive point for investors, who find that the scope for capital appreciation on the bonds is limited. In addition, portability has become a more frequent feature in bonds, even where a sale of the business is not expressed to be an element of the short-term strategy. It is relatively rare for the terms of covenants to change between the launch and pricing of an offering.

11 | Are there particular covenants that are looser or tighter, based on a particular industry sector?

The covenant package will be driven more by the rating, size, category (sponsor versus corporate) and business model of an issuer than by the industry. Participants in the same industry may have different approaches to owning or leasing assets, for example, and the covenants will need to provide for the chosen model.

Change of control

12 | Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Changes of control trigger the obligation to make a repurchase offer to all bondholders at a price of 101 per cent of the bonds' principal amount plus accrued interest. However, these provisions are sometimes subject to portability provisions that allow for the obligation to be avoided for a given time if a leverage ratio is respected.

Asset sales with proceeds above a given threshold that are not used for specified purposes set out in the covenant (typically, to reinvest in the business) must be used to make a repurchase offer to all bondholders at par plus accrued interest.

13 | Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

No, this is something that is typically seen only in crossover credits that have an investment grade-style covenant package.

Crossover covenants

14 | Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Companies that are just below investment grade are in some cases able to issue on investment grade terms, using French law and avoiding any restrictive covenants (other than the customary Eurobond-style negative pledge and change of control provisions).

REGULATION

Disclosure requirements

15 | Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

The French securities market regulator is not involved in reviewing high-yield offering documents because high-yield bonds are not customarily listed on a French-regulated securities market. Instead, the bonds are most often listed on the Euro MTF market of the Luxembourg Stock Exchange or on the Irish Stock Exchange. Consequently, the main drivers of disclosure are the expectations of high-yield investors and the US Securities and Exchange Commission disclosure regime, which is applied by analogy in Rule 144A offerings and many Regulation S offerings.

Disclosure standards have not changed significantly in recent times, although in response to the Association for Financial Markets in Europe recommendations, there is a tendency to provide greater detail about other indebtedness in the issuer group and to describe very extensively the intercreditor arrangements.

Use of proceeds

16 | Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

The issuer will usually have agreed with the underwriters in the purchase agreement that it will use the proceeds in the manner described in the offering document (and the issuer could also face securities law liability if it does not). The purchase agreement will also contain representations from the issuer not to use the proceeds in a way that would violate any relevant sanctions or cause others to violate them.

Restrictions on investment

17 | On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Because the bonds are privately placed in France and elsewhere exclusively with qualified investors, other investors will generally be ineligible to purchase them during the initial distribution.

Closing mechanics

18 | Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

No.

GUARANTEES AND SECURITY

Guarantees

19 | Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

Security and guarantees granted by French companies will be affected by financial assistance and corporate benefit limitations. Most forms of French company will be unable to give security and guarantees to support debt that has served to finance the acquisition of its shares or the shares of its holding company. In addition, limitations as to corporate benefit mean that a guarantee will generally need to be limited to the amount of the high-yield proceeds actually on-lent to a French member of the issuer's group.

The 2019 Finance Act provides that the tax-deductibility of the interest due to the bondholders no longer depends on the guarantees granted for the debt of the issuer by other members of the group, which was previously a concern due to the thin capitalisation rules (see question 28).

Collateral package

20 | What is the typical collateral package for high-yield debt securities in your jurisdiction?

We would generally expect security to be granted over shares, intercompany debt (including the proceeds loans) and bank accounts.

Depending on the type of business, security may also be granted over material intellectual property or business undertakings.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

As discussed above, the general limitations as to the ability to grant guarantees may dramatically reduce the scope of the security package that may be taken in practice. In addition, there are certain types of security that may not be taken in a high-yield context as they may only be granted for the benefit of credit institutions. This would be the case, for example, of receivables security in the form of an assignment (Dailly assignment).

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

The structure for holding the security will depend on the different classes of debt included in the structure. Generally, security for high yield will need to be granted to a security agent holding the security under a parallel debt structure. It is common to have financings in which bank and high-yield debt share a security package. In this context, an intercreditor agreement would be implemented under the terms of which a common security agent would manage enforcement of security. This intercreditor agreement would also manage ranking in relation to the security proceeds and also the ability to release debt claims in the context of an enforcement sale with corresponding value protection provisions.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

We would expect legal fees to be covered by the issuer.

Security interests

24 How are security interests recorded? Is there a public register?

There is no general public security register. Certain types of security (notably the business undertaking pledge) would need to be registered at the commercial registry of the place of business or, in the case of intellectual property, where there are specific registries in relation to that type of asset; but these are specific exceptions rather than a general requirement to publicly file all security.

25 How are security interests typically enforced in the high-yield context?

This will of course depend on the type of asset in question. The enforcement of share security, for example, would most likely be carried out by foreclosure. However, the ability to enforce does need to be considered in the context of the French pre-insolvency protection regimes, which may well prevent or limit the ability to enforce.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 How does high-yield debt rank in relation to other creditor interests?

Traditionally, bondholders in France have been subordinated to bank lenders structurally, contractually and by being unsecured or secured on a second-ranking basis. However, the rise of secured bonds as an alternative to bank lending has led to more transactions where bondholders rank pari passu with banks.

This can take the form of bondholders sitting side by side with term loans or where a company's long-term debt is entirely made up of bonds and its working capital needs are met through a super senior revolving credit facility (RCF).

Regulation of voting and control

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

When it comes to voting, the trend continues towards equal voting power for banks and bondholders in pari bond structures. In bond or super senior RCF structures, the bondholders will drive the process subject to certain triggers that allow the RCF lenders to step in.

TAX CONSIDERATIONS

Offsetting of interest payments

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

As a general rule, interest paid or accrued on a loan agreement entered into by a French company or on high-yield bonds issued by a French company is deductible from that company's taxable income in the same fiscal year, provided that the debt is incurred for bona fide business purposes and the interest rate is set at arm's length. Nevertheless, over the past 10 years, a number of anti-avoidance rules have been introduced in French tax legislation that curb tax deductions for interest. While those rules do not specifically target high-yield bond issues, they are drafted in such a manner that high-yield bonds will generally fall within their scope.

Article 34 of the 2019 Finance Act, which was enacted in December 2018, substantially modified the French limitation of interest deduction rules, in particular as regards the following:

- The 30 per cent EBITDA test deriving from Council Directive (EU) 2016/1164 of 12 July 2016 (ATAD), or a €3 million test if higher, was introduced into the tax code (described below). As a result, the rule known as the *rabot* (general 25 per cent non-deduction of net financial charges above €3 million) was repealed from French law.
- A new thin capitalisation mechanism (described below), which is more stringent than the previous rules, was also introduced. As a result, the former thin capitalisation tests for a related-party loan were repealed (including rules relating to financings, such as high-yield bonds, where a related party grant of a guarantee or security was treated as related-party indebtedness under the former thin capitalisation rules).
- These new rules relating to the deductibility of financial charges are applicable as from 1 January 2019, without any grandfathering.

Other anti-avoidance rules may be applicable too.

ATAD implementation (general 30 per cent tax EBITDA limitation)

As a matter of principle and subject to the specific rules applying in the case of thin capitalisation (described below), under the new regime introduced under article 212-bis of the French Tax Code, applicable to financial years starting as from 1 January 2019, the net financial charges of companies subject to corporation tax are only deductible up to the greater of (i) 30 per cent of the company's tax EBITDA or (ii) an amount of €3 million per financial year (standard deduction capacity).

Net financial charges that are not tax deductible during a given financial year pursuant to the above rules can be carried forward and deducted from the taxable results of the following financial years within the same limits, without any allowance or time limitation (excess net financial expenses).

Furthermore, in the event that the tax-deductible net financial charges for a given financial year would not exceed the standard deduction capacity, the excess capacity could be carried forward during the next five financial years to allow the deduction of net financial charges, which would otherwise not have been tax deductible following the application of the standard deduction capacity of a given year (excess standard deduction capacity). The excess standard deduction capacity cannot, however, be used to deduct the excess net financial expenses.

New thin capitalisation rules

Article 212-bis of the French Tax Code may limit the deductibility of interest paid on loans granted by a related party within the meaning of article 39.12 of the French Tax Code. If the average amount of any financing granted by related parties, directly or indirectly, exceeds one and a half times the taxpayer's net equity during a financial year, the company is regarded as thinly capitalised and net financial charges are deductible as follows:

- the net financial charges borne by the company and corresponding to (i) financings granted by unrelated parties and (ii) financings granted by related parties up to one and a half times the company's net equity are only deductible up to the higher of:
  - 30 per cent of the taxpayer's tax EBITDA multiplied by a fraction equal to (i) the average amount of any financing granted by non-related parties and one and a half times the taxpayer's net equity, divided by (ii) the average amount of all financings granted to the taxpayer during such financial year; or
  - an amount of €3 million per financial year multiplied by the same fraction; and
- the net financial charges borne by the relevant taxpayer and corresponding to financing granted by related parties exceeding one and a half times the company net equity are only deductible up to the higher of:
  - 10 per cent of the taxpayer's tax EBITDA multiplied by a fraction equal to (i) the average amount of any financing granted by related parties exceeding one and a half times the taxpayer's net equity, divided by (ii) the average amount of all financings granted to the taxpayer during such financial year; or
  - an amount of €1 million per financial year multiplied by the same fraction.

Specific rules apply to companies that are members of a French tax consolidated group, and additional deduction capacity may be available for companies that are members of a consolidated group for accounting purposes (safeguard rule).

Tax rulings

29 | Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No.

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

Over the last decade, European jurisdictions have witnessed a gradual but stable convergence between the terms governing bank loans and high-yield debt securities. However, this does not appear to be the case in Greece, as maintenance financial covenants are still embedded within bank loans provided by financial institutions to corporate borrowers. Nevertheless, regardless of the extent of convergence between the terms governing bank loans and high-yield corporate bonds, there are discrepancies that mainly touch upon the nature of the covenant package in each case, the drawdown provisions, the repayment terms and the amendment mechanics of the relevant instrument, as well as the resulting reporting obligations and events of default. Further, bank loans benefit from certain exemptions regarding stamp duty and collateral registration fees that, until early 2019, were not applicable to corporate bonds listed on non-Greek exchanges, thus rendering the issuance of high-yield bonds less attractive and more costly for Greek corporates. In recent years, certain Greek corporates opted for issuing corporate bonds listed on the Athens Stock Exchange (ASE) and mainly subscribed by Greek retail investors. These corporate bonds fell within the scope of exemptions of the Greek Bond Loan Law (as defined below), but the significant disclosure requirements and the lack of flexibility in obtaining the required waivers in the absence of the requisite quorum rendered these issuances less attractive for Greek corporates.

Bank lending to medium and large Greek corporates mainly took the form of bond loans issued under the provisions of Law 3156/2003 (the Greek Bond Loan Law). As of 1 January 2019, a new law regulating bond loans came into force. This law will govern the issuance of bond loans by Greek corporate entities after that date (see below). Greek banks have pushed for a comprehensive set of representations and warranties (usually to be in place on each interest payment date), extensive covenants and events of default. In particular, whereas high-yield bonds are mainly incurrence-based (ie, tested at the time of a transaction only), loan covenants tend to be maintenance-based (ie, they must be met during the lifetime of the loan). In the same vein, high-yield bond covenants provide greater flexibility to the issuer. Since they include a series of baskets with growers that evolve along with the growth of the issuer's business providing additional flexibility to the issuer, it is much more burdensome to obtain the requisite waiver or waivers in order to amend the covenant package, as opposed to the amendment of a loan facility agreement, which can often be easily effected with a group of relationship banks across the table.

In relation to prepayment mechanics, it should be noted that prepayment in the framework of bank loans usually comes without any penalty, as opposed to fixed rate high-yield debt securities. The non-call periods for high-yield bonds effectively mean that the issuer can only redeem the notes by paying an expensive non-call premium or by using the proceeds of certain equity offerings in order to fund this redemption to a certain amounts.

The reporting obligations that require the issuer to comply with specific public reporting requirements on a regular basis are not present solely in high-yield bond transactions. However, while loan reporting covenants are increasingly converging, the degree of public disclosure on the borrower group that characterises the bond market, including the publication of an annual report, is not required due to the private nature of the credit agreements.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

Prior to the entry into force of the New Company Law (as defined below), high-yield bonds issued by Greek companies were largely structured as follows: a finance entity of the group, established outside of Greece, would be the issuer of the notes, and the main operating company, which in most cases is incorporated in Greece and is often publicly listed, would act as a guarantor together with any material subsidiaries. The issuer would subsequently on-lend the proceeds of the issuance to the operating entities through a proceeds loan that would take the form of a bond loan, issued pursuant to the provisions of the Greek Bond Loan Law, in case these proceeds were intended to be used by a Greek entity within the group.

Since 2003, a particular type of lending under the provisions of the Greek Bond Loan Law has been the main method of issuing debt for Greek corporates, provided certain criteria are met. From a regulatory perspective, the most notable recent development in Greek bond loans has been the adoption of Law 4548/2018, which replaced the provisions of the Greek Bond Loan Law regarding bond loans issued by Greek issuers from 1 January 2019 onward (the New Company Law). Any bond loans issued pursuant to the Greek Bond Loan Law and the New Company Law are exempt from taxes, including stamp duty, the bank levy payable on bank loans not issued as bond loans, as well as notarial and registration fees regarding the collateral provided. If the proceeds loan described above would not meet the Greek Bond Loan Law criteria or if it does not meet the New Company Law criteria or, in general, if the Greek Independent Authority of Public Revenue (IAPR) would invoke against the financing structure that has been put in place anti-avoidance provisions that entered into force as of 1 January 2014, then a tax audit may find that stamp duty in the amount of 2.4 per cent (or 3.6 per cent in case real estate collateral is provided) of the principal amount of the proceeds loan is due. This finding could lead to a criminal investigation against the management of the Greek entity.

Current market activity

3 | Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

The Greek GDP, in constant prices, recorded an average annual decline of 0.3 per cent in both 2015 and in 2016, mainly due to uncertainty, significant external liquidity shortages and the need to implement additional fiscal adjustment measures, further to the implementation of the three-year ESM financial assistance programme (Third Economic Adjustment Programme), which paved the way for additional financial assistance to Greece and provided for a series of reformative measures.

Nevertheless, after a prolonged recession (from 2008 to 2017), the economic and business environment in Greece has gradually improved, culminating in Greece's successful completion and exit from the Third Economic Adjustment Programme in August 2018. The Greek GDP recorded an average annual growth of 1.4 per cent in 2017, while the projected GDP growth for 2018 amounts to 2.1 per cent. Despite the recent positive macroeconomic developments, economic activity continues to remain subject to downside risks in view of the gradual improvement in household disposable income, tight liquidity conditions and the need to adhere to prescribed target budget surpluses.

Against this background, the systemic banks in Greece, the 'traditional' sources of corporate lending, gradually became subject to more stringent regulation in terms of their capital adequacy requirements and the management of their non-performing loans (NPLs), which, in turn, led to a restriction in their ability to lend large amounts of money (even in syndication) to corporates, irrespective of their size. As a result, between 2013 and 2017 most businesses in Greece found it difficult to raise sufficient capital to refinance their payment obligations, finance their working capital needs or even implement their business plans, unless they obtained access to the international debt capital markets through the issuance of high-yield bonds, EMTN programmes etc. A decline in the corporate high-yield debt activity was observed in 2015, when the macroeconomic conditions in Greece deteriorated to a significant extent and Greek corporates faced significant difficulty in attracting investor demand for their debt securities on an international level. More issuers managed to successfully raise funds through the international debt capital markets in 2016 and 2017, with major listed companies obtaining access to a large and liquid pool of investors. Nevertheless, the high-yield debt activity for corporates in the past three years did not reach the level of issuances or attempted issuances that took place in 2014.

While Greek issuers are often mature, publicly listed companies with exposure to international markets, it appears that in 2018 the Greek companies returned to their slightly preferred form of capital raising (ie, local bank financing), given that this type of financing has become cheaper in the current market conditions and that the disclosure requirements entailed are much less onerous than the ones they will have to become subject to, should they decide to become part of the international capital markets universe.

Main participants

4 | Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants in Greece are the same as in other European markets. Entities that have a track record of acting as New York law trustees act frequently on high-yield debt offerings as trustees, paying agents and transfer agents. The usual big rating agencies are also active in the Greek market and the ratings process is a key workstream for the issuer. Both European and US investment banks that are active in the European high-yield market are also active in the Greek market. The four Greek systemic banks (ie, Alpha Bank SA, Eurobank Ergasias SA, National Bank of Greece SA, and Piraeus Bank SA) are almost always part of the underwriting syndicate acting as joint bookrunners and initial purchasers.

New trends

5 | Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Owing to the credit rating that Greek issuers or guarantors achieve (effectively limited by the sovereign rating of Greece), loose bond covenants are not generally suitable for high-yield bond transactions, which are characterised by a Greek element. During the peak of the Greek economic crisis, one of the key trends in terms of structuring a high-yield debt transaction involving a Greek corporate would be to ring-fence foreign assets of the group (ie, group companies located in other jurisdictions in which the group had substantial business operations outside of Greece). This ring-fencing is no longer market practice.

Despite relatively tight covenant packages, the majority of high-yield debt issuances involving Greek companies are currently structured as unsecured deals because of tax, stamp duty and registration fees considerations. For instance, security granted in the context of high-yield securities as well as Greek bond loans (see above) attracts a stamp duty of at least 2.4 per cent, which increases to 3.6 per cent if real estate collateral is provided. The notarial and registration fees for mortgages are approximately 2 per cent. It remains to be seen whether the changes adopted under the New Company Law will allow the issuance of high-yield bonds directly by Greek issuers, in which case security would be granted without significant costs, save for concerns in relation to the imposition of withholding tax on interest payments.

DOCUMENTATION TERMS

Issuance

6 | How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

High-yield debt securities offered by finance affiliates of Greek corporates are issued under a New York-law-governed indenture and are generally issued in euros and cleared via Euroclear and Clearstream clearing and settlement systems. Prior to issuing the securities, the issuer (together with its legal and financial advisers) will take into consideration recent transactions that present similar characteristics to the one in question (most notably, the geography, industry sector and size of the offering). Upon consultation, these parties agree to the precedents that will be used as reference points throughout the transaction, including with respect to disclosure as well as covenant package. The particular characteristics of the specific offering are then taken into consideration and bespoke terms will apply (usually to a large extent) on that offering, as necessary.

Maturity and call structure

7 | What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

The typical maturity ranges from between five and 10 years, with the non-call period for fixed rate instruments ranging from two to five years (depending on the maturity of the instrument). The non-call period can be shorter for floating rate notes and, more rarely, for fixed rate notes.

The issuer can redeem the notes during the non-call period. However, this redemption is accompanied by the payment of a costly make-whole premium. Typically, the issuer also has the option to redeem 35 per cent or 40 per cent of a series of bond with the proceeds of equity offerings. It is not common for high-yield bonds issued by Greek companies to include the option to redeem 10 per cent of the notes during the non-call period at 103 per cent, as well as to provide for tender offer drag along rights.

Generally, issuers avoid issuing high-yield bonds with original issue discount beyond what is considered de minimis for US tax purposes so as not to dissuade US investors, which is particularly relevant with respect to additional offerings under an existing indenture.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The launch, pricing and settlement process do not differ from the corresponding processes in other European countries. Following or concurrently with launch, there is a management roadshow presentation in the major European financial capitals and depending on the marketing strategy of the initial purchasers in consultation with the issuer, there could be roadshow presentations held in the US as well. Upon completion of the roadshow, the banks evaluate investors' evaluations and feedback and determine the coupon range, which is then further tested with investors to come up with a firmer range and, finally, the exact pricing proposal that will be agreed with the issuer.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

The following covenants comprise the customary high-yield bond covenant package:

- limitations on indebtedness and issuance of preferred stock (the debt covenant);
- restricted payments (eg, dividends, repurchases of equity or subordinated debt, minority investments);
- asset sales;
- transactions with affiliates;
- agreeing restrictions on the payment of dividends by subsidiaries; and
- issuing guarantees.

There will also be an obligation to report to bondholders annually, quarterly and on the occurrence of material events. As the notes will be listed on an EU exchange, the Market Abuse Regulation would also apply.

Although the above covenant package is customarily included in bank loans, there has not been any significant convergence between high-yield covenants and covenants in facilities provided by Greek and international credit institutions, as companies still consider bank loans containing maintenance covenants for the most part, as opposed to incurrence covenants, which are common in bonds. The covenant package included in bond loans listed on the ASE, recently issued by Greek corporates and distributed to Greek retail investors, is more similar to the covenant package included in loan facilities than to the covenant package found in high-yield bonds.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

Over the past few years, there has been a gradual long-term trend towards greater issuer flexibility. In particular, in 2018, a general covenant erosion was observed in the European market, mainly driven by big sponsor transactions. For instance, the ability to make restricted payments subject to a leverage ratio test has become more common. In addition, in some sponsor-driven high-yield issuances, we noticed the deletion of the requirement to comply with a financial test to access the restricted payments build-up basket, as well as the ability to classify and reclassify restricted payments enabling issuers to free up capacity in the build-up basket to make distributions, but also allowing them to game the covenants to their advantage (ie, in anticipation of a potential subsequent deterioration in profitability). Moreover, we are regularly seeing uncapped pro forma adjustments to EBITDA for cost savings and synergies that, in conjunction with the proliferation of baskets with a grower element where EBITDA is the primary constituent, are allowing for additional leakage of value. These can prove to be sensitive points for investors. Nevertheless, it appears that the Greek high-yield bond issuances have not incorporated all recent permutations or high-yield technology that characterise these transactions in the rest of Europe.

Regarding the changes in terms of covenants between launch and pricing, very often the banks proceed to pre-sounding and pre-marketing procedures, therefore reducing the occasions on which the terms of the covenants will change between launch or pricing.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

As a matter of principle, the covenant package is mainly driven by the size of the offering, the rating of both the corporate entity and the instrument to be issued and the business model of the issuer as opposed to the industry sector in which the issuer is active. The European market has developed a line of precedents in the real estate sector that include maintenance covenants, but are otherwise covenant-lite, often governed by English law and distributed outside the US only.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Changes of control trigger the obligation to make a repurchase offer to all bondholders at a price of 101 per cent of the bonds' principal amount plus accrued interest. Nevertheless, the presence of portability provisions allows for the avoidance of this obligation under certain conditions. For instance, this obligation can be avoided in the absence of a rating event or if a leverage ratio is met. That said, the inclusion of this portability provision is not as common in high-yield debt deals with a Greek element as it is in other European high-yield debt issuances.

Asset sales the proceeds of which exceed a prescribed threshold that are not used for specified purposes set out in the corresponding covenant (primarily, to reinvest in the business) must be used to make a repurchase offer to all bondholders at par plus accrued interest.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

The scarcity of the portability feature in Greek high-yield debt issuances is evidenced by the fact that, over the recent years, there has only been one Greek high-yield debt issuance with a change of control put (the €250 million 2.375 per cent guaranteed notes due 2024, issued by Titan

Global Finance PLC), which requires a rating event to trigger the bondholders' right to put the notes back to the issuer.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

The concept of a 'crossover' covenant package is not common in Greece due to the unfavourable credit rating for the vast majority of Greek corporates.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

The Greek securities market regulator, the Hellenic Capital Markets Commission (HCMC) is not involved in reviewing high-yield offering documents because high-yield bonds issued pursuant to Rule 144A/Regulation S are usually not listed on a Greek-regulated securities market. Instead, the bond are most often listed on the Euro MTF market of the Luxembourg Stock Exchange or on the Euronext Dublin (formerly known as the Irish Stock Exchange). Therefore, the disclosure is based on the expectations of high-yield investors and the SEC disclosure regime, which is applied by analogy on Rule 144A/Regulation S debt offerings.

Disclosure standards have not changed significantly recently, but there is a tendency to provide more detail in connection with the issuer group's other indebtedness and the intercreditor agreement (to the extent there is one), further to the Association for Financial Markets in Europe's recommendations.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

The use of proceeds is described throughout the offering memorandum. As a matter of principle, the issuer will have agreed with the underwriters in the purchase agreement that it will use the proceeds from the offering in the manner described in the offering memorandum. The purchase agreement will further include representations from the issuer that they shall not use the funds in a way that would violate any relevant sanctions or cause others to violate them. The issuer could be subject to securities laws liability if they do not use the proceeds in the way described in the offering memorandum.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Given that the bonds are privately placed exclusively with qualified investors, other investors will generally be ineligible to purchase them during the initial distribution. Unless a key information document (KID) is prepared, retail investors (as defined under MiFID II) will be precluded from investing in high-yield securities under MiFID II.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

There are no particular closing mechanics as such. Documentation will be executed outside of Greece even on behalf of the Greek guarantor or guarantors for stamp duty reasons.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

The New Company Law allows the granting of upstream corporate guarantees or other securities, and generally guarantees granted to related parties subject to certain conditions. These guarantees and other securities can be granted upon a specific approval by the board of directors, which must be made public. Within 10 days of publication, shareholders representing at least 1/20 of the share capital may cause the company to subject the granting of guarantee or security to the approval of the shareholders. The process described above does not apply to guarantees or collateral provided in favour of wholly-owned subsidiaries or subsidiaries where no related party of the parent has a shareholding. In the case of affiliates that are both wholly-owned subsidiaries of the same parent, approval by the board of directors accompanied by a written statement of the 100 per cent parent that it approves the provision of this guarantee or security will suffice. The above restrictions apply only when the issuer is a Greek entity.

The New Company Law also prohibits the granting of a guarantee or security that falls within the provisions regarding financial assistance without the observance of specific requirements of the law.

Greek law provides for a number of defences to a contracting party, including, indicatively, defences related to the validity of the transaction if that transaction is found to be in contradiction with the company's corporate interest or commercial benefit, or if that contract is found to be the product of mistake, fraudulent or negligent misrepresentation or duress and undue influence.

In the case of notes issued by a foreign entity, stamp duty on the guarantee granted by the guarantor may be payable in Greece upon the performance of any rights under the guarantee in Greece, or upon enforcement in Greece of a judgment obtained in any jurisdiction outside or within Greece or upon payment in Greece by the guarantor of its obligations under the guarantee, either voluntarily or pursuant to a judgment obtained in any jurisdiction outside or within (in which case any owed stamp duty amounts that have not been paid upon execution of the guarantee documents shall be subject to surcharges and penalties).

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

The vast majority of high-yield debt offerings by affiliates of operating Greek corporates are structured as unsecured deals owing to stamp duty and registration fees considerations.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

Regarding general limitations, see questions 19 and 20. Further, security cannot be provided for certain types of assets, such as administrative licences and relevant rights, or for rights that are personal in nature and cannot be transferred, or for contractual claims whereby the underlying contract prohibits the transfer.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

Secured high-yield debt issuances usually benefit from collateral in the form of share pledges over the shares in the operating group entities (for non-listed entities), as well as liens over bank accounts, insurance claims and claims from intra-group receivables. Because of the stamp duty and registration costs considerations, security over assets of the group located in Greece, such as mortgages, mortgage prenotations, floating charges over business receivables or other eligible claims, non-possessory pledges over equipment, is not usually provided. Such security is typically provided in bank loans and corporate bonds that benefit from the exemptions of the Greek Bond Loan Law or the New Company Law. In the case of direct issuance of high-yield debt by Greek corporates, which is now possible under the New Company Law, these types of security may become available for such deals. In the case of Greek corporates with more complex debt structure, whereby both high-yield and bank loans have been issued, crossing lien and collateral proceeds' sharing arrangements may be put in place, depending on the overall indebtedness, group structure and associated costs.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

We would expect legal fees to be covered by the issuer.

Security interests

24 How are security interests recorded? Is there a public register?

Certain registration formalities exist for the perfection of the real estate collateral, as well as in relation to collateral in the form of floating charge and non-possessory pledge. Unless a bond loan structure under the Greek Bond Loan Law or the New Company Law is in place, the cost of these registrations is significant. That said, perfection requirements exist for other types of collateral, such as the annotation of share certificates and the registration of the share pledge in the shareholders' book, or service by court bailiff of the pledge agreement to the counterparty of the underlying pledged claim, but these are usually not onerous to observe.

25 How are security interests typically enforced in the high-yield context?

To the extent that security over Greek assets has been provided, enforcement typically requires an auction of the secured asset. This is the case for share pledges, floating charges, non-possessory pledges and mortgages. If, and to the extent applicable, this security is governed by the Greek financial collateral law, which transposed the financial collateral directive, enforcement on the underlying assets could be effected through appropriation, free disposal to third parties or collection, as the case may be. This is the case with listed shares and other securities, bank accounts as well as claims that fall within the provision of the financial collateral law. Banks benefit from specific Greek law provisions that render enforcement easier, such as the quick issuance of an enforceable title.

Under the Greek Code of Civil Procedure, any interested person may apply for an injunction or interim measures in case of emergency or in order to prevent immediate or imminent danger, which, if successful, may lead to suspension of the enforcement procedure, or even to the provisional settlement of the situation under dispute.

In addition, secured creditors' claims have priority over assets securing their indebtedness over the claims of other unsecured creditors. However, under Greek law, certain other classes of creditors such as, indicatively, the state or employees or social security organisations, hold a general privilege in relation to specific claims that are ranked either prior to or in parallel with secured creditors. As the relevant provisions changed recently, the ranking of claims having a general privilege versus secured claims depends on the time of taking the security.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 How does high-yield debt rank in relation to other creditor interests?

Traditionally, bondholders in Greece have been subordinated to bank lenders both structurally, as the issuer is either a finance subsidiary or a foreign parent holding company, and effectively, as the notes are largely unsecured.

Regulation of voting and control

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

Owing to the structure of Greek high-yield issuances as unsecured deals (for the reasons explained above), intercreditor agreements (ICAs) entered into by and among bondholders and bank lenders are not that common. However, to the extent that ICAs are part of the deal structure and documentation, they generally follow the same form as the ICAs that govern the issuance of senior notes with senior subordinated guarantees across Europe (especially with respect to key aspects, such as blockage period, turnover, standstill, etc).

TAX CONSIDERATIONS

Offsetting of interest payments

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Payments of interest under the notes by the issuer

Individual holders

Payments of interest under the notes by the issuer to individual (non-corporate) holders of the notes who are Greek tax residents are subject to income tax at a flat rate of 15 per cent. If payment of interest is effected through a Greek paying agent, the entire income tax of 15 per cent will be withheld. Interest from notes will be subject to

a further tax called a solidarity contribution. The rate of the solidarity contribution rises progressively from 2.2 per cent to 10 per cent and is calculated with reference to both taxable and tax-exempt annual income exceeding €12,000.

Corporate holders

Payments of interest under the notes by the issuer to corporate holders (ie, legal entities) of the notes that are Greek tax residents (or to Greek permanent establishments of non-Greek legal entities) will be included in the calculation of their annual corporate income. The corporate income tax rate is set at 28 per cent for income generated in 2019 and shall be progressively reduced to 27 per cent for income generated in 2020, 26 per cent for income generated in 2021 and 25 per cent for income generated in 2022. If payment is effected through a Greek paying agent then a withholding of 15 per cent applies, which will be treated as an advance payment over income tax for that financial year.

Non-Greek tax residents would not be subject to income tax in Greece for payment of interest under the notes as there would be no income generated in Greece.

Payments of interest under the guarantee

Individual holders – Greek tax residents

Payments of interest under the notes by the guarantor to individual (non-corporate) holders of the notes who are Greek tax residents are subject to income tax at a flat rate of 15 per cent. The entire amount of tax will be withheld by the guarantor. Interest from notes will be subject to the solidarity contribution tax.

Individual holders – non-Greek tax residents

Payments of interest by the guarantor to individual (non-corporate) holders of the notes who are non-Greek tax residents are subject to income tax at a flat rate of 15 per cent, withheld by the guarantor, insofar as the imposition of income tax over interest is not reduced or prohibited by an applicable double taxation avoidance treaty. Where this is the case, appropriate documentation to this effect must be filed. Interest will be subject to the solidarity contribution tax. Individuals who are tax resident in a jurisdiction that has entered into a double taxation treaty with Greece are exempted from the solidarity levy, in the event that Greece has no taxing rights under the provisions of the double taxation treaty in respect of the relevant Greek source income.

Corporate holders – Greek tax residents

Payments of interest by the guarantor to corporate holders (ie, legal entities) of the notes that are Greek tax residents or to their permanent establishment in Greece shall be included in the calculations of their annual corporate income. A withholding of 15 per cent will apply to the payment, which will be treated as an advance over income tax for that financial year.

Corporate holders – non-Greek tax residents

Payments of interest by the guarantor to corporate holders (ie, legal entities) of the notes who are non-Greek tax residents are subject to income tax at a flat rate of 15 per cent, withheld by the guarantor, insofar as the imposition of income tax over interest is not reduced or prohibited by an applicable double taxation avoidance treaty. Where this is the case, appropriate documentation to this effect must be filed.

Disposal of notes – capital gains

Individual holders

Capital gains realised by Greek tax residents over corporate bonds issued by EU, EEA and EFTA issuers are exempted from income tax over capital gains, as is the case with Greek corporate bonds, on the basis of the principle of non-discrimination of EU entities (POL 1032/2015 paragraph 2.iii). However, capital gains will be subject to the solidarity contribution tax. In this context, it should be noted that the tax authorities have expressed the view that the difference between the acquisition value of the secondary market and the payment of principal received upon expiry of a corporate bond does not constitute capital gains.

Corporate holders

Capital gains of corporate holders (ie, legal entities) that are Greek tax residents or permanent establishments in Greece over corporate bonds issued by EU, EEA and EFTA issuers are deferred until capitalisation or distribution, as is the case with Greek corporate bonds, on the basis of the principle of non-discrimination of EU entities (POL 1032/2015 paragraph 2.iii, 11). Upon capitalisation or distribution, these will be taxed at the corporate income tax rate.

Non-Greek tax residents would not be subject to income tax in Greece for capital gains from the issuance of the notes, as there would be no income generated in Greece.

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No. However, as mentioned elsewhere hereunder, if the structure of the bond issuance presents certain challenges, it is quite common for Greek corporate clients to seek tax advice from an independent tax advisor or one of the 'big four' audit firms. In those cases, all parties (the issuer, the legal counsel and the tax adviser) will work together in order to make sure that the transaction is structured as appropriate.

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

One of the key differences between high-yield debt securities and bank loans is the regulatory framework applicable to bank loans. Only duly authorised credit institutions and financial companies can carry out credit transactions (including the granting of loans, guarantees and other commitments) on a professional basis (isolated transactions are excluded). On the contrary, the issue of debt securities does not require regulatory authorisation, thus giving greater flexibility for companies to seek a wider range of investors through high-yield debt securities as opposed to bank loans.

Another key difference is typically found in the covenant package: bank loans have financial maintenance covenants, while high-yield bonds have incurrence-based covenants. Typically, financial maintenance covenants are triggered if the borrower does not meet certain leverage ratios (eg, debt-to-earnings before interest, tax, depreciation, and amortisation (EBITDA)) or a certain limit of interest coverage (eg, EBITDA-to-interest expense) or some other coverage metric set forth in the business model. Nonetheless, loan agreements usually establish exceptions for investments, disposals and liens that are in line with the business model. Cash sweep mechanisms that force the borrower to prepay the loan if there is an excess cash flow are also common. In incurrence-based covenants of high-yield bonds, however, a potential breach of the same may only occur whenever the issuer raises new debt, makes an acquisition, pays a dividend, or undertakes some other relevant corporate action (usually it requires an action from the borrower). From the issuer's perspective, incurrence-based covenants, which are usually tailored to the specific case, are preferable as they give more flexibility and, therefore, constitute an advantage compared to bank loans.

Another consequence of having the covenant package established is that the process for obtaining waivers or consents in a bank loan is easier and more flexible. In this regard, the borrower is able to approach a limited number of lenders and agree with them on waivers or consents within a short period, while in the case of high-yield bonds the issuer has to communicate with a wider range of investors, the threshold for amending key economic terms is higher and the process is more costly and time-consuming.

Finally, another relevant difference is the level of disclosure of information, in particular if there is a public placement of the securities or if they are admitted to trading (see question 6).

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

In recent years bank loans have been subject to stricter regulation, in particular regarding interest rates, the payment of interest, fees and other charges as well as the information disclosed to the borrower.

As to high-yield bonds, investment in these securities is not regulated. However, several laws applicable to securities have been toughened in recent years with a view to providing greater protection and information to investors namely by means of an increasing control over the other parties (mainly intermediaries); high-yield bonds are traded on secondary markets or non-regulated markets where information level requirements are lower, thus being less likely for investors to be provided with an adequate level of information for the risk being taken.

From a regulatory perspective, the second Markets in Financial Instruments Directive (2014/65/EU) (MiFID II) has already been implemented into Portuguese national law by means of Law No. 35/2018, of 20 July 2018. MiFID II aimed at ensuring a fairer, safer and more efficient functioning of the capital markets as well as greater transparency for all participants.

In this regard, Law No. 35/2018 followed MiFID II and new reporting requirements and tests have been established that consequently increase the level of information available and contribute to reducing the use of less transparent pools and OTC trading. Moreover, the protection of investors has also been strengthened via the creation of new requirements on product governance as well as independent investment advice, among many others (including the provision of rules on the responsibility of management bodies, inducements, information and reporting to clients, cross-selling, remuneration of staff and best execution). Another important change refers to the terminology used in respect of the categories of investors, as the concept of qualified investors has been replaced by that of professional investors, which should not be disregarded, as the markets have been showing that high-yield bonds are usually sought mostly by institutional investors and big players and not retail investors (the non-professional investors).

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

After a record-breaking year in 2017 for the European high-yield market (including the Portuguese segment), with European high-yield issuances totalling around €114 billion according to *DebtWire*, 2018 fell short in comparison, as the European high-yield issuance volume amounted to approximately €71 billion. This significant drop in the issuance volume owes much to the second half of 2018 in which, after a strong first half (April being the best month, with issuances above €10

billion), fewer deals than expected were completed, to the point that no European high-yield issuances took place in December. Nonetheless, 2018 also marks the year when the market saw €5 billion-worth deals being postponed or pulled out from the market, as volatility disrupted pricing of new high-yield bonds and, in some cases, the issuers simply could not raise the intended financing.

As to the main underlying factors, both trade tensions (such as the one between China and the US) and political risks (in particular those involving Brexit and the populist rise of European anti-establishment forces) have contributed to an increase of risk aversion as well as to a jump in volatility, thus resulting in an investor pushback. The refinancing activity also contributed decisively to this cooling, with a drop from €70 billion in 2017 to €37 billion in 2018 (however, the M&A related European high-yield issuances rose from €10 billion to €18 billion). As to the average yield to maturity on European unsecured notes, it has increased from around 4.3 per cent in 2017 to 5.0 per cent in 2018.

The trends at the beginning of 2019 are not very positive. According to Moody's, European high-yield volumes have recorded their second lowest January since 2012, with a high-yield bond volume of just €2.3 billion (considerably lower than the €5.9 billion registered in January, 2018). In this context, one must not disregard that the European Central Bank (ECB) had announced that the quantitative easing (QE) would end in 2018. As the ECB is to stop purchasing debt under the QE programme (since 2015 the ECB has purchased not only sovereign bonds but also corporate bonds in the investment-grade market), this may result in higher borrowing costs for high-yield issuers as well as in a slowdown in growth in the market. Not surprisingly, the European high-yield market has registered outflows ranging from 7 to 8 per cent during 2017 and 2018 (showing that investors are repositioning their capitals for the end of QE).

As with the distribution of the high-yield debt activity by the different economic sectors, we have seen issuances in the telecommunications, power and energy, security and alarms, and pharmaceutical sectors among others (namely the financial and basic industry sectors).

As to the activity and trends from a technical standpoint, high-yield bonds are commonly regulated by a New York law governed indenture pursuant to which a trustee and a security agent are appointed to represent and defend the interests of the holders of high-yield bonds. However, with the significant increase in European high-yield bond issuances we have seen in recent deals the indenture being ruled by English law and, in some cases, German law.

Other typical documents in high-yield bond transactions are the purchase agreement pursuant to which the purchasers underwrite the notes issued by the issuer; the intercreditor agreement between the bank lenders, the noteholders and the issuer; and the security agreements pursuant to which the several companies of the issuer's group grant security in case of secured deals. Legal opinions and accountants' comfort letters are also a necessary element of these transactions.

In terms of security, and aside from the classic corporate guarantee granted by Portuguese subsidiaries, share security and certain types of *in rem* security (eg, pledges over bank accounts, insurance policies and receivables) are taken without affecting the day-to-day business activity of the company.

High-yield bonds are usually exclusively offered to professional investors rather than to retail investors. As such, they usually do not entail a public placement in Portugal for the purposes of the Securities Code and have a nominal unitary value of at least €100,000. Investors in high-yield debt securities are usually mutual funds (eg, corporate bond funds, high-yield funds and income mutual funds), insurance undertakings and pension funds.

Finally, we have been seeing in the majority of financings a clear overlap between high-yield debt securities and loan financings, although usually the lion share of the financing arises from high-yield bonds.

Main participants

4 | Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants (aside from the issuer, guarantors, legal advisers and auditors) in a high-yield debt financing and their roles are as follows:

- Initial purchasers and underwriters: the role of the initial purchasers is to advise the issuer on the structure and timing of the offering and to coordinate and market the transaction. They have a major role in the discussion of the offering memorandum with the legal teams and accountants. They underwrite the securities from the issuer under the purchase agreement and resell them to investors.
- Security agent: given that neither the trusteeship nor parallel debt are recognised legal concepts under Portuguese law, the security agent has a major role in high-yield bond transactions. It is a party to the intercreditor agreement and the security documents and is responsible for monitoring and enforcing the collateral guaranteeing the notes in an enforcement scenario (as usually guarantees and security are granted in its favour, for its benefit and for the benefit of the secured parties).
- Paying agent: the role of the paying agent is to make payments of principal and interest to the noteholders.
- Rating agencies: ratings are issued by two of the largest four rating agencies (eg, DBRS, Fitch, Moody's and Standard & Poor's).

The fees of the initial purchasers are usually calculated as a percentage agreed on an individual basis of the aggregate principal amount of the notes. The other parties referred to above receive market-standard fees (usually flat fees) in connection with their involvement.

New trends

5 | Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Covenant packages vary considerably depending on the economic and credit cycle. They are more restrictive if there is more risk aversion and interest rates and spreads are higher. If, however, there is less risk aversion and interest rates and spreads are lower, the covenant package is less restrictive.

The first half of 2018 maintained the trend from 2016 and 2017 and therefore covenant packages continued to be very favourable to issuers. By the same token, covenant-lite issuances continued to be adopted, as did soft-cap grower baskets calculated on the higher of a fixed amount or a percentage of assets or EBITDA. In addition, European (including Portuguese) high-yield bonds continue to provide issuers with more flexibility to redeem notes and equity claws are more and more common.

Notwithstanding this, further to the continuation of covenant loosening in the first half of 2018, during the second half of 2018 the market reacted adversely to a handful of covenants due to the tightening of the bond market and an increase in the risk aversion of investors. Several examples illustrate the above-mentioned shift, as is the case of economic terms in respect of which we have seen shortened maturities, the use of floating rate bonds and even the lengthening of the non-call periods. Other examples include changes in restricted payments covenants (the underwriters being more reluctant to employ leverage-based ratios), the inclusion of contribution debt baskets (allowing the incurrence of debt up to 100 per cent of any new equity injection, as opposed to the 200 per cent more easily seen in the US context) and the refusal of portability covenants, very popular in Europe in 2017 (currently, it is more difficult to get investors to accept that a change of control is effected without that triggering put rights).

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Transaction documents are prepared based on recent relevant precedents, including the offering memorandum or prospectus, the purchase agreement and the indenture as well as, if combined with a loan financing, the relevant senior facilities agreement.

Previous issuances by the same issuer will tend to set such a precedent, as will set it issuances by companies in the same industry or sector or with a similar credit risk profile. By the same token, the standard covenant forms of lead banks (and, in sponsored deals, of sponsors) typically also play an important role in negotiating the covenants with the issuer, as both will try to use a covenant package familiar to them.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

Typically, high-yield debt securities have maturities that range from five to 10 years.

In relation to redemption or call rights, it is rare to have mandatory redemption provisions requiring an issuer to prepay the outstanding notes prior to their maturity and it is very common for the issuer to have call rights.

Notwithstanding, there are usually non-call periods and declining premium redemptions. In recent years high-yield bonds have provided issuers with more flexibility to redeem notes, namely with shorter non-call periods and the widespread use of the equity claw redemption, although the first few months of 2019 may indicate that this is a trend that may come to an end shortly. See question 5.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The launching, pricing and closing of high-yield bonds issued by a Portuguese issuer follow the standard process and steps of a typical high-yield offering. The offering is launched by preparing and distributing the preliminary offering memorandum to investors, which is then followed by a roadshow with several investor meetings, which typically lasts from three days to two weeks.

The roadshow ends with the pricing of the offering, which basically consists of executing the purchase agreement. While the company is on the roadshow, the company counsel will be negotiating the purchase agreement with the banks and the purchasers. The most significant aspect of the purchase agreement, besides the pricing of the notes, is the dramatic and temporary change it entails in the relationship between the company and the initial purchasers.

Prior to executing the purchase agreement, the company and the initial purchasers have an informal arrangement to do a deal if there is one to be done. Either party can walk away at any time with no liability being triggered (without prejudice to the general clauses under civil law for breaches due to fraud and bad faith). Once the purchase agreement is signed, the parties are bound to close, typically within the third business day after pricing (T+3) although sometimes up to as many as nine business days later (T+9).

The closing of a high-yield offering is relatively uneventful. The initial purchasers will initiate a bring-down due diligence call in which they will ask the company whether there have been any material events since the pricing. After that, the transfer of funds and delivery of the notes will take place.

The majority of high-yield bonds have a fixed coupon, although there has been a recent rise in the use of floating rates. The coupon is determined based on investor demand, which in turn depends on several factors, including, among others, the general market development, the financial condition of the issuer, the covenant package and the prospects for the industry in which the issuer is operating. However, as mentioned before, we note that in recent years there has been an increase in floating rate unsecured high-yield bonds.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

As mentioned above, covenants for high-yield bonds are generally incurrence-based, as opposed to maintenance-based (more common in the banking market). The issuer will not typically be required to maintain any financial ratios, but will be restricted from taking certain actions (including in relation to subsidiaries, except if it is an unrestricted subsidiary), unless it meets an exception to the relevant restrictions. Typical covenants relate to the following:

- fixed-charge coverage ratios;
- credit facility and debt baskets;
- permitted investments;
- change of control or ownership;
- limitations on payments, distributions, liens and asset sales; and
- transactions with affiliates.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

As mentioned above, covenant trends in the first half of 2018 were still very favourable to issuers, with covenant-lite issuances and soft-cap grower baskets being frequently used. However, as seen before (see questions 3 and 5), the year of 2018 saw very specific fears from investors, which have contributed to what may be seen as a shift in the covenant package paradigm so far.

On another note, covenant terms are often redrafted and renegotiated between the launching and pricing of an offering as well as during the marketing process, with additional covenants sometimes being added and others removed.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

If the relevant industry sector is characterised by certain customary specifics or requires more investment (eg, telecommunications, energy, etc), the covenants will contain adequate exceptions to reflect these industry specifics and grant more flexibility to the issuer. Coherently, some transactions in other sectors do not have the same elasticity as they are more standardised and, therefore, the underwriters may not be open to these adjustments.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Typically, high-yield bonds documentation establishes that, upon a change of control, the issuer is forced to make a repurchase offer for the notes at a fixed percentage, which is usually 101 to 103 per cent. Portable change of control provisions have become increasingly popular during 2017, however, as stated before, this was one of the many covenants that started to receive considerable investor pushback in marketing during the second half of 2018.

There are also put option rights of the noteholders upon the sale of certain assets to the extent that the cash proceeds of the sale are not reinvested in the business or used to repay debt.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

Yes. Some high-yield bonds include a 'double trigger' change of control covenant giving more protection to investors against a deterioration in credit quality as a result of a change of control event of the issuer. Consequently, there is only an obligation to exercise the relevant put (poison pill put) if there is a change of control event of the issuer followed by a ratings downgrade. However, this is not very common.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Yes, a 'crossover' covenant package is common for issuers who are on the verge of becoming investment grade. Usually there is no restricted payments' covenant and limitations on indebtedness' covenant might apply to secured debt only. Another difference is the basket mechanics, which are adjusted in light of the lower credit risk of the issuer.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

In the case of a private placement, there are no specific statutory disclosure requirements to be complied with and the typical high-yield debt offering disclosure standards are followed. However, whenever the issuer is a publicly traded company or a company issuing securities traded in the market, private placements shall be subsequently reported to the Portuguese Securities Market Commission (CMVM) for statistical purposes. However, the private placement offering memorandum does not need to be approved by the CMVM.

Contrarily, public offerings of high-yield bonds in Portugal, as well as the listing of debt securities in a Portuguese secondary regulated market, require the filing of a prospectus for approval by the CMVM and the offering itself is subject to prior registration. The CMVM will verify that the prospectus contains all necessary information concerning the issuer and the securities in order for investors to make an informed investment decision and that it complies with the applicable regulations (mainly EU Prospectus Directive regulations).

The prospectus shall contain all information that, according to the particular nature of the issuer and the securities offered to the public or admitted to trading on a regulated market, is deemed necessary to allow investors to make an informed assessment on, primarily, the assets and liabilities, financial position, risk factors, profit and losses, and prospects of the issuer and of any guarantor, as well as on the rights attaching to these securities.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

There are very few limitations on the use of proceeds by an issuer in the context of an issuance of high-yield securities. The more important limitations are those arising under the financial assistance rules set forth in the Portuguese Companies Code (prohibiting the use of the proceeds to fund the acquisition of own shares or even own notes) and anti-money laundering or similar laws that limit the possible use of proceeds.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Any investor can potentially invest in high-yield securities. In fact, a variety of investors participate in the high-yield bonds market either directly or indirectly via investment funds or other entities investing in high-yield securities.

However, if high-yield securities are offered by way of a private placement, the nominal unitary value of the notes must be at least €100,000 (or otherwise that must be the minimum subscription or sale price, per addressee, by each offering) and all actions that could permit a public offering of any of the notes in Portugal or for the offering memorandum to be distributed in Portugal are prohibited, except in circumstances that will not be deemed as a public offering under article 109 of the Securities Code.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

No, there are no particular closing mechanics in the case of the issuance of high-yield bonds in Portugal.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

In Portugal, a high-yield deal comprises the granting of guarantees by material subsidiaries of the issuer (upstream guarantees) and, in cases where the issuer is not the top holding company, also by its parent company (downstream guarantee), as well as by any material sister companies (cross-stream guarantees). The guarantors are usually the same as the guarantors under the senior facilities agreement (if any).

Pursuant to the Portuguese Companies Code, Portuguese guarantors may only secure third parties' obligations if the company has a justified corporate self-interest in the granting of the guarantees or the security, or both, or if the company is in a group or controlling interest with the entities whose obligations are being secured.

Under the Portuguese Companies Code the definition of 'controlling interest' includes relationships between companies where one company holds, directly or indirectly, the majority of the share capital or the voting rights in another company or otherwise has the right to appoint

the majority of the members of its board of directors or supervisory board. A 'group interest' includes relationships between Portuguese companies where one is 100 per cent owned or controlled, directly or indirectly, by the other; or between companies that are bound by a group agreement or a subordination agreement, whereby one company is subject to the instructions or management of the other.

In the absence of a control or group interest, the validity of a guarantee or security interest could be challenged if there is no justified corporate self-interest in its granting, as the interested parties (such as the shareholders of the company) may argue that the granting of said guarantee or security is contrary to the purpose of the company.

In addition, the obligations under the high-yield bonds' guarantees or security granted by the guarantors shall not extend to any use of the proceeds of the notes for the purpose of acquiring shares representing the share capital of the guarantor or shares representing the share capital of the parent guarantor, or refinancing a previous debt incurred for the acquisition of shares representing the share capital of the guarantor or shares representing the share capital of its parent guarantor. This would constitute unlawful financial assistance pursuant to article 322 of the Companies Code.

In this respect, guarantee limitation language is included in such high-yield bonds' guarantees or collateral to ensure that in no case can any high-yield bonds' guarantees or collateral granted by a guarantor secure repayment of the above-mentioned funds.

Finally, we also outline that, for tax reasons (namely in the context of the payment of stamp duty), the obligations under high-yield bonds' guarantees or collateral granted by the guarantors are typically limited to an agreed maximum secured amount (which is commonly established as an aggregate maximum amount should there be multiple guarantees). As a result, the guarantors will not have a direct obligation to repay any amounts once the relevant maximum secured amount has been reached, as applicable.

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

In Portugal, the typical collateral package for high-yield debt securities includes pledges over the issued share capital, plant and equipment (this refers to manufacturing plant and machinery, trucks, generating sets, drilling rigs and similar items), bank account pledges, and assignments of receivables by way of security, among others.

The typical collateral package granted by entities in connection with high-yield debt securities depends on the type of assets owned by the issuer and its subsidiaries as well as on the sector of activity. Usually it comprises:

- share security (namely, a financial pledge over the issued share capital and a promissory pledge over any equity that is issued afterwards);
- bank account security (namely, a financial or commercial pledge over the bank accounts);
- assignment of receivables, whether present or future (including intercompany receivables);
- security over fixed movable assets (namely, a pledge over stock, equipment or inventory); and
- assignments of receivables emerging from, or pledges over, insurance policies and, in some cases (although less commonly), intellectual property rights.

In very few issuances, security is taken over real estate (this will usually include mortgages and assignments of income emerging from the relevant real estate).

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

The limitations on the granting of guarantees are those already mentioned above in respect of the granting of upstream, downstream and cross-stream security (see question 19). As to the types of assets that can be pledged, there is a very broad diversity of assets to be considered in this context as, conceptually, a pledge will be created over a certain moveable asset or otherwise a credit or other right, which may not be mortgaged. However, the type of pledge itself will vary according to the pledged asset and other factors. Hence, one may grant financial or commercial pledges, rotary pledges (in which the pledged asset is not always the same), pledges over credit rights, shareholdings, commercial establishments, credit notes, among others.

If the assets of the Portuguese issuer or guarantor are covered by the immunities legally set forth – which include, but are not limited to, assets that are part of the public domain of Portugal or allocated to public service purposes – the relevant issuer or guarantor will be entitled to claim for itself immunity from suit, attachment or other legal process in respect of its obligations under said guarantees.

We also note that, as a general rule, under law, any guarantee, pledge or mortgage must guarantee or secure another obligation to which it is ancillary, which must be identified in the security agreements. Therefore, the guarantee or security follows the underlying obligation in such a way that the invalidity of the underlying obligation entails the invalidity of the guarantee or security and the termination of the underlying obligation entails the termination of the guarantee or security.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

There is no typical collateral structure in Portugal, as this structure will primarily depend on the issuer and its guarantors as well as on their credit profile risk, capital and financial structure.

Crossing lien structures (where lenders benefit from first ranking security and noteholders benefit from second ranking security) are not very common but we have seen them being used. This concept can be implemented in practice, although it can be more complex in relation to certain types of assets, such as real estate.

It is also common to regulate this type of issue (ranking and priority of debt and security) in the intercreditor agreement through waterfall provisions.

Finally, we have also seen structures where there is a mixed issuance of senior secured notes and senior unsecured notes.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

In Portugal, the issuer usually bears the costs of legal expenses related to the transaction, including the fees to be paid by the initial purchasers to their legal counsel. It is also common for the issuer to bear any expenses related to the security interests, including the payment of stamp duty and any registration costs.

Security interests

24 | How are security interests recorded? Is there a public register?

Bank account pledges are subject to registration with the bank with whom the account is held, while share security is subject to registration with the issuer, a depositary or a bank in the case of registered, deposited or dematerialised shares. Mortgages over real estate or registrable movable assets (eg, vehicles, ships and aircraft), assignments of real estate income, as well as pledges over quotas, are recorded in the competent land or commercial registry office, whose register is in both cases public.

25 | How are security interests typically enforced in the high-yield context?

Portuguese law does not recognise the concept of parallel debt or trusteeship. The indenture will thus provide (along with the intercreditor agreement) that only the security agent may enforce the security documents in its capacity as agent and joint and several creditor, and that usually the holders of the notes will not have direct security interests. Therefore, the holders will not be entitled to take enforcement action in respect of the guarantees or collateral securing the high-yield bonds, except through the trustee, who will provide instructions to the security agent in respect of the notes' guarantee or collateral, or both.

The security interests are thus enforced by the security agent, if necessary, and following an instruction by the noteholders or lenders in accordance with the provisions of the indenture, the intercreditor agreement and the relevant security agreement. Depending on the type of security, the ways of enforcing can be very different. Financial pledges over financial instruments and bank accounts allow for an appropriation of the asset by the pledgor and allow for an extrajudicial sale of the asset to the extent that said appropriation right as well as the rules for the evaluation of the asset have been established in the contract. Nonetheless, the pledgor is subject to the obligation of paying the difference between the value of the relevant asset and the amount of the secured obligations to the pledgee. The enforcement of a mortgage, however, requires a judicial enforcement proceeding, whereas the assignment of receivables only requires a notification to the debtor or client of the issuer to make payments directly to the secured parties (said notification being an enforceability requirement rather than a validity one).

Finally, it is very common for the guarantors to grant power of attorney in favour of the security agent allowing it to enforce the security and to sell the assets upon the occurrence of an event of default, as well as to carry out any other necessary actions in respect of the enforcement of the security or otherwise its perfection.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 | How does high-yield debt rank in relation to other creditor interests?

The majority of high-yield bonds are senior unsecured notes, which means that they rank equally in right of payment with all existing and future non-subordinated obligations of the issuer and rank senior to any existing or future subordinated indebtedness. If collateral is granted (which is often the case), the notes will, in practice, rank senior to any existing or future unsecured obligations to the extent that the proceeds of the enforcement of the collateral satisfy with priority the obligations of the issuer under the high-yield debt securities.

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However, certain guaranteed credits – namely, special statutory liens (eg, real estate special statutory liens such as state credits related with real estate property tax) and movable assets special statutory liens (eg, credits resulting from legal expenses incurred in the interest of the creditors) – may rank above the security of high-yield debt.

If there are privileged credits, which are credits secured by general statutory liens over assets integrated in the insolvency estate (labour, tax and social security debts), they rank as higher priority than common credits up to the amount corresponding to the value of the assets granted in guarantee or the general statutory liens, which means that they rank above senior unsecured high-yield bonds.

Regulation of voting and control

27 | Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

The terms of the intercreditor agreement governing control of enforcement proceedings depend on the collateral structure and the ranking of high-yield debt in relation to bank debt. Structures involving super senior bank debt with lenders controlling the enforcement are less common and deals with pari passu structures provide for a right of the noteholders to participate in the control of enforcement proceedings by voting as a class (the vote of said class is usually achieved by the majority rule by reference to the capital held).

TAX CONSIDERATIONS

Offsetting of interest payments

28 | May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Issuers of securities, including high-yield bonds, may generally set off their interest payments against their tax liability. However, there is a general annual limitation to tax deduction for corporate income tax purposes of financial expenses in excess of the highest of €1 million or 30 per cent of EBITDA (as adjusted for tax purposes). Non-deductible financial expenses can be carried forward to the five subsequent years. In the event that net financial expenses of a tax year are below the 30

per cent EBITDA threshold, the difference may be used as an extra deduction on top of the 30 per cent of EBITDA during the five subsequent years.

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, it is uncommon for issuers to obtain any tax rulings in connection with the issuance of securities, including high-yield bonds.

Russia

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

Under a bank loan agreement, the lending party is a single bank or a banking syndicate. This structure provides an opportunity to alter the loan terms by obtaining the relevant consent from the lending bank (or banking syndicate).

When issuing high-yield debt securities an issuer enters into a legal relationship with multiple lenders. In this regard if the issuer faces financial difficulties, the negotiation process is more cumbersome, requiring more time and bigger expenses.

On the other hand, high-yield debt securities provide access to new funding markets. In addition, issuers' covenants to lenders under high-yield debt securities are generally less strict than borrowers' covenants under bank loans, especially financial covenants.

It is also worth noting that, unlike a borrower under a bank loan, a bond issuer would in most cases be subject to information disclosure requirements. A requirement to disclose certain sensitive information to the general public could be a critical point for certain companies, especially considering the matter of international sanctions. This would be an important issue to consider when choosing a funding method.

Issuance of high-yield debt securities would be governed by Russian law, whereas a loan may be governed by Russian law or by English law.

For investors, it is important that high-yield debt securities have higher liquidity, and in most cases are traded on stock, which facilitates their trade. Bank loans are not traded on an organised market, which makes the transfer of loans more complicated. In addition, the transfer of loan sometimes requires the borrower's consent.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

The high-yield debt securities market is relatively new for Russia. The market started to develop between 2016 and 2017. The Central Bank (regulatory authority) is currently working on promoting these kinds of instruments for small and medium-sized enterprises.

At the end of 2018 a bill was passed that was designed to simplify the procedure for issuance of securities, including high-yield debt securities. However, the bill addresses the capital markets in general rather than being focused on high-yield debt securities market. No increase in regulation targeting high-yield debt securities in particular is currently being seen.

It is worth mentioning that since 2016 the amendments introduced to the law and the stock exchange have ensured that almost any high-yield debt securities require that a bondholders' representative is appointed (an analogue of trustee in Russian law) in order to maintain the issuer's control in the interests of bondholders.

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

The high-yield debt securities market has demonstrated significant growth over the past few years. There are plans to provide state support, and the Ministry for Economic Development has suggested introducing subsidies to cover expenses on bond issuance, as well as subsidies related to coupon payments. It is expected that the joint-stock company 'Russian small and medium business corporation' will be hugely involved in the issuance of bonds, including high-yield bonds. One of the possible forms of its involvement would be providing guarantees for bonds.

There are three main industries in the high-yield debt securities market: leasing, construction and microfinance organisations. Other issuers come from various industries, such as bank financing, agriculture, energy, or metalworking, etc.

An important characteristic of the high-yield debt securities market is an absence of institutional investors in the market. The vast majority of investors are individuals. It is worth mentioning that the government is making a major effort to bring individuals to the financial markets, which includes introducing special tax deductions. The reason for this could be a need for diversification of the limited sources of funding after sanctions were imposed on the Russian economy.

On the other hand, the level of involvement of individuals into investing in loan financing is extremely low compared to that of institutional investors and corporate investors and, therefore, we see the groups of investors involved in the high-yield debt securities market and in the loan financing market are not the same.

Currently high-yield bonds are unsecured. At present a significant number of issues have no guarantees, no collateral and no covenants. The investors are fully exposed to the issuer's default risk.

Main participants

4 Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

We see no actual cases where rating agencies would actively participate in the high-yield bonds market as this market is concentrated in a segment of unsecured bonds issued by companies unable to obtain any rating. Obtaining a rating for an issue of high-yield debt securities would be a rare exception.

In addition, institutional investors are currently staying away from high-yield debt securities, which decreases the need to obtain an investment rating.

The following are currently significant to the issuers of securities:

- A pool of securities distributors (generally represented by average local brokers). European securities market participants are not involved in issuance of high-yield debt securities. There is a specific class of local arrangers specialising in high-yield debt securities issues.
- A bondholder representative should be appointed for most kinds of high-yield debt securities issues due to regulatory requirements.
- Market regulation – most of these bond issues undergo registration in the Moscow Stock Exchange and the National Settlement Depository, and therefore the listing rules of the Moscow Stock Exchange are significant.

New trends

5 Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

A new approach to regulating qualified investor status is currently being developed. It is quite possible that the new regulations will limit the involvement of individuals who do not possess qualified investor status in the high-yield debt securities market. More and more issues include covenants, which are expected to become common practice in the future.

New issuances contain more covenants than the old ones. These include change of control, limitation on indebtedness (eg, debt/EBITDA, EBITDA/interest expense), events of default (eg, cross-default that can include bankruptcy of the issuer or its subsidiaries, not paying principal on time, etc) and failure to meet disclosure requirements. We do not see any new trends in the structure of high-yield debt securities issuances. The main thing to note about the structure of Russian high-yield debt bonds is there are no issuances with the seniority that could determine the classes of creditors.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Typically, high-yield debt securities are corporate bonds that are registered by a stock exchange in the form of exchange-traded bonds or commercial bonds. Commercial bonds are the other form of corporate bonds that are registered by National Settlement Depository and these issuances do not have a prospectus. Commercial bonds are instruments that are sold on the OTC market via private placement. The other advantages of commercial bonds are the lack of requirements regarding the borrower's financial standing and disclosure requirements, the unsecured nature of borrowing, and the absence of restrictions as to the amount and timing of borrowing.

If an issuer plans to issue high-yield debt securities that are registered by a stock exchange, the documentation package includes an application, decision on issuance of bonds, prospectus and some formal documents regarding the issuer (including a copy of the shareholders' decision, the certificate of incorporation, etc). The main document of issuance contains all the terms and conditions of the security, including the rights of the bondholders and details of the security placement. After the decision and prospectus (if applicable) are registered on the stock exchange, the issuer files an application for listing with a set of documents depending on the requirements of a particular stock exchange and level of listing.

If an issuer plans to issue high-yield debt securities that are registered by a National Settlement Depository, the documentation package includes an application, a decision on the issuance of bonds (in the form of a programme of commercial bonds) and formal documents regarding the issuer. No prospectus is required. After the decision on issuance of bonds is registered and the identification number is obtained the bonds may be placed via private placement on the OTC market.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

The typical maturity of high-yield debt securities is three to five years with an annual call option. We do not see any issue discount in high-yield debt securities issuances. High-yield debt bondholders rights may be protected by covenants, call provisions and by a bond representative.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

As described above, the procedure depends on the type of high-yield debt bonds and the registration body (stock exchange or National Settlement Depository). A public offering is not permitted until the registration of prospectus (if required). The placement of bonds may be performed during a placement period and should be only after full payment is received. If issuance is placed on stock exchange settlements should be processed under clearing and other applicable rules of stock exchange. Coupons are typically determined by the issuer before the placement of bonds. On the Russian high-yield debt securities market we currently see only fixed rates.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

The main covenants are the following:

- Change of control – this allows bondholders to redeem the bond when a specified event has changed the ownership or control of the company that issued the securities.
- Limitation on indebtedness – the most frequently used ratios are leverage (debt/EBITDA) and interest coverage (EBITDA/interest expense). This covenant allows the bondholders to restrict an issuer from borrowing beyond a prescribed level during the maturity of bonds.
- Default events – these can include bankruptcy of the issuer or its subsidiaries, not paying the principal on time, etc. The typical grace period for missed payments to the other issuer's obligations (cross-default) is five days, allowing the issuer to prevent default.
- Failure to meet disclosure requirements, including annual accounting reports.

These covenants are also typical for bank loans.

10 | Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

There has been a tightening of covenants as the market of high-yield debt securities has developed. Also, the universe of covenants of particular issuance depends on the underwriter and its reputation.

Terms of covenants are often determined in a decision on issuance of securities and are not changed after registration.

11 | Are there particular covenants that are looser or tighter, based on a particular industry sector?

We do not see any particular covenants that are tighter or looser, based on a particular industry sector.

Change of control

12 | Do changes of control, asset sales or similar typically trigger any prepayment requirements?

No, these covenants typically do not trigger any prepayment requirements.

13 | Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

We do not see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade.

Crossover covenants

14 | Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

There is no concept of a 'crossover' covenant package in Russian jurisdiction for issuers who are on the verge of being investment grade.

REGULATION

Disclosure requirements

15 | Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

Russian law does not provide for any specific requirements related to high-yield debt securities. The issuers are subject to general requirements. If the securities have been admitted to on-exchange trading, the issuer is required to disclose information under a special procedure. Most of the bond issues are valued at under 1 billion roubles. Therefore, the issuers are not required to disclose a prospectus and are only required to disclose a memorandum. Unlike the requirements to a prospectus that are established by the Central Bank of Russia, the requirements to a memorandum are set in the rules of the stock exchange, so the memorandum needs to be approved by the stock exchange.

Club deals are another possible way of issuing commercial bonds. In this case the issuer would be subject to minimum disclosure requirements that cause the least expense.

Use of proceeds

16 | Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

Imposing limitations on the use of proceeds from an issuance of high-yield securities by an issuer is not a common practice in the Russian securities market. The targeted use of funds is a requirement that could be found in securitisation deals or infrastructure products. However, this kind of limitation could possibly be used in high-yield debt securities as well.

Restrictions on investment

17 | On what grounds, if any, could an investor be precluded from investing in high-yield securities?

As the vast majority of investors in high-yield debt securities are individuals, an investor could be precluded from investing in high-yield debt securities if they lack qualified investor status.

Investors are required to possess this status to invest in debt securities if the issuer's net asset value is below the amount of its charter capital, or the issuer is showing signs of insolvency at the time of bond issuance. Application of the Basel principles makes investing in high-yield debt securities more complicated for banks.

Closing mechanics

18 | Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

Russian law does not provide for particular closing mechanics for high-yield debt securities. High-yield debt securities are to be recorded and deposited in the National Settlement Depository irrespective of the way they were offered.

GUARANTEES AND SECURITY

Guarantees

19 | Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

There are high-yield debt securities issues where a parent company provides a guarantee against its' subsidiary's default. However, in most cases no guarantee is provided. As for the specific rules, it is worth noting that there is a requirement under which in most cases these transactions are to be approved as major transactions to comply with Russian company law.

It should also be considered that only certain parties may act as surety under a suretyship agreement securing a bond issue, namely commercial organisations with net asset value equal to or exceeding the amount of surety to be provided. Therefore, there is a limited opportunity to use surety in certain transactions.

Collateral package

20 | What is the typical collateral package for high-yield debt securities in your jurisdiction?

The current regulations allow for registration of bonds by the Central Bank of Russia, by the Moscow Stock Exchange (for bonds that qualify as exchange bonds), or by the National Settlement Depository (for bonds that qualify as commercial bonds). Exchange bonds and commercial bonds undergo a simplified procedure of bond issuance. Therefore, the high-yield debt securities are usually issued as exchange or commercial

bonds. However, these types of bonds are not allowed to be secured by pledge.

There are currently no bond issues secured by pledge in the high-yield debt securities market. In theory, if the bond issue undergoes registration with the Central Bank of Russia, this issue could be secured by pledge, however, the market decided to choose another direction. It is worth noting that securing an obligation by pledge is typical for a bank loan, but quite uncommon for Russian bond market (except for specific complex bond issues).

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

This is currently not applicable due to the lack of high-yield bonds issues secured by pledge.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

As mentioned above, high-yield debt securities are not commonly secured by pledge. In addition, banks do not invest in high-yield debt securities.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

Typically, all costs relating to the security are paid by the issuer.

Security interests

24 How are security interests recorded? Is there a public register?

The information about pledge is directly stated in the bond decision, which in this case becomes a pledge agreement. In addition, in Russia a public registry of pledges is maintained. It is common practice that the issuer makes an entry regarding the pledge in this register but it is not applicable for high-yield debt securities, in view of bonds being issued unsecured.

In addition, information about mortgages is reflected in the unified state register of real estate.

25 How are security interests typically enforced in the high-yield context?

If high-yield debt securities were secured by pledge, the enforcement procedure would normally mean that the issuer is required to appoint a bondholders' representative, and optimally this would take place in the following order: in the event of default, the bondholders' representative may enforce the pledge at his or her own initiative or at the bondholders' requirement. This order provides for centralised enforcement. The collected amounts are transferred to the account of the bondholders' representative with the National Settlement Depository. After that the funds are distributed proportionately among the bondholders.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 How does high-yield debt rank in relation to other creditor interests?

There is a lack of effective rules regulating intercreditor arrangements in Russia, as the bankruptcy legislation does not provide for an opportunity to alter the order of claims in the event of the issuer's bankruptcy.

However, in most cases high-yield debt securities would be subordinated to bank lenders contractually, as banks hold the collateral securing the issuer's obligations under loans.

Besides, if at the time of issuing the high-yield debt securities bondholders rank pari passu with banks, the issuer can at any time provide collateral to its creditors, which would lower the rank of high-yield debt securities.

Regulation of voting and control

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

The relationships among the creditors with respect to the issuer's obligations are governed by an intercreditor agreement that addresses such issues as voting rights, notifications of default, etc. The voting rights could be exercised by bondholders via a bondholder's representative. Currently there are no intecreditor agreements in the high-yield debt securities market because all high-yield debt securities are unsecured. Russian legislation does not provide for the possibility of changing the priority of creditors' claims governed by Federal Law 'On Insolvency (Bankruptcy)' by agreement.

As per the provisions of article 309.1 of the Civil Code there is a possibility of entering into an intercreditor agreement, but this agreement regulates just transferring the performance to the other creditor if the performance was received in breach of the agreement and does not change the priority of creditors' claims during the bankruptcy process.

TAX CONSIDERATIONS

Offsetting of interest payments

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Under Russian law, the coupon payment under bonds, including high-yield debt securities, may be set off against the issuer's tax liability. Obviously the set off is not possible in relation to the interest on a loan issued to the company by an entity that is a part of the same group. In this case, the thin capitalisation rule is applied.

There are no special tax considerations for the high-yield market in relation to set off interest expenses.

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

It is uncommon for issuers to obtain tax rulings in connection with the issuance of securities, including high-yield bonds.

UPDATE AND TRENDS

Current Developments

30 | What are your expectations for the year ahead?

We expect that the high-yield debt securities market will continue to grow in the near future, including through the involvement of small and medium-sized enterprises.

The necessary infrastructure will continue to evolve. The Cbonds-CBI RU High-Yield index was introduced in late 2018.

It is worth noting that high-yield bond issues are significantly different in size than other corporate bond issues. Minimum bond issues are less than US$500,000, while the standard issue of bonds starts at US$15 million.

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

One of the main differences between corporate bank loans and high-yield notes is the control of financial ratios. For corporate bank loans, the borrower is required to maintain certain financial ratios during the term of the loan (maintenance covenants), as well as when it wishes to take a particular action (incurrence covenants), to avoid being in default. Moreover, maintenance covenants are subject to regular controls as they could be breached without a specific concerted action on the part of the borrower or any other company of their group. This is not the case for high-yield structures, for which there are typically fewer covenants, all of which are incurrence covenants that would typically affect the issuer and its restricted subsidiaries. This gives the company more flexibility to perform its business.

High-yield debt securities tend to have longer maturities, from five to 12 years (even though they normally range between seven and 10 years) and bullet repayments. High-yield notes have a non-call period (usually half term of the notes), where they may not be reimbursed unless the issuer pays a penalty fee. Despite that, the inclusion of an equity claw redemption clause permits the issuer to use the proceeds of public or private equity issuances to redeem a portion of the outstanding notes (traditionally between 35 and 40 per cent), usually paying a small fee. Once the non-call period has elapsed, the early repayment fee is reduced progressively.

On the other hand, bank loans are typically granted for a slightly shorter term (four to six years) and have compulsory repayment schedules (monthly instalments and French amortisation system). Moreover, high-yield notes usually have a fixed interest rate while the bank loans usually have a variable interest.

Furthermore, high-yield bonds generally offer a greater return to the investor compared to other types of notes (investment grade notes) or the granting of traditional bank financing, as it is an investment product that carries greater risk. In 2019, the return in high-yield notes stands at around 6 per cent while in the long-term bank loans for professional investors with a standard security package, the return stands at around 1.5 per cent.

The downsides of high-yield notes are the higher transaction costs, which require a minimum issue amount of not less than €150 million to €200 million to be cost effective, a longer timeframe for document preparation, higher interest rates compared to bank financings and a costly and time-consuming process if consent solicitation from investors is required. High-yield notes are also very market dependent, with quite specific windows for issuing bonds. Regardless these concerns, the issuance of high-yield notes has the added benefit of increasing the issuer's presence on the international stage through public capital markets, leading to possible further fundraising.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

As mentioned below, Spanish high-yield debt issues for foreign investors are normally private placements governed by New York law and admitted to trading on the Irish or Luxembourg alternative stock exchanges.

Moreover, since the marketing of these high-yield notes is done under circumstances that do not constitute a public offer of securities in Spain, they do not fall under the Prospectus Directive (Directive 2003/71/EC), and are therefore exempt from the requirement to approve and publish a prospectus.

However, on 3 July 2016, a new Market Abuse Regulation scheme came into effect replacing the existing EU regime on insider trading and market abuse (which only applied to financial instruments admitted to trading on a regulated market) and expanding it to securities traded on a multilateral trading facility. The new regulation also imposes new disclosure and reporting obligations and amends the scope of inside information.

Therefore, as most high-yield transactions are listed on unregulated markets, such as the Irish Stock Exchange (Global Exchange Market) and the Luxembourg Stock Exchange (Euro MTF) the market abuse regime that previously was only applicable to regulated markets also applies to them.

Despite the latter, in the recent years the Spanish regulations with regard to the gradual easing in the requirements on issuance of tradeable securities was possible thanks to the amendment of Spanish Corporate Law by means of the Law 5/2015, of 27 April 2015, on Promoting Business Financing and the adoption of the new circular 2/2018, of 4 December, on admission and removal of securities in the alternative fixed income market (MARF).

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

Spain does not have specific consolidated industries that are more active than others in the high-yield market. In the past, Spanish issuers belonging to a wide range of industry sectors – including the automotive, transportation, pharmaceutical, construction, hotel, energy and gaming sectors – have participated in high-yield debt issues. To date, there have been very few private equity transactions, most of which involved only Spanish entities acting as guarantors of European issuers. Moreover, many high-yield issues launched in the last couple of years were undertaken to refinance previous issues, taking advantage of lower interest rates.

In terms of the main features of Spanish high-yield deals, Law 5/2015, 27 April 2015 on Promoting Business Financing (Law 5/2015) significantly changed the legal regime for the issuance of notes through several amendments to the Companies Act and the Securities Market Act. The aim of these changes was to make the Spanish bond market more flexible and to lessen Spanish companies' traditional dependence on bank financing, which is particularly critical among small and medium-sized companies.

Briefly, the main changes introduced are as follows:

- Private limited liability companies may now issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments. Previously, only public limited liability companies could issue debt or guarantee bonds, and were subject to a limit. This limit now applies to issues of twice their own funds by private limited liability companies, unless the issue is secured by a mortgage, a pledge of securities, a public guarantee or a joint and several guarantee from a credit institution.
- The requirement to publish an announcement with details of the issue in the Official Gazette of the Commercial Registry has been eliminated.
- On the requirement to execute a public deed of issuance, when the issuer is a Spanish company, there are doubts as to whether it is necessary. However, it is no longer necessary for the deed to be registered at the Commercial Registry before the notes can be released into circulation. Moreover, a deed is not necessary if the securities are to be listed on a regulated market that requires the preparation of a prospectus, or on a multilateral trading system established in Spain.
- A new regime for the incorporation of a syndicate of holders and a commissioner have been introduced, as described in question 4.
- Furthermore, additional provision 1 of Law 10/2014 on the Organisation, Supervision and Solvency of Credit Institutions provides for a special tax regime for bond offerings. This consists of an interest withholding tax exemption, subject to certain requirements – mainly that the bonds are admitted to trading on regulated exchanges, multilateral trading systems and other organised exchanges; certain tax-related information is supplied to the paying agent; and the net proceeds are placed within an entity belonging to the same consolidated group or subgroup of companies.

In the past, only financial institutions or listed companies, or wholly owned subsidiary special purpose vehicles (SPVs) of these entities, could benefit from this tax regime. Now Spanish-resident companies (and therefore privately held companies), wholly owned subsidiary SPVs of Spanish-resident companies that are resident within the EU, and public entities in corporate form can benefit from this special tax regime.

These changes facilitate the direct issue of bonds by Spanish companies, eliminating the need to create foreign vehicles.

With respect to collateral, the majority of Spanish high-yield issues are secured, although there are some exceptions that have been only guaranteed by certain subsidiaries of the issuer.

Investors in high-yield bonds are typically investment banks, pension funds, hedge funds, mutual funds, insurance companies and private wealth management accounts, while loan financing is almost exclusively granted by the traditional banking sector in Spain. Direct lending by other players, such as investment managers and hedge funds, is still to be developed.

Main participants

4 | Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants in Spanish high-yield bond issues do not differ much from those in other European jurisdictions, as to our knowledge all Spanish issues in this market are governed by New York law and tend to follow American standard procedures.

The investment banks leading the transactions normally act as initial purchasers of the bonds, and will resell them to the final investors, receiving a commission. The fees will vary from deal to deal and may be directly included in the purchase agreement and deducted from the purchase price, or documented in separate fee letters.

A paying agent and a registrar and transfer agent are also appointed. The former will be in charge of making all payments, including principal, premium, if any, and interest on the notes; while the latter will maintain a register reflecting ownership of the definitive registered notes outstanding from time to time.

Additionally, a listing agent is appointed to help the issuer with the listing of the notes on the relevant stock exchange if they are to be admitted to trading.

In high-yield secured issues, a security agent is appointed to hold any collateral on behalf of the trustee and the noteholders, as well as to initiate any enforcement procedure if required. Spanish law does not contemplate the concept of a security agent, and, although this by itself does not prohibit this agent from being appointed, the fact that there is a lack of regulation on the matter results in uncertainty as to how a Spanish court would recognise the actions of a security agent in an enforcement situation.

A bank or trust company will also be designated to act as trustee on behalf of the noteholders.

Prior to the entry into force of Law 5/2015, there were some risks related to the interplay between certain provisions of US and Spanish law. In Spain, issuers of debt securities such as high-yield notes were generally required to have a syndicate of holders represented by a commissioner. However, because the indentures of the relevant issues contained mandatory provisions relating to the appointment of a trustee, neither a syndicate of holders nor a commissioner was designated, which led to potential issues and challenges under Spanish law. In some cases, a syndicate of holders and a commissioner were also appointed in addition to the trustee, leading to potential conflict of their roles.

It has now been clarified that Spanish issuers are only obliged to create a syndicate of holders and appoint a commissioner if:

- the terms and conditions of the notes are governed by Spanish law or by the law of a state that is not a member of the EU or the OECD; and
- there is an initial public offering of the notes in Spain, or they are listed on a Spanish-regulated market or a multilateral trading system established in Spain.

In all other cases, the law to which the issuance is subject will determine the collective organisation of noteholders.

Typically, two of the main three rating agencies (Fitch, Moody's or Standard & Poor's (S&P's)) will be appointed to assign credit ratings to the bonds, and therefore provide a risk assessment for the investors.

New trends

5 | Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

As stated in question 3, the current Spanish legal regime for issuance of high-yield notes provides more flexibility than before, providing

companies with an alternative funding option to the traditional banking system.

Since the creation of the Spanish Alternative Fixed-Income Market (MARF) in 2013, a multilateral trading facility similar to those in some other European countries such as Germany, Ireland and Luxembourg, there have been several companies that have used this alternative market to issue bonds or commercial paper. The terms of the existing issues in MARF are governed by Spanish law and, in some cases, by English law. Some of the bonds admitted to trading in this market may not be strictly considered as high-yield notes, but are proving to be a good alternative for medium-sized companies, which, owing to the size of the volume of issuance, do not have access to the international high-yield market.

The adoption of the new Circular 2/2018, of 4 December, on admission and removal of securities in the alternative fixed income market (MARF) (Circular 2/2018), has reduced the formal requirements, documentation and procedures for admission and removal of securities in the MARF. In particular, without limitation, the following applies:

- Both the incorporation and validity of the issuer and the content of its by-laws and the deposit of accounts must be accredited, although not necessarily by the issuer. This work may also be carried out directly by the MARF if telematic access to the corresponding registers is possible.
- The requirement that the issuer's annual accounts do not contain qualifications disappears.
- There is no need to provide the corporate resolutions authorising the issue.
- A credit assessment or solvency report will be provided only if its preparation has been required by the issuer or investors.

In terms of covenants, we are seeing more flexibility and higher baskets in recent deals than in previous years.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Spanish high-yield bonds are typically issued either directly by a Spanish company (currently, private limited liability companies and public limited liability companies can issue bonds) or through foreign SPVs, normally incorporated in Luxembourg or Ireland, but governed by New York law.

As high-yield bonds were originally developed in the US and US investors tend to be a key target when marketing the bonds, most high-yield bond issuances in Spain have been governed by New York law.

As mentioned in question 3, if the issuer is a Spanish company, in addition to the documents required by New York law, it is advisable to execute a public deed of issuance and file with the Commercial Registry.

The structure of the offering memorandum is similar in all transactions. Some sections, such as general risk factors or limitations on validity and enforceability of civil liabilities, are standard; while the remaining sections are bespoke for each company. The description of the notes contained in the offering memorandum is a summary of the terms of the indenture.

The indenture is the legal contract containing the key terms of the notes, such as maturity, interest rate, representations, covenants, guarantees, events of default, etc. It is entered into by the issuer, the guarantors, if any, and the trustee of the notes.

In issues where a senior credit facility is also entered into, it is normally governed by English law and follows the standard format of the Loan Market Association.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

The typical maturity of most Spanish high-yield bonds is seven years, although they may be issued with shorter (three years) or longer maturities (12 years). While normally issued at par, in some cases, the bonds could be issued at a discount. Although fixed interest is more common, there are a few cases of issues with floating interest.

One of the various yield protections included in the documentation is having a non-call period during which the issuer is restricted from redeeming the notes. This period is normally halfway through their tenor. After this, the notes can be redeemed at a premium that typically begins at 50 per cent of the coupon and then decreases rateably to par in the following years. If the notes are redeemed prior to the first call date, the issuer will have to pay 100 per cent of the principal amount of the notes redeemed plus a make-whole premium, plus accrued and unpaid interest and additional amounts, if any, to the date of redemption.

Another protection is the change of control covenant, which requires the issuer to offer to purchase at a tender offer all outstanding notes at a price equal to 101 per cent of their principal amount and purchase all bonds that are tendered.

Equity clawbacks further limit the right of the issuer to use proceeds from equity offerings (initial public offerings) to redeem the outstanding notes. This feature normally allows the issuer to redeem 35 per cent to 40 per cent of the outstanding bonds with the initial public offering proceeds.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

Spanish high-yield debt issues are normally private placements admitted to trading on the Irish or Luxembourg alternative stock exchanges and therefore exempt from the requirement to approve and publish a prospectus with the relevant authority under the Prospectus Directive.

Before the launch, the issuer, the arrangers and the underwriters will have prepared the preliminary offering memorandum, which will contain a description of the risks related to an investment in the bonds, a description of the issuer's business and the industry and markets in which it operates, management information, historical financial statements, a description of the notes, a description of the material agreement and any other key information, and certain legal and tax matters. The description of the notes section of the offering memorandum is one of the most negotiated parts because it includes the main covenants.

Following the launch of the offering, the issuer and the underwriters will go on an investor roadshow. Once the roadshow is completed (typically a few days to two weeks), the price of the bonds will be fixed (including the final amount of the issue, maturity and coupon), and a bring-down due diligence call will take place.

After the launch, the issuer, the initial purchasers and the guarantors, if any, will sign the purchase agreement, prepare the final offering memorandum and the rest of the transaction documents, such as the indenture, intercreditor agreement and facility agreements, as the case may be. Comfort letters, legal opinions and other related closing documents are also delivered at this stage.

Coupons are determined during the roadshow depending on the investors' demand, market conditions, risk assessment of the issuer and its business and other factors.

Most Spanish high-yield issues have fixed interest rates.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

The standard covenant package for non-investment grade high-yield bonds typically restricts the ability of the issuer and its restricted subsidiaries to:

- incur or guarantee additional debt and issue preferred stock;
- make certain payments, including dividends or other distributions;
- make certain investments or acquisitions, including participating in joint ventures;
- prepay or redeem subordinated debt;
- engage in certain transactions with affiliates;
- create unrestricted subsidiaries;
- sell assets or consolidate or merge with or into other companies;
- sell or transfer all or substantially all of the issuer's assets or those of its subsidiaries on a consolidated basis;
- issue or sell share capital of certain subsidiaries; and
- create or incur certain liens.

The aim of these covenants is to restrict the issuer and its restricted subsidiaries from engaging in acts that could compromise its ability to meet its obligations under the bonds. However, there are a series of exemptions to the standard covenant package. These include specific baskets, depending on the business of the issuer and the flexibility that it might need.

In general terms, high-yield bond covenants impose fewer restrictions and obligations on the issuer than bank loans. The fact that they are also incurrence covenants as opposed to maintenance covenants gives the issuer more flexibility to operate its business.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

In the current market situation, where in general terms there are fewer high-yield issuances than in previous years, covenant packages in Spain seem to show more flexibility than in previous deals. This is in line with what other European jurisdictions are experiencing.

The covenants are negotiated between the issuer and the arranger and the initial purchasers prior to the launch of the notes, and in our experience, they do not normally change much during the roadshow and prior to pricing.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

As mentioned in question 3, Spain does not have specific consolidated industries in the high-yield market. Therefore, the tightness or looseness of covenants depends more on the company, the nature of its business, its financial strength and the particularities of the transaction rather than on the industry sector.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

A change of control triggers the right of each noteholder to require the issuer to repurchase all or any part of that holder's notes in an amount equal to 101 per cent of the aggregate principal amount of notes repurchased, plus accrued and unpaid interest, if any, on the notes repurchased, to the date of purchase.

Similarly, any net cash proceeds from asset sales that are not applied or invested within a certain time frame, and that exceed a specified threshold amount, normally constitute excess proceeds, which must be used by the issuer to make an offer to repurchase the notes at a price equal to 100 per cent of principal amount plus accrued and unpaid interest to the date of purchase and other pari passu indebtedness with similar provisions.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

No. Spanish high-yield issues tend to include the traditional single-trigger change of control provision, whereby ultimate shareholders directly or indirectly have the power to cast or control the casting of at least 50.01 per cent of the eligible votes in the company's general meeting, and appoint or remove all or the majority of the directors; or hold beneficially at least 50.01 per cent of the issued share capital of the company with voting rights.

Double-trigger provisions are seen more in European high-yield issuances for private equity transactions where portability could be important for the private equity sponsors, but not often in Spanish deals where bonds are normally issued by corporate-owned issuers.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

The suspension of certain covenants typically occurs when the notes are rated investment grade but not before. Once the notes are rated Baa3 or better by Moody's, BBB- or better by S&P, or BBB- by Fitch, covenants such as restricted payments, limitations on sale of assets, incurrence of indebtedness, dividend restrictions and others cease to be effective and are not applicable to the issuer and its restricted subsidiaries. Therefore, the crossover covenant package is not something customary in our jurisdiction.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

The offering memorandum contains detailed disclosure information about the issuer, including its business, its industry sector, any guarantees and security, its financial statements and the terms of the notes, to enable investors to make an educated investment assessment.

Spanish high-yield bond issuances are normally governed by New York law and admitted to trading on the non-regulated markets of Ireland or Luxembourg. Therefore, the law to which the issuance is subject is that governing the rights of the noteholders vis-à-vis the issuer, their forms of collective organisation and the regime for repayment and

redemption of the securities; while Spanish law determines the capacity, the competent body and the conditions for adoption of the resolutions approving the issuance.

Furthermore, if the bonds are admitted to trading on the non-regulated market of Ireland, Luxembourg or any other alternative market, they are subject to the listing conditions and disclosure requirements required by these markets.

If high-yield debt notes are offered, sold or distributed to the public in Spain, except in circumstances which do not constitute a public offer of securities in Spain according to the Spanish Securities Market Law, or listed on the Spanish regulated market, the issuer must register a prospectus with the Spanish Securities and Exchange Commission, to comply with the minimum disclosure requirements of the Prospectus Directive.

Should the high-yield notes be admitted to trading on the MARF, an information memorandum is required and must be approved by the MARF pursuant to Circular 2/2018, as mentioned in question 5. The disclosure requirements are similar to those contained in European offering memorandums.

Use of proceeds

16 | Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

There are no limitations in Spanish law on the use of proceeds of a high-yield debt issuance by an issuer. However, if those proceeds are used to finance or refinance the acquisition of its shares or its parent (or, in some cases, of companies within the same group), these obligations cannot be secured or guaranteed by a Spanish guarantor as it would breach the financial assistance prohibition. Therefore, these limitations would restrict the ability of Spanish guarantors to grant guarantees or provide security for financing used for this acquisition.

Restrictions on investment

17 | On what grounds, if any, could an investor be precluded from investing in high-yield securities?

There is no specific provision that precludes Spanish investors from investing in high-yield securities. Notwithstanding this, there are a number of rules aimed at protecting retail investors that might make it very difficult to sell these products to them.

Closing mechanics

18 | Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

The approval of Law 5/2015 significantly simplified the closing mechanics in Spain. The main requirement, if the issuer is a Spanish company and assuming the terms of the notes are governed by a foreign law and the notes are not admitted to trading in a regulated or alternative market in Spain, is the execution of a public deed of issuance. Additionally, if the issue is guaranteed, the relevant guarantors must also appear before a notary public when the deed of the issue is granted.

GUARANTEES AND SECURITY

Guarantees

19 | Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

It is customary that in high-yield structures the parent company and certain subsidiaries guarantee jointly and severally the obligations of the issuer under the bonds on the issue date. Additionally, the parent company shall cause any subsidiary considered as a restricted subsidiary after the issue date to become a guarantor.

Under Spanish law, unlike in other EU jurisdictions, there is no specific obligation for companies to justify that they are acting for the company's benefit when granting a guarantee or security, although it is advisable to do so according to the characteristics of a specific transaction or to uphold the effectiveness of the security or guarantee if the grantor becomes insolvent.

The Spanish law prohibiting financial assistance generally prevents both public and private limited companies from advancing funds, granting loans, supplying guarantees or providing any sort of financial assistance aimed at allowing a third party to acquire a company's own shares; or the units or shares of its parent company, in the case of public limited companies, or the units or shares of any company belonging to its corporate group, in the case of private limited companies. There are two limited exceptions for public limited companies: ordinary operations carried out by banks and credit entities, and financing for employees.

The guarantee is normally regulated under the indenture and subject to New York law. The indenture is sometimes notarised in Spain to have access to a more expeditious enforcement process against the assets of a Spanish guarantor if the guarantee is to be enforced directly in Spain.

Furthermore, in those cases where it is necessary to execute a public deed of issuance and the issue is guaranteed, the relevant guarantor must also appear before the notary public when the deed of the issue is granted.

Collateral package

20 | What is the typical collateral package for high-yield debt securities in your jurisdiction?

The typical security package for secured high-yield bond issues involves pledges over the shares of the issuer, the parent company and certain of its subsidiaries, as well as over material assets, such as bank accounts, receivables and insurance policies.

Other security, such as non-possessory pledges over movable assets or real estate mortgages, is less common, mainly because of associated registration fees and stamp duty.

Broadly speaking, a security interest can only secure one main obligation and its ancillary obligations. If two different main obligations need to be secured, two different guarantees must be created. Spanish law does not provide for a 'universal guarantee' over all the debtor's assets, although there are exceptions – for instance, mortgages; nor does it provide for the creation of a floating or adjustable lien or encumbrance.

Guarantees subject to Spanish law or security documents must be granted before a notary public to benefit from an executive proceeding in Spain.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

Any type of security in Spain can secure high-yield bonds if the relevant formalities for each type of security are met.

Real estate assets can only be secured by a mortgage, which covers:

- the plot of land and the buildings built on it;
- the proceeds from the insurance policies insuring the property; and
- the improvement works carried out on the property and natural accretions.

Mortgage agreements must be drafted in Spanish and executed before a notary public in a deed of record. The law requires the mortgage deed to be filed and registered at the relevant land registry.

Pledges over shares and credit rights (such as bank accounts, receivables and insurance policies) are the most common type of security.

Under Spanish law, receivables can be attached to three different types of security interests:

- possessory pledges;
- non-possessory pledges; and
- subject to certain limitations, financial collaterals.

Perfection of possessory pledges requires that the pledgor transfer the possession of the receivable to the pledgee or to a third party (as appointed by pledgor and pledgee (eg, a security agent)). Spanish law is unclear on how this transfer of possession should be made in connection with a receivable, as in general Spanish security interest rules only foresee the transfer of tangible assets. In practice, it is generally accepted that notarisation of the pledge, plus giving notice to the obligor, is sufficient to perfect a possessory pledge. When the parties prefer not to give notice for commercial (eg, confidential or reputational) reasons, alternative means of transferring the possession of the receivable may be available.

Non-possessory pledges must be registered with the relevant movable assets registry. Non-possessory pledges are signed before a Spanish notary public and are notarised in the form of a public document.

Non-possessory pledges are also granted over movable assets that cannot be the object of a chattel mortgage because their specific identity cannot be registered; or of a possessory pledge, given the legal or financial impossibility of transfer to the creditor or to a third party.

Certain types of receivables could also be attached to financial collateral pursuant to Royal Decree Law 5/2005, which provides that financial collateral must be in written form and no additional formality is required to perfect financial collateral. Royal Decree Law 5/2005 also provides that the delivery by a pledgor to the pledgee of a list of receivables in writing is sufficient to consider the receivables transferred to the pledgee.

In practice, it is customary to perform the same perfection requirements required for possessory pledges when creating financial collateral (ie, notarial document and notice to the obligor).

For the pledge to be enforceable against third parties (also in the event of the pledgor's insolvency), a notarised agreement or, as the case may be, a deed must be created, as these public documents verify the date and terms and conditions of the pledge. Thus, a pledge created under a law other than Spanish law will be valid; although, to enforce the pledge in Spain, it will be necessary to execute a document equivalent to a Spanish notarised agreement or deed, as a document that only legalises the grantor signature will not be sufficient.

With Law 5/2015 coming into force, the prior limitations on which entities could provide security or guarantee bonds have been removed. Private limited liability companies may now issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments. Previously, only public limited liability companies could issue debt or guarantee bonds. Also, the general issue limit preventing public limited companies and limited partnerships by shares issuing notes in excess of their own funds has been removed.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

Spanish law is based, inter alia, on the principle of integrity, by virtue of which a security interest can secure only one main obligation and its ancillary obligations, such as interest, costs, etc. Except for floating mortgages, where the law expressly contemplates it, there are uncertainties as to the possibility of using a single pledge to secure different obligations with different creditors and different terms.

In many Spanish high-yield notes deals, a senior facility agreement is also entered into. The same collateral will typically secure both the senior facility and the secured notes in pari passu ranking.

There are various alternatives to achieve pari passu ranking, such as:

- a single pledge securing the senior facilities agreement and the secured notes;
- various pledges, each over a percentage of the collateral in order to secure each obligation;
- multiple concurrent pledges with the same ranking, each securing 100 per cent of the obligations arising from the senior facilities agreement and the secured notes; or
- subsequent ranking pledges.

Each alternative has its advantages and disadvantages to be analysed case by case. Regardless of the option chosen, it is customary to enter into an intercreditor agreement to regulate the majorities required for enforcing the security as well as the sharing provisions for the proceeds of enforcement of each pledge.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

The issuer normally pays all legal expenses, such as notarial costs, registration fees, and stamp duty, if any, arising from the granting of the security, which are paid with the proceeds of the issue.

Security interests

24 How are security interests recorded? Is there a public register?

The only security interests that need to be recorded are mortgages and non-possessory pledges.

In the case of real estate mortgages, they need to be filed and registered at the relevant land registry, while chattel mortgages or non-possessory pledges over movable assets are subject to registration with the chattel registry. Failure to do so will render these security interests void and not binding against third parties.

25 How are security interests typically enforced in the high-yield context?

Security interests are normally granted in favour of the security agent on behalf of the secured creditors, which will, in the event of default, enforce the security interest on their behalf. However, Spanish law expressly recognises neither the concept of security agent nor the concept of trustee and the security agency or security trustee structure may not be recognised by Spanish courts. Therefore, where an entity acts as security agent of the actual beneficiaries of the security interest or a guarantee (ie, the creditors of the secured obligations), it must be duly empowered at the time it acts as security agent.

If a default takes place resulting in acceleration of notes, the security agent may, as instructed by the trustee and on behalf of the secured creditors, choose any of the proceedings available under Spanish law to enforce the security.

In case of a pledge over shares, these proceedings would include a declaratory court judgment, enforcement proceedings under the Code of Civil Procedure or the extrajudicial procedure in article 1872 of the Civil Code and in the Notaries Act of 28 May 1862; or, if applicable, the procedure established in Royal Decree Law 5/2005 of 11 March on urgent reforms to promote productivity and improve government contracting.

Depending on the nature of the collateral (eg, pledge over bank accounts or receivables), the security agent could, instead of initiating the above-mentioned proceedings, enforce the pledge by means of setting off the balances of the bank accounts or the amounts owed by the debtors against the amounts due and payable under the secured obligations, with the sole requirement of prior notification to the pledgor.

In an insolvency, credits whose collateral consists of specific property or rights (eg, mortgage or pledges) are considered privileged credits with special privilege. Privileged credits are generally paid first. Once privileged credits have been paid, the rest of the assets are divided among the ordinary creditors in proportion to the amount of their debt. Once the ordinary credits have been paid, the remaining assets, if any, are used for paying subordinated credits.

One of the effects of the declaration of insolvency is that acts or transactions involving the attachment of the debtor's property required for the continuity of its professional or business activity, including mortgages and pledges, are suspended or cannot be executed until:

- the plan of reorganisation is approved;
- liquidation starts; or
- one year has elapsed from the date of declaration of insolvency.

Clawback can apply to any act or transaction performed within the two years before the debtor's declaration of insolvency that is deemed to damage the debtor's estate. Fraud is not required under Spanish insolvency law for the avoidance of transactions.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 How does high-yield debt rank in relation to other creditor interests?

In Spanish deals, it is typical for high-yield bonds to rank equally in right of payment with the senior facility that might be entered into. If the notes are secured, the security interests will normally be shared on a pro-rata basis with the senior facility.

The bonds are normally considered as general senior obligations of the issuer, ranking equally in right of payment with all existing and future senior indebtedness of the issuer and ranking senior in right of payment to any future obligations of the issuer subordinated in right of payment to the notes.

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Unless the notes are secured, they will be effectively subordinated to all obligations of the issuer that are secured by assets, to the extent of the value of the property or assets securing these obligations. The notes will be structurally subordinated to any existing and future indebtedness of the subsidiaries of the issuer that do not guarantee the notes.

An intercreditor agreement is normally entered into to regulate the relationship between the senior noteholders, the senior lenders and any other noteholder, lender or swap provider. Among senior secured noteholders and senior secured lenders or senior noteholders and senior lenders, the proceeds of enforcement of guarantees or security interests is shared pari passu and on a pro-rata basis among each group.

Regulation of voting and control

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

In a high-yield context, the intercreditor agreement tends to follow the Loan Market Association template, which is governed by English law.

Usually, neither the senior noteholders nor the senior lenders may take any enforcement action without the prior written consent of the majority (more than 50 per cent of the relevant participations). This action will be carried out by the security agent on behalf of the secured parties, which shall not have any independent power to enforce the security except through the security agent.

TAX CONSIDERATIONS

Offsetting of interest payments

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

In general, interest payments are deductible for the issuer's corporate tax purposes, provided that they have been recorded in the accounts of the entity according to the accounting standards on their accrual. However, taking into account the international trends (base erosion and profit shifting), Spanish legislation foresees a general limit per tax year on the corporate income tax deduction of any kind of financial expenses (interest-capping rule).

In this regard, it establishes that net financial expenses exceeding 30 per cent of the taxpayer's operating profit (ie, EBITDA with some adjustments) will not be deductible for corporate income tax purposes. However, net financing expenses not exceeding €1 million per company will be tax-deductible in any case. Financial expenses disallowed under the interest-capping rule can be carried forward without any temporary limitation in subsequent years subject to the aforementioned limits. In parallel, in those cases in which financial expenses are below the 30 per cent limit, the difference between the aforesaid expenses and the limit can be added to that limit until the difference has been deducted (within a maximum of five years).

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, it is uncommon.

Switzerland

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

Traditionally, Swiss companies sought external debt financing primarily by borrowing from banks and, occasionally, by issuing corporate bonds. High-yield debt securities, however, made their first appearance in the Swiss corporate finance market only in March 1997 when Doughty Hanson acquired the Swiss sanitary systems manufacturer Geberit from the Geberit family in a transaction worth more than 1.8 billion Swiss francs. This leveraged acquisition was partly financed by a 157.5 million Deutschmark-denominated high-yield bond. The high-yield bond was priced at a spread of 420 basis points over German government bonds and was five times oversubscribed. Doughty Hanson exited this investment in 1999 by listing Geberit on the Zurich Stock Exchange (now known as SIX Swiss Exchange AG).

In the meantime, high-yield bonds became increasingly established in the Swiss corporate finance market with issuers such as the two Swiss telecommunications companies Sunrise and Orange (now known as Salt), the global travel retail company Dufry, the airport services provider company Swissport, and the steel producer and trader Schmolz + Bickenbach.

For Swiss companies seeking finance, high-yield bonds and bank loans have a number of similarities but also differ in numerous ways; therefore, each of these instruments has specific advantages and disadvantages. Neither Swiss law nor, in particular, Swiss financial market regulation provides for clear definitions of high-yield bonds and bank loans.

A common element of both instruments is that they are external debt financing instruments that increase the liabilities of a company raising funds and, should it become financially distressed, its bankruptcy risk.

High-yield bonds and bank loans differ as follows:

- Market: high-yield bonds are bond instruments issued in the debt capital market and held by dispersed institutional investors, whereas bank loans are granted in a private market by one or several banks that are organised among themselves in a consortium agreement and represented by one of the banks acting as agent.
- Secondary market: high-yield bonds are listed on a regulated exchange that provides for a regulated secondary market, whereas bank loans or bank loan commitments cannot be traded in a regulated secondary market, but can only be transferred in negotiated transactions.
- Issuer and borrower: high-yield bonds issuers are often special purpose vehicles (SPVs), whereas borrowers of bank loans are usually holding companies, treasury companies or operating companies.
- Subordination: high-yield bonds are junior to bank loans since they are either contractually or structurally subordinated and bear higher risks but compensate investors for the higher risks by yielding higher returns.
- Term: high-yield bonds are usually issued with terms of between five and 10 years with non-call features (eg, 7nc3 or 8nc4), whereas term loans granted by banks are usually given for terms of between three and five years and allow for voluntary early repayment and cancellation.
- Availability of funds: high-yield bonds are fully drawn at issuance and repayable at maturity (bullet maturity), whereas loans in particular under revolving credit facilities can be drawn flexibly whenever the borrower needs funds.
- Interest: high-yield bonds can have fixed or floating interest rates, whereas bank loans commonly have floating interest rates (LIBOR or EURIBOR plus margin).
- Covenants: high-yield bonds are subject to incurrence-based covenants, namely covenants that the issuer only needs to comply with on the incurrence of certain events; whereas bank loans are subject to maintenance covenants, namely covenants that the borrower needs to comply with as long as the loan is outstanding.
- Reporting: high-yield bond issuers are subject to disclosure requirements as set forth in the applicable listing requirements, whereas borrowers of bank loans are subject to reporting and disclosure requirements as agreed in the bank loan documentation, which can be more frequent or relate to further topics.
- Security: high-yield bonds are usually guaranteed but unsecured, but recently a number have been guaranteed as well as pari passu secured with bank loans. Investment grade bank loans are usually unsecured, whereas sub-investment grade loans or leveraged acquisition loans are usually secured and guaranteed.
- Applicable law: so far, all high-yield bonds issued by Swiss issuers, except for Groupe Arcotec SA (see question 2), have been subject to New York law, whereas bank loans are usually subject to Swiss law or, should the loan not be able to be syndicated in the Swiss market, English law.
- Swiss withholding tax: bank loans granted to borrowers incorporated in Switzerland are subject to the so-called 10-/20-non-bank mechanisms to avoid Swiss withholding tax being triggered on interest payments under the loans; high-yield bonds issued by Swiss issuers held by dispersed institutional or other investors are not subject to this mechanism and, therefore, Swiss withholding tax is triggered on interest payments under these bonds.
- Rating: it is market practice that high-yield bonds are rated by two external rating agencies, mostly two out of: Fitch Group, Moody's and Standard & Poor's (S&P) and the rating is below investment grade (Fitch: BB+; Moody's: Ba1; S&P: BB+), whereas no external rating is required for bank loans.

Based on the differences outlined above, for a company seeking financing, high-yield bonds are more expensive than bank loans, but leave the issuer and its group companies more operating freedom. Bank loans, on the other hand, usually have stricter covenants than high-yield bonds and restrict the borrower's freedom to operate more. However, bank loans also allow the borrower to use the funds more flexibly and, since the bank loan creditors usually consist of a lender syndicate represented by an agent, it is easier to amend, extend and restate a bank loan arrangement.

Regulation

2 | Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

In October 2014, the Regulatory Board of the SIX Swiss Exchange AG cleared the way for the listing of high-yield bonds in Switzerland. This is of particular relevance since in recent years, Swiss issuers have increasingly been tapping the high-yield bond market.

Previously, listing of high-yield bonds on the SIX Swiss Exchange was not possible since typical high-yield bond issuers, namely SPVs, were usually unable to satisfy the listing requirements (eg, track record of three years). Furthermore, it was not possible to have these listing requirements satisfied by a substitute guarantor since the SIX listing requirements only allowed direct or indirect parent companies of the issuer to act as substitute guarantors. However, since high-yield bonds usually only benefit from upstream or cross-stream guarantees, there was hardly ever a guarantor that could act as substitute guarantor for the issuer. As a consequence, high-yield bonds could not be listed on the SIX Swiss Exchange and, therefore, were generally listed in Luxembourg, Ireland or elsewhere outside Switzerland. For companies with shares listed on the SIX Swiss Exchange, this resulted in having to simultaneously comply with different listing and disclosure requirements.

The change in the Regulatory Board's practice that facilitated listing of high-yield bonds on the SIX Swiss Exchange was its decision to also allow direct or indirect subsidiaries or sister companies of the issuer to act as substitute guarantor – that is, group companies of the issuer which are granting upstream or cross-stream guarantees. The Regulatory Board also addressed any investor protection concerns resulting from this change by simultaneously raising the applicable disclosure standards. Furthermore, high-yield bonds are typically guaranteed (via both upstream and cross-stream guarantees) by a number of guarantors that collectively represent a fair share of group-wide earnings before interest, tax, depreciation and amortisation (EBITDA).

Groupe Arcotec SA was the first issuer to benefit from the new regulatory regime. On 22 September 2016, Groupe Arcotec SA issued the first Swiss law governed high-yield bonds that were listed on the SIX Swiss Exchange. It issued 106 million Swiss franc 4 per cent bonds due for 22 November 2021. The bonds were guaranteed by a group of guarantors collectively representing 66.2 per cent of the aggregate EBIT of the group, most of them incorporated in Switzerland, which granted upstream guarantees subject to Swiss law and Swiss financial assistance limitations. Bank loans, on the other hand, will become subject to stricter regulation.

Switzerland implemented the Basel III capital framework with effect as of 1 January 2013. In addition to this capital regime for all banks, special (higher quantitative and specific qualitative) requirements apply for systemically important banks (SIBs). Subject to certain phase-in provisions until end 2019, SIBs must hold sufficient capital that absorbs current operating losses to ensure that they can continue their business as a going concern even in financial stress scenarios, they neither require state support nor need to be restructured or wound up (going concern requirement). This going concern requirement fully applicable in 2020 consists of (i) a minimum requirement of 8 per cent of risk-weighted assets (RWA) and 3 per cent of leverage exposure, and (ii) a buffer of (i) 4.86 per cent of RWA and 1.5 per cent of the leverage exposure, leading to a so-called base requirement of 12.86 per cent of RWA and 4.5 per cent of leverage exposure, and (ii) an additional buffer surcharge, depending on the degree of systemic importance measured according to the market share and size criteria that already exist in the current system. In general, this requirement for systemically important banks must be met by common equity tier 1 (CET1) capital, with up to 3.5 per cent of RWA and 1.5 per cent of the leverage exposure of the minimum requirement and up to 0.8 per cent of RWA in the buffer permissible to be held in additional tier 1 capital instruments that would be converted into common equity or written down if the CET1 ratio falls below 7 per cent. The going-concern requirements for the two big banks of 5 per cent overall for the leverage ratio and 14.3 per cent overall for risk-weighted assets. The going concern requirement does not include any countercyclical buffers, which have to be held on top (see below).

For systemically important banks operating internationally (G-SIBs), such as Credit Suisse or UBS, additional requirements for loss-absorbing capacity apply. In addition to the going concern requirement, they must issue sufficient qualifying debt instruments to allow for restructuring without recourse to public resources (gone concern requirement). Similar rules apply to domestically systemically important banks (D-SIBs), with certain quantitative alleviations and qualitative specialities (mainly driven by the legal nature of some of the existing D-SIBs).

Furthermore, Swiss capital requirements provide for a supplemental counter-cyclical buffer of up to 2.5 per cent of a bank's risk-weighted assets. Since 30 June 2014, the counter-cyclical buffer has been set at 2 per cent of a bank's risk-weighted assets pertaining to mortgage bonds that finance residential property in Switzerland. Effective from 1 July 2016, Switzerland introduced the option of an extended countercyclical buffer, which is based on the BIS countercyclical buffer that could require banks to hold up to 2.5 per cent of RWA in the form of CET1 capital.

The effect of these increased capital adequacy ratios and gone concern ratios on bank loans is that it will become even more expensive for banks to extend bank loans because the capital adequacy requirements to support counterparty risks caused by this lending activity (and the resulting RWA) will be increased. Instead of granting bank loans at increased costs, banks may become inclined to convince clients to refinance by issuing capital market instruments such as high-yield bonds.

Current market activity

3 | Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

In line with the European market, the Swiss high-yield bond market was turbulent in 2018 with a number of deals withdrawn from the market throughout the course of the year and a sharp issuance decline in the fourth quarter of the year. Against this background, an ever-growing trend is that the Swiss market sees more refinancings of high-yield bonds with term loan B facilities. This started in October 2015, when Gategroup Holding AG refinanced its €250 million 6.75 per cent high-yield bonds by entering into a €250 million unsecured term loan B, fully underwritten by ING. At the company's current leverage level, the annual interest cost for the new term loan B facility was set at below 3 per cent, allowing savings of more than 10 million Swiss francs per annum. The refinancing was even worth the payment of an early repayment fee under the bonds of 17 million Swiss francs. This one-off repayment will be compensated by total interest cost savings in excess of 50 million Swiss francs over the term of the bonds.

We expect other high-yield bond issuers to follow Gategroup's example and refinance high-yield bonds with term loan B facilities or

generally to seek sub-investment grade funding in the term loan B or unitranche market rather than the high-yield bond market. Key terms of loan B financings are more closely aligned with those of high-yield bonds than senior bank loans. In particular, term loan B facilities have less strict covenants, with financial covenants only needing to be tested on an incurrence basis. Furthermore, term loan B facilities are generally secured pari passu with the other (ie, term loan A) lenders. However, term loan B facilities usually have less call protection than high-yield bonds, allowing borrowers greater flexibility in making prepayments under term loan B facilities.

Main participants

4 Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants in the Swiss high-yield bond market are the two major Swiss banks, Credit Suisse and UBS. They act as underwriters as well as financial advisers for the issuers. They become particularly involved when they help a borrower under a bank loan to refinance a loan with a high-yield bond.

New trends

5 Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Many of the high-yield bonds issued by Swiss companies in the context of leveraged acquisition transactions have been secured pari passu with senior secured credit facilities agreements. In addition, both the high-yield bonds and the credit facilities have been guaranteed by group companies representing a certain minimum threshold of the group's EBITDA or total assets, for example, 80 per cent or more.

The pari passu treatment of the guarantees and the security granted in relation to the senior secured credit facilities agreement and the high-yield bonds is achieved, first, by including claims under the senior secured credit agreement and the high-yield bonds in the definition of 'secured obligations'; and, second, by governing the application of the proceeds in the intercreditor agreement between, among other things, the issuer of the high-yield bonds, the borrowers under the senior secured credit facilities agreement, the guarantors, the security providers and the security agent.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

In principle, high-yield bond issuances by Swiss issuers follow the precedents in the European high-yield bonds market. However, important precedents up to and until today are the senior secured notes issued by Sunrise Communications in October 2010. These notes were secured by first-ranking security interests, which at the same time were granted equally and rateably on a pari passu basis to the lenders under a senior credit facilities agreement. This high-yield bond issuance was seminal for several pari passu secured high-yield bond issuances to follow in the Swiss market, including, for instance, the senior secured notes issued by Swissport in January 2011; by Orange in May 2015; by Schmolz + Bickenbach in May 2017; by Salt in March 2017; and by Selecta in February 2018.

The documentation for the Swiss law governed high-yield bond issued by Groupe Arcotec SA on 22 September 2016, however, followed the leaner Swiss corporate bond documentation precedents, even though it included a discussion and analysis by the management of the group's financial condition and results of operations.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

High-yield bonds are usually issued with terms of between six and eight years with non-call features (eg, 7nc3 or 8nc4). After expiry of the non-call period, the high-yield bonds are typically redeemable at a redemption price equal to par plus one-half of the coupon and then declining rateably to par two years before maturity.

Issue discounts are rarely granted. Among the few examples are the 8.5 per cent senior notes due 2018 issued by Sunrise Communications in October 2010, which were issued at 99.224 per cent, and the 9.875 per cent senior secured notes due 2019 issued by Schmolz + Bickenbach in May 2012, which were issued at 96.957 per cent. The Swiss law governed high-yield bonds issued by Groupe Arcotec SA on 22 September 2016 were issued and will be redeemed at par.

Typical yield protection provisions include incurrence-based covenants such as restrictions on incurring additional debt; granting security or other liens on assets; making certain investments, dividend payments or distributions; selling assets; or entering into transactions with affiliates.

Further, yield protection is achieved by guarantees granted by group companies of the issuer. Typically, high-yield bonds are guaranteed by group companies representing a certain minimum threshold of the group's EBITDA or total assets, for example, 80 per cent or more.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The Swiss market practice for launch, pricing and closing of high-yield bonds follows established European market practice.

High-yield bonds usually bear fixed-rate interest. One of the few exceptions is the floating rate senior secured note issuance of March 2017 due for 2023 by Matterhorn Telecom (ie, Orange).

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

The negative covenants in a typical high-yield bond covenant package are essentially promises by the issuer and its restricted subsidiaries to refrain from certain acts that could impair the issuer's ability to satisfy its obligations under the high-yield bonds. In particular, high-yield bond covenants are designed to prevent the 'controlled group' from becoming over-leveraged, to protect the position of the holders of the high-yield bond in the controlled group's capital structure and to preserve the assets of the group and the issuer's access to those assets.

The covenants limit the ability of the issuer and its restricted subsidiaries to, among other things:

- incur additional debt;
- make certain 'restricted payments' that would result in value leakage out of the controlled group;

- enter into transactions with affiliates;
- issue guarantees of financial indebtedness of other members of the controlled group;
- grant liens on property;
- make sales of assets and subsidiary stock;
- enter into transactions that would result in a change of control of the issuer;
- enter into mergers or consolidations, or sell substantially all of the issuer's or the guarantors' assets;
- enter into consensual restrictions that limit distributions and transfers of assets around the controlled group; and
- modify the intercompany loans securing the high-yield bond or the terms on which the intercompany borrowers can issue other intercompany debt.

Convergence of the covenants listed above can be seen with covenants in term loan B facilities.

10 | Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

The financing conditions in the high-yield bond market in Switzerland and closely aligned to the European market. As in the European market, on the one hand, we have seen more aggressive bond terms such as, for instance, expansive acquired or acquisition debt basket or diminished default blockers under restricted payment covenants. On the other hand there was also considerable more investor pushback in 2018 than the year before and, therefore, the covenants of some high-yield bonds have been amended between launch and pricing.

11 | Are there particular covenants that are looser or tighter, based on a particular industry sector?

The constriction of covenants is less dependent on the industry sector, but rather on the rating of the issuer and the condition of the high-yield bond market in general.

Change of control

12 | Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Usually change of control provisions, if triggered, allow the holders of high-yield bonds to request the issuer to repurchase all or part of them. Prepayment obligations can also be contained in asset sale covenants; however, this prepayment obligation usually only applies with regard to excess proceeds that were not able to be reinvested.

13 | Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

The terms and conditions of the high-yield bonds issued by the Orange group subsidiary Matterhorn Telecom in May 2015 provided for an exemption from the change of control provision in case it was a 'specified change of control event' – namely, if the change of control occurred as a consequence of a merger or similar transaction, the consolidated net leverage ratio of the issuer and the restricted subsidiaries stayed below a certain level (4.5 to 1.0) and the specified change of control event only occurred once.

Crossover covenants

14 | Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

The concept of 'crossover covenant package' is known in the Swiss market. However, so far it has only been used in the context of credit facilities agreements (eg, bridge or revolving facilities agreements), but not in the context of high-yield bonds.

REGULATION

Disclosure requirements

15 | Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

As a matter of Swiss law, no prospectus needs to be prepared if a high-yield bond is only privately placed in Switzerland. Furthermore, since high-yield bonds are usually not listed in Switzerland but rather in Ireland or Luxembourg, no Swiss listing prospectus is needed. Also, there is no Swiss regulatory body approving any offering material or other disclosures that are distributed or disseminated in the context of a high-yield bond offering in Switzerland. The sole exceptions so far are the high-yield bond issued by Group Arcotec SA issued on 22 September 2016, which were listed on SIX Swiss Exchange and, therefore, the prospectus had to comply with Swiss listing requirements.

The terms 'public offering' and 'public subscription' are not defined in the Swiss Code of Obligations (CO). Generally speaking, a public offering is understood to be an offering made to an indefinite number of investors or by means of a public advertisement (eg, newspaper announcement, mass-mailings, web page with unrestricted access). By contrast, if issuers or placement agents solicit individually a limited number of selected investors, including by inviting them to roadshows or calling this finite number of handpicked investors individually, the offering is considered to be private as long as there are no public advertisements or similar communications relating to the offering.

A qualitative approach is generally considered appropriate to distinguish a public offering from a private placement. This approach is not based on a specific number of offerees, but considers whether investors were selected based on objective criteria as opposed to a general solicitation to the public or whether the investors have a pre-existing specific relationship with the issuer (eg, existing shareholders, existing employees).

Given the need for numeric guidance, practitioners and commentators have developed a quantitative rule of thumb, which focuses on the number of offerees. The threshold between a private placement from a public offering has, based on this rule of thumb, traditionally been set at 20 investors; although, following the practice established under the Prospectus Directive, there is a trend among practitioners to consider that the threshold is at 100 investors. Some practitioners recommend as an additional precautionary measure to limit an offering relying on this higher threshold to institutional investors and (possibly) high net worth individuals.

Even though Swiss law does not require a prospectus for a private placement of a high-yield bond, Swiss prospectus liability in accordance with article 752 of the Swiss Code of Obligations may still apply since this liability applies not only to public offering prospectuses, but also to any other offering or marketing material disseminated in the context of an offering, including a private placement. Prospectus liability claims can succeed only if, inter alia, the plaintiffs can establish causation. In other words, the plaintiffs must show that the misstatement of information

or the failure to provide certain information in the prospectus or other offering or marketing material was an actual and adequate cause of the damage suffered. For example, if an offering memorandum for a high-yield bond contains misleading information, the plaintiffs would have to prove that, first, they would not have bought the high-yield bond, or would have bought it at a different price, if they had not been misled by the information in the offering memorandum and, second, that misleading information caused the damage in question. In other words, if missing or misleading information in an offering memorandum does not constitute cause for the damage in question, there is not a cause of action for prospectus liability under Swiss law.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

Swiss financial market regulation does not limit the use of proceeds from a high-yield bond issuance. However, high-yield bond proceeds in Switzerland will trigger Swiss withholding tax.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Swiss financial market regulations contain investment restrictions for certain types of investors, such as insurance companies or pension funds. In particular, Swiss pension fund regulations set forth detailed asset allocation and risk diversification requirements that could prevent a Swiss pension fund from investing in a high-yield bond.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

Other than the closing requirements that apply to Swiss-law-governed security, Swiss law does not provide for closing mechanics specific to high-yield bonds.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

Should a Swiss guarantor or security provider grant upstream or cross-stream guarantees or security, these guarantees or security will be subject to Swiss financial assistance limitations and will need to be allowed by the corporate purpose provision set forth in the Swiss entity's articles of association. The granting of these guarantees or the provision of this security must be approved not only by the board of directors of the Swiss entity, but also by its shareholders. Furthermore, payments under these guarantees or the application of enforcement proceeds of the security will be limited to the amount corresponding to the Swiss entity's freely disposable equity at the time of enforcement. The amount must be determined based on current audited financial statements. Finally, a Swiss-language limitation is usually included in the guarantee and the respective Swiss security agreements.

The security is granted to the security agent which, with regard to a Swiss-law-governed security, acts as direct or indirect representative of the secured parties. With regard to accessory security rights, such as pledges, the security agent acts as direct representative in the name and on behalf of the secured parties; and with regard to non-accessory security rights such as assignments or transfers, the security agent acts as indirect representative in its own name but on behalf of the secured parties.

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

In the Swiss market, a typical security package includes a pledge over the shares or, in the case of a limited liability partnership, the quotas of the relevant Swiss entity and, furthermore, each Swiss security provider grants a pledge over certain of its bank accounts as well as over its material intellectual property rights, if any, and assigns for security purposes certain receivables, such as insurance, intragroup and trade receivables. Security over movable assets is hardly practicable under Swiss law; in particular, if they are needed by the Swiss security provider for operational purposes since, as a matter of Swiss law, the perfection of a pledge over, or the security transfer of, movable assets requires that they be handed over to the secured parties, typically represented by the security agent, and, the Swiss security provider will no longer be able to dispose of these assets.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

Other than for the financial assistance limitations described above, there are no limitations specific to high-yield bonds that apply to the granting of Swiss law governed security, the assets that could become subject to these security interests or the parties that could provide this security.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

The security is granted to the security agent that, with regard to Swiss law governed security, acts as a direct or indirect representative of the secured parties. With regard to accessory security rights such as pledges, the security agent acts as direct representative in the name and on behalf of the secured parties; and with regard to non-accessory security rights, such as assignments or transfers, the security agent acts as an indirect representative in its own name but on behalf of the secured parties.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

The costs of legal expenses related to perfection of the security interests, maintenance and enforcement are borne by the security providers.

Security interests

24 How are security interests recorded? Is there a public register?

Other than with regard to security over real property, which must be recorded in the Land Register, or security over aircraft, which must be recorded in the Swiss Aircraft Records Register, Swiss-law-governed

security interests, for perfection purposes, do not need to be recorded in any public registers.

Pledges over Swiss intellectual property rights are only registered with the Swiss Federal Institute of Intellectual Property for transparency and disclosure purposes, but not for perfection purposes.

Also, pledges over shares in Swiss corporations or quotas in Swiss limited partnerships, for instance, for perfection purposes do not need to be recorded in the registers of the respective entities.

25 | How are security interests typically enforced in the high-yield context?

The enforcement of Swiss law governed security is independent of whether the security has been granted to secure obligations under a high-yield bond or under any other agreement or undertaking. In principle, as long as the security provider is not subject to any insolvency or bankruptcy proceedings, the secured party or the security agent may enforce the security at its own discretion either by way of private enforcement or by way of enforcement proceedings pursuant to the Swiss Federal Debt Enforcement and Bankrutpcy Act.

During the course of a private enforcement, the secured parties or the security agent may either sell the pledged assets to a third party or acquire any and all or part of the assets on their own or the secured parties' behalf on arm's-length terms.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 | How does high-yield debt rank in relation to other creditor interests?

High-yield bonds are junior to bank loans as they are either contractually or structurally subordinated.

Regulation of voting and control

27 | Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

It is standard market practice in Switzerland that intercreditor agreements relating to high-yield bonds and bank loans are subject to English law, and voting and control rights are always allocated in accordance with European practice.

TAX CONSIDERATIONS

Offsetting of interest payments

28 | May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Issuers may set off interest payments on high-yield bonds against their tax liability. No special considerations apply for the high-yield bond market. To avoid the 35 per cent federal interest withholding tax, high-yield bonds are typically not issued by a Swiss-resident company but rather by a foreign resident issuer. There are restrictions, however, with respect to on-lending the proceeds to Switzerland by way of debt push-down and the permissible interest rates on intra-group loans.

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Tax rulings

29 | Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

Typically, high-yield bonds are issued by a foreign resident issuer. A tax ruling is typically obtained from the Swiss Federal Tax Administration to ensure that a foreign-issued high-yield bond is not considered a Swiss issuance for the purposes of Swiss withholding tax. In that respect, the Swiss Federal Tax Administration issued new guidelines on 5 February 2019 resulting in more flexibility with respect to the amount of permissible on-lending to Switzerland. Furthermore, tax rulings are regularly obtained from the cantonal tax administrations and the federal tax administration alike with respect to permissible interest on intra-group loans and thin capitalisation rules if the high-yield bond is secured by a Swiss resident company and the proceeds raised under high-yield bonds are on-lent to Switzerland.

United Kingdom

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

High-yield debt securities, unlike bank loans, are regulated by securities laws. In fact, an offering may be regulated by several different regimes if sold into multiple countries.

Typically, a tranche of high-yield securities issued by an English issuer will be sold, or at least be eligible to be sold, into the United States under an exemption from registration made available under Rule 144A under the US Securities Act of 1933. The US securities laws will therefore be relevant both as to whether the securities qualify for an exemption from registration and as to the disclosure standards applicable to the offering documents (see questions 2 and 15 on Rule 10b-5 under the Securities Exchange Act of 1934).

A tranche will also typically be sold to investors in the United Kingdom and the rest of Europe, so that UK and local requirements will apply to govern to whom the securities may be offered in each jurisdiction.

Finally, high-yield securities issued by English issuers are typically listed on a stock exchange, often in Luxembourg or Dublin, but also in various other jurisdictions. Therefore, the offering documentation must comply with stock exchange requirements and, depending on the type of stock exchange, potentially also national laws regulating the offering of stock exchange-listed securities.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

Yes, to a limited extent in relation to high-yield securities. High-yield securities in general are governed by New York law and subject to Rule 10b-5 when sold into the United States. As a result, changes in the US laws made from time to time as to disclosure requirements tend to flow through into the London high-yield market as well. In addition, European regulations as to listed securities have seen constant updating and reform, meaning that issuers of high-yield securities have become subject to higher disclosure standards, particularly in relation to ongoing reporting.

Indirectly, high-yield securities have also been affected by increased regulation of the investment banks that underwrite or arrange their sale. Investment banks are constrained in the leverage levels that they may offer to underwrite for issuers and also in their ability to trade in securities for their own account.

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

After a weak 2016, the European high-yield market returned strongly in 2017, with issuers achieving low interest rates and also generally securing favourable documentary terms. This trend continued at the start of 2018, with issuers achieving favourable pricing and ever-improving terms, before the market reversed itself in the second half of 2018, as margins widened and investors pushed back on some terms.

The traditional role of high-yield securities in the London market was in providing a junior layer of capital behind bank debt, often to provide a higher leverage level than available from bank-only financing. This role changed substantially over time. Particularly in the period after the Lehman collapse, when the loan market was much more constrained and bank balance sheets were impaired, high-yield investors filled the gap by financing senior secured notes that took the place of bank debt. These notes were often paired with a super senior revolving credit facility to provide liquidity to the issuer.

The London market has now seen a resurgence of the loan market, so that the senior secured note product has been replaced in many cases by a loan facility, and high-yield securities have often taken up their traditional position again in providing a junior layer of debt that adds more leverage.

The London and European markets as a whole have also seen the development of crossover or 'high-yield lite' packages, which are similar to investment grade covenant packages, even though issued by subinvestment grade issuers. This may continue if a sizeable number of large public companies are rated sub-investment grade.

Main participants

4 Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The participants in a high-yield debt financing in the United Kingdom are essentially the same as those in a US transaction. The key participants are the banks that play the role of the underwriters or initial purchasers. The underwriters have three main responsibilities:

- They create the process for the issuer. They create the timeline, prepare the issuer for meetings with investors, create roadshow schedules, bring the issuer on the roadshow to meet with investors and so on.
- They are responsible for marketing the offering for the issuer. For example, the offering document for a high-yield debt security will typically have a short section upfront commonly referred to as the 'box', and it will contain, among other things, strengths and strategies of the company, which is the marketing element of the disclosure document. The underwriters play a significant part in crafting the marketing story for the issuer.

- They act as the gatekeepers for the market in terms of the covenant package being negotiated. As opposed to bank loans, the underwriters typically do not hold the high-yield debt securities on their books, but they are looked on as the experts in terms of what the market will and will not bear as it relates to covenant packages. For their services, the underwriters will receive a gross spread tied to a percentage of the issue price.

There are other participants in a high-yield debt financing. Lawyers and accountants play a crucial role representing the issuer on the one hand and the banks on the other. Rating agencies are always involved because they have to provide a rating on the proposed high-yield debt security that is critical for the execution of the deal. And finally, there is the trustee. High-yield debt securities are very widely held. As a result, it would be impractical to have each investor sign the indenture, which is the document that contains the covenant package for the securities. Instead, the trustee signs the indenture on behalf of all of the note holders and acts as middleman between the issuer and the investors, which helps control the flow of information among the parties. The trustee comes equipped with its counsel on any transaction and receives fairly standard flat fees in connection with each engagement.

If a stock exchange listing is desired, thought must also be given to the selection of an appropriate stock exchange for the listing, together with counsel and a listing agent.

New trends

5 Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

The trends in high-yield are always changing based on the state of the market. For example, when the market is hot and there is much demand for high-yield paper, issuers and sponsors start to forge ahead. As a result, there tends to be more flexibility in the covenants, primarily in terms of issuing debt and making restricted payments. As the market cools off and investors become more selective in terms of the paper they are willing to buy, covenant packages start to tighten up.

The real trend is increased regulatory review and its effect on the high-yield market as a whole. Every statistic shows that the number of leverage buyouts over the past year or so has declined, and the size of those buyouts has declined as well. One reason for this is increased regulatory scrutiny of the banks and limits to how much debt they can lend to companies for these types of acquisitions.

DOCUMENTATION TERMS

Issuance

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Every high-yield debt security is issued pursuant to an offering memorandum or prospectus provided to prospective investors. The offering memorandum describes the business of the company, describes the transaction being undertaken and contains the covenant package being offered to investors.

There are always precedents and models that need to be reviewed prior to issuing the securities. In a sponsor leveraged-buyout scenario, the issuer will usually look to the last deal completed by that sponsor. Every sponsor has a form for its covenants and while every covenant package will be tailored to the particular needs of each issuer and its industry, the sponsor form is the starting point for these deals.

Every sponsor and bank has a form. If the issuer has issued high-yield debt securities in the past, then the prior covenant package is the appropriate starting point for the new issuance. However, for debut high-yield issuers, typically, the deal team will look at a combination of the lead bank's form, recent sponsor precedent (if relevant), recent precedents in the issuer's particular industry and perhaps recent precedents for issuers with a similar credit profile.

Maturity and call structure

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

High-yield debt securities issued in the London market tend to have either an eight-year or a seven-year maturity, although there are securities issued with different maturities, including substantial numbers with a five-year term. In general, high-yield debt securities are not redeemable at the option of the issuer for a specified number of years, permitting investors to lock in an interest rate for a significant period. For example, after a three-year non-call period, seven-year securities are typically redeemable at a redemption price equal to par plus half the coupon, and the premium then declines rateably to par two years before maturity. These terms change depending on the strength of the market and the strength of the issuer, with the premium payable or the non-call period changing.

Make-whole redemption allows issuers to call the securities during the non-call period at a price equal to the present value of the optional redemption price on the first optional redemption date and future interest payments up to that date. The present value is almost always calculated based on the Treasury (or Bund or Gilt, as applicable) rate plus 50 basis points, which approximates the price that investors would expect to receive in a tender offer.

Another significant exception to the non-call period is the ability of an issuer to redeem a portion of the securities with the proceeds of an equity offering during the three years following the issuance date (commonly referred to as the 'equity clawback' or 'equity claw'). This exception, which is nearly universal in high-yield offerings, permits the issuer to deleverage after an initial public offering or after raising additional equity capital. Typically, issuers may not redeem more than 35 per cent of the original principal amount of the securities in an equity claw, although 40 per cent is possible in some deals. The issuer must pay a redemption price to investors equal to par plus a premium equal to the full coupon, plus accrued interest.

A less common exception to the non-call period is the ability of the issuer to redeem a small portion (typically 10 per cent) of the securities during the three years after the issue date, at a specified premium to par (typically 103 per cent). This provision is much less common than the 'equity claw' provision described above. One argument for this provision is that secured notes became prevalent in the marketplace during the global financial crisis in 2008 and often substituted for secured term loans. While term loans are generally prepayable at par, many terms loans include a soft call at 101 per cent feature for a short period after the closing date if prepaid with the proceeds of another financing, so some issuers sought to mimic this type of redemption feature for secured notes. As a result, in capital structures where secured notes exist alongside secured credit facilities, it is sometimes possible to redeem up to 10 per cent of the notes in any 12-month period during the first three years after issuance, at a price equal to 103 per cent plus accrued interest. Occasionally this 10 per cent exception is found in unsecured notes too, particularly floating rate notes.

Some high-yield securities are issued with a floating rate of interest, and these securities tend to have terms more favourable to the issuer for redemption; they may be non-call for only a year or two, and have a low premium on being eligible for redemption, such as 2 per cent or 1 per cent.

The redemption features are not mutually exclusive.

A small amount of original issue discount (OID) is sometimes used in the bond market to ensure a successful syndication where needed. For deals that are otherwise not saleable, typically, if an underwriter is selling securities to refinancing a bridge facility, large amounts of OID may be offered to investors.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The timeline of a typical high-yield offering is as follows. An offering is launched by the distribution of the 'red' (ie, the preliminary offering memorandum or prospectus) to investors, which is often accompanied by a press release.

For a debut issuer or a significant transaction, the issuer may then go on the road to meet with investors while the banks are building the book. A formal roadshow can be as short as three days and as long as two weeks. The bankers will determine the length of the roadshow and will instruct accounts that books will close by a certain time on the last day of the roadshow, which is the deadline for submitting an order in the security. After the books have closed, the bankers will schedule a pricing call with the issuer and the bankers (in their role as initial purchasers of the securities) and the issuer will agree to the terms of the deal (eg, the coupon, issue price, maturity and call schedule).

Most high-yield debt securities are issued at a fixed coupon and the coupon is determined as a result of investor demand. Many factors lead to the determination of the coupon, including the general market, the health and stability of the issuer, the issuer's industry, the covenant package, the financial performance of the issuer and the issuer's performance during the roadshow.

After the pricing call, a pricing term sheet is sent to investors to confirm sales, coinciding with the signing of the purchase agreement between the issuer and the initial purchasers, pursuant to which the initial purchasers agree to purchase the securities from the issuer. Once a securities transaction is priced, the securities begin trading. As part of the pricing terms, the parties will also schedule a closing date, which is typically done on a T+3 basis. Therefore, three business days after pricing, the securities offering will close and the issuer will receive the proceeds of the offering.

Note that for a repeat high-yield issuer, launch and pricing are often accelerated to a single day, known as a drive-by. In other words, the offering would launch before the market opens, followed by single or multiple investor calls, followed by pricing later that afternoon. If the market is familiar with the issuer, the need to have a formal roadshow to meet with accounts is generally not required, resulting in an accelerated process.

Floating rate notes are less common than fixed-rate notes in the London market, but they did see some popularity among issuers because they mimicked some aspects of bank loans by having less call protection and a floating rate of interest. With the resurgence of the bank loan market, floating rate notes may prove less popular.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

High-yield covenants always seek to strike a delicate balance. On the one hand, the covenants provide protection for high-yield investors against an issuer overextending itself or using cash unwisely. On the other hand, the covenants must provide flexibility for the issuer to operate its business and grow over the life of the high-yield debt securities. In other words, the covenants protect the investors' ability to be paid principal and interest on the securities while preserving the issuer's ability to run its business without undue restrictions.

The high-yield covenant package is focused on regulating the ability of the issuer and its restricted subsidiaries to service its debt and achieve the balance described above. High-yield covenants are very flexible in permitting different types of transactions between the issuer and its restricted subsidiaries or among restricted subsidiaries – in many cases, regardless of whether those restricted subsidiaries are guarantors or non-guarantors.

While each high-yield covenant package is distinct, the main covenants are as follows:

- Limitation on restricted payments (RP): this is often called the 'RP covenant'. The RP covenant regulates the amount of cash and other assets that may flow out of the issuer and its restricted subsidiaries. It limits:
  - cash dividends and other distributions;
  - the redemption or repurchase of the issuer's capital stock;
  - the redemption or repurchase of subordinated debt obligations prior to their scheduled maturity; and
  - restricted investments, which are investments that are not listed as permitted investments.
- Limitation on indebtedness: the debt covenant restricts the amount and the type of debt the issuer can incur. High-yield investors, on their side, care very much about leverage and, when analysing an issuer, will often ask themselves: 'How much debt am I comfortable letting the company put ahead of me?'
- Limitation on liens: the lien covenant is focused on protecting the high-yield investors' position in the capital structure by regulating the incurrence of secured debt that may be effectively senior to or pari passu with the high-yield debt securities and ensuring that the securities have a senior priority lien on collateral that secures any junior debt.
- Limitation on asset sales: unlike a traditional credit agreement, high-yield debt securities do not place strict limits on asset sales. Instead, the high-yield asset sale covenant establishes guidelines that must be followed in any asset sale and permits the issuer to use the proceeds either to reinvest in the business or to prepay debt that ranks higher than or equal to the high-yield debt securities in the capital structure. If the issuer does not use the proceeds in this way, it is required to offer to repurchase the high-yield debt securities at par plus accrued interest.
- Limitation on affiliate transactions: the limitation on affiliate transactions covenant limits the issuer's ability to enter into transactions with affiliates unless those transactions are on terms no less favourable than would be available for similar transactions with unrelated third parties. The covenants are designed to prevent value from leaking out from the issuer to affiliates that are not subject to the covenants of the indenture.
- Reporting: the reporting covenant is aimed at ensuring the flow of information that high-yield investors need to support trading in

the high-yield debt securities, and to monitor the performance of the issuer.

- Mergers and consolidations: the merger and consolidation covenant is designed to prevent a business combination in which the surviving obligor for the high-yield debt securities is not financially healthy, as measured by a ratio test. The covenant also seeks to ensure that noteholders will have enforceable rights against the surviving entity in a merger, consolidation or transfer of all or substantially all the assets of the issuer or a subsidiary guarantor.
- Future guarantors: the future guarantors covenant is designed to make sure that if a subsidiary of the issuer is guaranteeing other debt, the noteholders get the benefit of that guarantee. As a result, the common formulation is that if a restricted subsidiary guarantees the bank facility of the issuer, that entity will guarantee the high-yield debt securities as well. In addition, if the issuer decides to issue new high-yield debt securities, the guarantor package will be the same across both tranches of securities. In securities where the notes are senior secured, there may also be a requirement that each material subsidiary becomes a guarantor of the high-yield securities.
- Change of control: the change of control covenant requires the issuer to purchase the high-yield debt securities from noteholders at a price equal to 101 per cent plus accrued interest if a 'change of control' of the issuer occurs. The rationale for giving investors this 'put' right is that investors purchased the securities based, in part, on their comfort with the management or the controlling shareholders of the issuer, or both.

Note that for covenants appearing highly restrictive, there is a set of baskets and exceptions giving the issuer the flexibility it needs to operate its business and grow over the life of the high-yield debt securities. The exceptions are limitless and they are highly negotiated.

During the second half of 2015, a number of lead sponsors were able to raise bank debt on terms containing covenants more akin to those set out above than traditional European senior bank deal covenants. This trend of term loans with high-yield-style covenants continued into 2016 and 2017, with more and more loans being executed on a 'covenant-lite' basis with terms approaching those available in the high-yield market.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

Tightening and loosening of covenants tends to depend on market conditions and the quality of companies coming to market. That said, various commentators and agencies that grade covenants have taken the view that covenants as a whole have loosened in the years following the collapse of Lehman Brothers in 2008.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

The European high-yield market has a large telecommunications and cable sector, and issuers in that sector typically are able to obtain more covenant flexibility than in some other industries, largely because of the strong cash generation and low volatility typical within it.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

As discussed in question 9, a change of control typically requires the issuer to offer to prepay the bonds at 101 per cent plus accrued interest. Of course, if the trading price of the bonds increases (ie, above 101 per cent) after announcement of a change of control, then holders will most likely elect not to put. In other words, if the bonds trade up, that typically means that the investors are comfortable with new management or the new owner and would prefer to stay invested in the bonds, but the issuer must still make the offer to the investors.

Asset sales only trigger a prepayment obligation at par plus accrued interest if the issuer does not use the asset sale proceeds in a manner permitted by the asset sale covenant (ie, use the proceeds to reinvest in the business or pay down debt). If an issuer is unable to apply the net proceeds of an asset sale in the manner and in the time allowed under the covenant, it must then make an offer to acquire the bonds at par plus accrued interest once the excess proceeds reach a negotiated threshold. If the offer is oversubscribed, then the issuer must purchase the bonds on a pro rata basis. If the offer is undersubscribed, then the issuer can use the remainder for general corporate purposes, and the excess proceeds amount is reset to zero.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

The double-trigger concept based on ratings has been found in some deals, particularly in the telecommunications and cable area. However, much of the focus in the London market has been on a double trigger based on leverage levels rather than ratings. For a period, many sponsor-backed deals had this feature, especially if the high-yield securities were issued in contemplation of a possible exit in the near future. It has now spread more widely in the market and has become an increasingly common feature.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Yes. Crossover covenant packages have been provided for issuers with split high-yield or investment grade ratings from rating agencies as well as issuers on the cusp of being investment grade, and in some cases to issuers that have strong fundamental credit characteristics that are not reflected in their ratings. Crossover packages vary widely, some resembling investment grade packages and some adding additional features such as limitations on indebtedness rather than just a negative pledge clause.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

High-yield debt securities arranged in the London market are typically sold to institutional or other sophisticated investors through various private placement exemptions. Securities sold into the United States are sold in reliance on the Rule 144A exemption (see question 1). As a result, the securities do not need to comply with the requirements for securities that are publicly offered and sold within the United States.

Nevertheless, high-yield securities typically strive to meet this standard. Investment banks and issuers are concerned to ensure that they present a full package of information to investors such that investors can make informed investment decisions about the issuer. Rule 10b-5 will apply to securities sold within the United States. The rule makes it unlawful for any person to make an untrue statement

of material fact, or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. As a result, issuers and investment banks are keen to include all information that would be required in a regulated offering, unless the conclusion can be safely reached that it is not material despite that regulatory requirement.

In addition, a listing on a stock exchange will require issuers to meet stock exchange listing requirements. Given the high level of disclosure in a high-yield offering memorandum, any additional information required by a stock exchange will usually be only incremental.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

None other than in violation of any anti-terrorism, anti-money laundering or similar law, or general corporate laws.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

As noted above, offerings of high-yield securities are typically made only to sophisticated investors in reliance on exemptions from laws restricting the offering of securities. Securities are usually offered into the United States in reliance on Rule 144A under the Securities Act of 1933, which allows private resales to qualified institutional buyers. Securities sold in the United Kingdom will be offered only to specified categories of persons, including certain investment professionals, high net worth companies and so on. To qualify for the most favourable private placement treatment with the EU, high-yield securities are frequently issued with a minimum denomination of £100,000 or €100,000.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

High-yield securities are typically cleared through Euroclear and Clearstream in the same manner as other securities.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

The United Kingdom is generally a friendly jurisdiction in its ability to grant guarantees. Often, a high proportion of the issuer's subsidiaries will be able to guarantee the high-yield notes. Financial assistance rules still apply in the case of public limited companies.

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

It is relatively simple to take security in favour of high-yield securities and their guarantees. A typical package for senior secured notes would consist of a pledge of the shares of the issuer's material subsidiaries, intercompany receivables and bank accounts, often captured in an English law-governed all-assets debenture, which usually includes a floating charge (see question 20). Sometimes further asset security is given, for instance, in companies with a portfolio of real estate.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

England is generally a friendly jurisdiction for the grant of security. Among others, a floating charge may be granted over the entirety of a company's enterprise, and an equitable charge may be granted over future property that the chargor does not yet own. High-yield securities do not suffer from any particular limitations that do not apply to debt generally. There are no general limitations on the type of security an English private limited company or public limited company can provide, although if the entity granting security is a limited liability partnership (LLP), there are certain other factors that need to be considered; for example, LLPs are also required to register the security they create at Companies House (see question 24).

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

Crossing liens are uncommon. Typically, security is shared pursuant to the terms of an intercreditor agreement that regulates the ranking of the security in enforcement or insolvency situations and covers questions as to the right to direct enforcement and any standstills or consultation required among different creditor groups.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

Typically, the issuer pays these expenses.

Security interests

24 How are security interests recorded? Is there a public register?

Recording of interests depends on the type of asset subject to the security interest. In general:

- A legal mortgage over real estate that is registered must be registered at the Land Registry; a legal mortgage over unregistered real estate is registered at the Land Charges Department, although there may be an obligation to register this real estate as a consequence of creating the legal mortgage; an equitable mortgage may be registered and it is recommended that this registration is made to protect the priority position of the security being created.
- Security over assets such as bank accounts, shares and intercompany receivables and other non-possessory security created by an English company must be registered at Companies House within 21 days of its creation. Failure to register in time results in the charge being void against a liquidator, administrator or creditor of the relevant English company creating the charge.
- A charge of registered intellectual property may be registered at the appropriate patents, trademarks or design registry at the UK Intellectual Property Office.
- Security over assets such as aircraft or ships, agricultural charges and security given by individuals are subject to a separate registration regime, which depends on the asset being secured and the entity granting security.

25 How are security interests typically enforced in the high-yield context?

Security for high-yield securities that are junior in the capital structure is rarely enforced; typically, in an enforcement scenario, the senior secured bank loans or other instruments ranking ahead in the capital structure will control the process and therefore enforcement. However, the security interest in favour of the high-yield securities still has a role: to enforce efficiently in a sale to a third party, that security will have to be released so that the buyer can purchase an asset free of competing security. This release in turn will require the enforcing creditors to comply with whatever requirements are imposed by the intercreditor agreement to allow that release.

These requirements are designed to protect the high-yield investors and may include, among others:

- the need for a fair market value opinion to be obtained in relation to an enforcement sale;
- the need for consultation to take place with the high-yield investors or their representative; or
- that an auction process be held, sometimes with a requirement that the high-yield investors be entitled to participate in that auction.

Security for senior secured notes is enforced by the holders of a sufficient principal amount of the securities directing the security agent to enforce in accordance with the provisions included in the intercreditor agreement. An auction process is often conducted by the security agent.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 How does high-yield debt rank in relation to other creditor interests?

It is entirely dependent on where in the capital structure the high-yield debt is intended to sit. In the case of senior secured notes, the high-yield component will, in principle, rank equally with other senior secured debt, although the high-yield note holders may be pursuant to an intercreditor arrangement agreement that certain super senior debt may be recovered first from the proceeds of enforcement. Super senior debt may include a limited revolving credit facility or hedging, for example. In the case of high-yield that is designed to rank after senior secured bank loans, the high-yield securities are often issued from a holding company of the bank debt borrower, and so are structurally subordinated to the bank debt. Guarantees will be provided from the bank debt borrower and its subsidiaries that guarantee the bank debt, but these guarantees will typically be provided on a senior subordinated basis, pursuant to which they rank behind the bank debt and are subject to certain limitations on enforcement.

Regulation of voting and control

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

For senior secured notes, an intercreditor agreement will typically provide for sharing of the collateral with certain classes of future debt and hedging, as well as any revolving credit facility and senior term loan facility existing at the time of issuance. The intercreditor agreement will often provide for a majority vote across all senior secured creditors to control the enforcement of collateral. The super senior lenders, if any, may also have a separate right to enforce if the senior secured creditors do not take action within a certain period of time to enforce.

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For senior notes with senior subordinated guarantees provided by the issuer's subsidiaries, the guarantees will be subject to an intercreditor agreement made with the representatives of the other debt in the structure, usually senior secured bank debt. The guarantees will be subject to restrictions on payment if the bank debt has suffered from a payment default or if a limited blockage period, typically 179 days, has been invoked by the bank debt lenders due to a default under their instrument. The high-yield investors also agree to receive proceeds from an insolvency proceeding only after the bank debt has been repaid, and to be subject to an obligation to turn over payments received on their guarantees in violation of the intercreditor agreement. The guarantees will also usually be subject to a 179-day standstill period after default before they can be enforced.

TAX CONSIDERATIONS

Offsetting of interest payments

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Generally speaking, interest on debt is deductible, subject to various exceptions. The Treasury recently consulted on several questions as to the tax deductibility of corporate interest expense including, among other things, proposals for a discussion on the possibility of a cap on deductibility based on a ratio of interest expense to earnings before tax, depreciation and amortisation.

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, this would be uncommon.

United States

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MARKET OVERVIEW

High-yield debt securities versus bank loans

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

The major difference between high-yield debt securities and bank loans in the United States is that securities are governed by securities laws. As a result, there are disclosure obligations that issuers must abide by. The regulatory aspect of a securities offering adds a layer of legal liability on parties participating in the offering, and parties generally have to follow the disclosure standards in accordance with the securities laws. Here is an example to illustrate the point. Assume that company A wants to buy company B. Company A would prefer to issue high-yield debt securities to finance the acquisition but company B is a private company that has no audited financial statements. Assuming this is a significant acquisition for company A, it would need company B's historical financial statements as well as pro forma financial statements as part of its required disclosure to investors under the securities laws. In many situations such as this, instead of forcing company B to prepare the requisite financial statements, which may be costly and time-consuming, company A may instead decide to turn to the loan market, which is not subject to the same regulatory regime.

Another key difference is that high-yield indentures are generally difficult to amend and this is one of the primary reasons that high-yield covenants are more flexible than traditional credit agreements. Credit agreement amendments are fairly common and credit agreement covenant packages are often designed to require a borrower to seek consent from its lenders for material departures from its ordinary course of business. High-yield debt securities, however, are securities that are usually widely held and high-yield investors traditionally do not expect to be approached for consent, except in special circumstances. Most amendments to an indenture tend to be expensive because high-yield investors will expect a consent payment, which may be significant.

In addition, unlike the administrative agent under a typical credit agreement, the trustee under a high-yield indenture is not expected to closely monitor or be in frequent contact with an issuer. Instead, amending a high-yield indenture requires a formal consent solicitation process that follows an established market practice, which is time-consuming and costly for the issuer and may create hold-up value for the investors.

Regulation

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

Regulation regarding high-yield debt securities is always changing as the Securities and Exchange Commission (SEC) adds rules, clarifies rules or makes other changes to the regulations. In addition, following the 2008 global financial crisis, we are seeing more federal regulation. For example, there are certain limitations on banks' ability to hold securities for their own account, which can create certain complicated issues in leveraged financing situations.

Further, we were starting to see more regulation of bank loans. Again, following the 2008 global financial crisis, more laws have been passed limiting the ability of banks to make loans in certain situations where leverage would be viewed as being too high.

Having said all that, the Trump administration has been easing certain regulations imposed on banks during the 2008 global financial crisis. However, even though certain regulations have been eased, most banks established internal processes during the 2008 global financial crisis, which in certain instances, continue to maintain portions of the prior regulations. The one place where we have been seeing more deregulation is within the SEC. During the past couple of years, the SEC has continued to push its agenda of simplifying reporting requirements and disclosure obligations for issuers and that has flowed into the high-yield debt market in terms of disclosure in offering documents. This issue continues to evolve as the SEC looks to ease disclosure burdens even further and we will see how it unfolds in the coming months or years.

Current market activity

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

The year 2018 was an odd one for high yield. The first nine months were extremely busy for issuers across all industries. President Trump's pro-business agenda aided in part by tax cuts, increased economic growth and low unemployment numbers helped stabilise the markets. And then the market ran into a buzz saw in the last three months of the year. The Federal Reserve raised interest rates, yields on high-yield debt began to rise, investors began getting nervous about a potential government shutdown (which started in December 2018 and lasted into February 2019) and as a result, we started seeing significant outflows from the high-yield debt market. The high-yield debt market showed signs of slowing down in October and in November and December it was basically shut down.

At the time of writing this chapter, it feels like market activity is picking up again and it feels like 2019 will be a solid year for high yield, potentially better than 2018. In the first few months, we have begun to see cracks in the second lien loan market and as a result, a lot of issuers have started turning to secured bonds Instead. As a matter of fact, in the first 45 days of 2019, half of all high-yield debt bonds were done on a secured basis. As a result, we believe that 2019 will see the resurgence of secured bond deals.

A typical high-yield covenant package will include incurrence-based covenants (ie, there are typically no maintenance covenants and companies must only test the covenants at the time of taking a certain action), which include limitations on:

- incurring debt and issuing certain types of preferred stock;
- incurring liens;
- making restricted payments and investments;
- entering into transactions with affiliates;
- entering into mergers and sales of all or substantially all assets;
- consummating asset sales; and
- consummating change of control transactions.

Almost all high-yield debt securities are guaranteed by the issuer's subsidiaries, which guarantee the bank facility and other material debt of the issuer.

Most high-yield debt securities are held by qualified institutional buyers (ie, institutions knowledgeable about the instrument) and the overlap between investors in high-yield debt securities and loan financings has been increasing.

Main participants

4 | Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The key participants in a high-yield debt financing in the United States are the banks, which play the role of the underwriters (or initial purchasers in an unregistered deal). The underwriters have three main responsibilities:

- They manage the process for the issuer. Among other things, they create the timeline, prepare the issuer for meetings with investors, create roadshow schedules, and bring the issuer on the road to meet with investors.
- They are responsible for marketing the offering for the issuer. For example, the offering document for a high-yield debt security will typically have a summary section upfront, commonly referred to as the 'box', and it will contain, among other things, strengths and strategies of the company, which is the marketing portion of the disclosure document. The underwriters play a key part in crafting the marketing story for the issuer.
- Finally, they act as the gatekeepers for the market in terms of the covenant package being negotiated. As opposed to bank loans, the underwriters typically do not hold the high-yield debt securities on their books but are viewed as the experts in terms of what the market will and will not bear as it relates to covenant packages. For their services, the underwriters receive a gross spread tied to their allocation of the aggregate principal amount of securities being offered.

There are other participants in a high-yield debt financing, but none play as big a role as the banks. Lawyers play a crucial role representing the company on the one hand and the banks on the other. Accountants also play an important role in advising the company on financial presentation in the offering document and delivering a comfort letter to the underwriters. Rating agencies are always involved because they have to provide a rating on the proposed high-yield debt security, which is obviously critical for execution of the deal. And finally, there is the trustee. The trustee retains its own counsel on any transaction and receives fairly standard flat fees in connection with each engagement.

New trends

5 | Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

The trends in high-yield are always changing based on the state of the market. For example, when the market is hot and there is much demand for high-yield paper, issuers and sponsors start to forge ahead. As a result, there tends to be flexibility in the covenants, primarily in terms of incurring debt and liens and making restricted payments. As the market cools off and investors become more selective in terms of the paper they are willing to buy, covenant packages start to tighten up. A lot of these trends are industry specific. For example, over the past 18 months, we have seen significant tightening of covenants in the energy space because of weaknesses in that sector. Investors have a long memory and since the 2008 financial crisis hit the energy investors especially hard, they have sought tighter covenants.

DOCUMENTATION TERMS

Issuance

6 | How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Every high-yield debt security is issued pursuant to an offering memorandum (or a prospectus in a registered deal) provided to prospective investors. The offering memorandum describes the business of the company and the transaction being undertaken, and it contains the covenant package being offered to investors.

There are always precedents and models that need to be reviewed prior to issuing the securities. In a sponsor leveraged-buyout scenario, the issuer and sponsor will normally look to the last deal completed by that sponsor. Every sponsor has a form for its covenants and while every covenant package will be tailored to the particular needs of each issuer and its industry, the sponsor form is the starting point for these deals.

If the issuer has issued high-yield debt securities in the past, then the prior covenant package is the appropriate starting point for the new issuance. However, for debut high-yield issuers, typically, the deal team will look at a combination of the lead bank's form, recent sponsor precedent, recent precedents in the issuer's particular industry and recent precedents for issuers with a similar credit profile.

Maturity and call structure

7 | What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

High-yield debt securities generally tend to have either an eight-year or a 10-year maturity. However, in 2017 and 2018, we saw an increased number of issuers issuing high-yield debt securities with a five-year maturity in order to get a lower coupon. In general, high-yield debt securities are not redeemable at the option of the issuer for a specified number of years, permitting investors to lock-in an interest rate for a significant period. For example, after a five-year non-call period, 10-year securities are typically redeemable at a redemption price equal to par plus half the coupon, and the premium then declines to par two years before maturity. For eight-year securities, the usual formulation is a four-year non-call period after which the securities are redeemable at a redemption price equal to par plus half the coupon, declining to par. Sometimes, however, eight-year securities with a three-year non-call period are issued, in which case the redemption price after the non-call period is typically equal to par plus 75 per cent of the coupon (although an increasing number of three-year non-call deals have the first step down at 50 per cent of the coupon), declining to par.

Make-whole redemption allows issuers to call the securities during the non-call period at a price equal to the present value of the optional redemption price on the first optional redemption date and scheduled interest payments up to that date. The present value is almost always

calculated based on the Treasury rate plus 50 basis points, which approximates the price that investors would expect to receive in a tender offer.

Another significant exception to the non-call period is the ability of an issuer to redeem a portion of the securities with the proceeds of an equity offering during the first three years following the issuance date (commonly referred to as the 'equity clawback' or 'equity claw'). This exception, which is nearly universal in high-yield offerings, permits the issuer to deleverage after an initial public offering or after raising additional equity capital. Typically, issuers may not redeem more than 35 per cent of the original principal amount of the securities in an equity claw, although 40 per cent is possible in some deals. The issuer must pay a redemption price to investors equal to par plus a premium equal to the full coupon, plus accrued interest.

A less common exception to the non-call period is, in the case of secured notes, the ability of the issuer to redeem a small portion (typically 10 per cent) of the outstanding securities during each of the three years after the issue date, at a specified premium to par (typically 103 per cent). This provision is much less common than the equity claw provision described above. One rationale for the inclusion of this provision is that secured notes became prevalent in the marketplace during the global financial crisis in 2008 and often substituted for secured term loans.

While term loans are generally prepayable at par, many terms loans include a soft call at 101 per cent feature for a short period after the closing date with the proceeds of another financing, so some issuers sought to mimic this type of redemption feature for secured notes.

As a result, in capital structures where secured notes exist alongside secured credit facilities, it is sometimes possible to redeem up to 10 per cent of the notes in any 12-month period during the first three years following issuance, at a price equal to 103 per cent plus accrued interest. Occasionally, this 10 per cent exception can also be found in unsecured notes too, particularly floating rate notes.

The redemption features are not mutually exclusive.

Offerings

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The timeline of a typical high-yield offering is as follows. An offering is launched by the distribution of the 'red' (ie, the preliminary offering memorandum or prospectus) to investors, which is often accompanied by a press release. For a debut issuer or a significant transaction, the issuer may then go on the road to meet with investors while the banks are building the order book. A formal roadshow can be as short as three days and as long as two weeks.

The bankers will determine the length of the roadshow and they will instruct accounts that books will close by a certain time on the final day of the roadshow, which is the deadline for submitting an order for the security. After the books have closed, the bankers will schedule a pricing call with the issuer and the bankers and the issuer will agree to the terms of the deal (eg, the coupon, issue price, maturity and call schedule).

Most high-yield debt securities are issued at a fixed coupon and the coupon is determined as a result of investor demand. Many factors lead to the determination of the coupon, including the general market, prevailing interest rates, the health and stability of the issuer, the issuer's industry, the covenant package, the maturity of the high-yield debt securities, and the financial performance of the issuer.

After the pricing call, a pricing term sheet is sent to investors to confirm sales, coinciding with the signing of the underwriting agreement (or purchase agreement in an unregistered deal) between the issuer and the underwriters, pursuant to which the underwriters agree to purchase the securities from the issuer.

Once a securities transaction is priced, the securities begin trading. As part of the pricing terms, the parties will also schedule a closing date, which is typically done on a T+2 basis. Therefore, two business days after pricing, the securities offering will close. Under certain circumstances, however, closing may be done on a T+5 or even a T+10 basis.

Note that for a repeat high-yield issuer, launch and pricing are often accelerated to a single day, known as a drive-by offering. In other words, the offering launches before the market opens, followed by single or multiple investor calls, followed by pricing later that afternoon. If the market is familiar with the issuer, the need to have a formal roadshow to meet with accounts is generally not required, resulting in an accelerated process.

Covenants

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

High-yield covenants always need to strike a delicate balance. On the one hand, the covenants provide protection for high-yield investors against an issuer overextending itself or using cash unwisely. On the other hand, the covenants must provide flexibility for the issuer to operate its business and grow over the life of the high-yield debt securities. In other words, the covenants protect the investors' ability to be paid principal and interest on the securities while preserving the issuer's ability to run its business without undue restrictions.

The high-yield covenant package is focused on regulating the ability of the issuer and its restricted subsidiaries to service their debt and achieve the balance described above. High-yield covenants are generally flexible in permitting different types of transaction between the issuer and its restricted subsidiaries or among restricted subsidiaries – in many cases, regardless of whether those restricted subsidiaries are guarantors or non-guarantors.

While each high-yield covenant package is distinct, the main covenants are as follows:

- Limitation on restricted payments (RP): this is often called the 'RP covenant'. The RP covenant regulates the amount of cash and other assets that may flow out of the issuer and its restricted subsidiaries. It limits:
  - cash dividends and other distributions;
  - the redemption or repurchase of the issuer's capital stock;
  - the redemption or repurchase of subordinated debt obligations prior to their scheduled maturity; and
  - restricted investments, which are investments that are not defined as permitted investments.
- Limitation on indebtedness: the debt covenant restricts the amount and the type of debt the issuer can incur.
- Limitation on liens: the lien covenant is focused on protecting the high-yield investors' position in the capital structure by regulating the incurrence of secured debt that may be effectively senior to or pari passu with the high-yield debt securities, and ensuring that the securities have a senior priority lien on collateral that secures any junior debt.
- Limitation on asset sales: unlike a traditional credit agreement, high-yield debt securities do not place strict limits on asset sales. Instead, the high-yield asset sale covenant establishes guidelines that must be followed in any asset sale and permits the issuer to use the proceeds either to reinvest in the business or to prepay debt that ranks higher than or equal to the high-yield debt securities in the capital structure. If the issuer does not use the proceeds

in this way, it is required to offer to repurchase the high-yield debt securities at par plus accrued interest.

- Limitation on affiliate transactions: the limitation on affiliate transactions covenant limits the issuer's ability to enter into transactions with affiliates unless those transactions are on terms no less favourable than would be available for similar transactions with unrelated third parties. The covenants are designed to prevent value from leaking out from the issuer to affiliates that are not subject to the covenants of the indenture.
- Reporting: the reporting covenant is aimed at ensuring the flow of information that high-yield investors need to support trading in the high-yield debt securities, and to monitor the performance of the issuer.
- Mergers and consolidations: the merger and consolidation covenant is designed to prevent a business combination in which the surviving obligor for the high-yield debt securities is not financially healthy, as measured by a ratio test. The covenant also seeks to ensure that noteholders will have enforceable rights against the surviving entity in a merger, consolidation or transfer of all or substantially all the assets of the issuer or a subsidiary guarantor.
- Future guarantors: the future guarantors covenant is designed to make sure that if a subsidiary of the issuer is guaranteeing other debt, the noteholders get the benefit of that guarantee. As a result, the common formulation is that if a restricted subsidiary guarantees the bank facility of the issuer, that entity will guarantee the high-yield debt securities as well. In addition, if the issuer decides to issue new high-yield debt securities, the guarantor package will be the same across both tranches of securities.
- Change of control: the change of control covenant requires that the issuer purchase the high-yield debt securities from noteholders at a price equal to 101 per cent plus accrued interest if a 'change of control' of the issuer takes place. The change of control 'put' right is a defining feature of high-yield debt securities.

Note that for covenants appearing highly restrictive, there is a set of baskets and exceptions giving the issuer the flexibility it needs to operate its business and grow over the life of the high-yield debt securities. The exceptions are limitless and they are highly negotiated.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

As mentioned above, any tightening or loosening of covenants typically tracks the overall market or the particular industry. In the past couple of years or so, there have been more instances of covenants being changed between the launch and the pricing of an offering. As investors get more selective and as investors have more time to digest a particular covenant package, there are likely to be more changes to it. Sometimes, the changes can be fairly benign, such as reducing a particular basket size or tweaking a particular definition. At times, however, the change can be more drastic, such as the wholesale introduction of a new covenant.

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

The energy sector is a good example of an industry sector with certain covenants that are looser and certain covenants that are tighter compared to a typical covenant package. Typically, the formation of a joint venture will trip the RP covenant discussed above. Most high-yield covenant packages will have some kind of a basket specific to joint ventures that will allow an issuer to make investments in joint ventures up to a certain dollar threshold. As these structures are the backbone of the energy industry, however, there is a separate exception referred to as the 'permitted business investment' exception. This exception simply allows the issuer to make unlimited investments as long as it is the kind of investment that is customary or is becoming customary in the energy sector. As the sector has revived following the prolonged downturn, however, there have been increased instances of investors demanding tighter covenants and while the example above has not caused investor concern, we have seen increased investor focus on RP covenants and the ability of these companies to pay dividends. Investors have also focused on how much debt (particularly secured debt) issuers can incur in this space and, as a result, the liens covenant in the energy sector is tighter than most other industries. For example, many deals have a lien covenant for unlimited liens so long as the issuer meets a particular senior secured leverage ratio. But in the energy sector, this type of covenant is extremely rare.

Change of control

12 Do changes of control, asset sales or similar typically trigger any prepayment requirements?

As discussed in question 9, a change of control typically requires the issuer to offer to prepay the bonds at 101 per cent plus accrued interest.

Asset sales only trigger a prepayment obligation at par plus accrued interest if the issuer does not use the asset sale proceeds in a manner permitted by the asset sale covenant (ie, reinvest in the business or pay down debt).

If an issuer is unable to apply the net proceeds of an asset sale in the manner and in the time allowed under the covenant, it must then make an offer to acquire the bonds at par plus accrued interest once the excess proceeds reach a negotiated threshold.

If the offer is oversubscribed, then the issuer must purchase the bonds on a pro-rata basis. If the offer is undersubscribed, then the issuer can use the remainder for general corporate purposes, and the excess proceeds amount is reset to zero.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

A double-trigger change of control put option has slowly crept into some high-yield debt securities from the investment grade world in recent years. In a double-trigger change of control put, the put is triggered only if there is both a change of control and a ratings downgrade from one or more rating agencies within a specified period following the announcement of a transaction that will be a change of control.

The double-trigger concept in effect shifts to rating agencies the determination as to whether the change of control is positive for investors. Rather than permitting individual noteholders to decide whether to put their securities based on their views of the transaction, the double-trigger provision puts rating agencies in the position of assessing the effect of the transaction on the financial health of the issuer on behalf of investors.

Double-trigger change of control provisions in high-yield offerings are more likely to be encountered for issuers that may be on the cusp of reaching investment grade status, such as issuers with split high-yield or investment grade ratings from the rating agencies. During the past year, however, there have been more instances of investors pushing back on the double-trigger concept and demanding a more standard change of control provision. For example, in the energy sector, investors have pretty much universally pushed back on the double-trigger concept in 2018.

Crossover covenants

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Yes. Crossover covenant packages are common for issuers with split high-yield or investment grade ratings from rating agencies as well as for issuers on the cusp of being investment grade. A typical crossover covenant package will be similar to a typical high-yield covenant package except that there is usually only a limitation on secured debt and the covenant is often accompanied by an exception allowing an issuer to secure debt up to a negotiated percentage of its consolidated net tangible assets; there is typically no restricted payments covenant; and the change of control covenant is usually a double trigger.

REGULATION

Disclosure requirements

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

High-yield debt securities are typically sold on either the public market or the 144A market. Securities sold on the 144A market typically include an obligation to complete a back-end exchange offer, which is an offer to allow holders to exchange the privately placed securities for freely transferable, SEC-registered securities within a specified period after the closing.

The back-end requirement reduces – or can even eliminate – any negative impact on the coupon of the notes from their having been sold as relatively less liquid 144A securities that can only be traded among sophisticated institutions, at least during a specified period. In addition, some buy-side investors operate under investment guidelines that limit the amount of securities they can buy without back-end registration rights.

After the adoption of Sarbanes-Oxley and the related SEC rules and regulations, however, private companies have begun to resist the obligation of back-end exchange offers and are increasingly opting for 144A for-life transactions that do not contemplate registration rights. These companies point to the added burdens of Sarbanes-Oxley and related SEC rules and the resulting increase in expenses. In addition, the number of 144A for-life deals has increased owing to a rise in the number of secured high-yield deals.

The reporting requirements of Rule 3-16 of Regulation S-X (which requires financial statements in SEC-registered deals for certain subsidiaries whose securities are pledged as collateral) are onerous and costly. Indentures for SEC-registered notes must also comply with the Trust Indenture Act of 1939, which imposes extra requirements on issuers of secured notes. Issuers of 144A for-life securities can avoid these complications.

To offer the securities on a registered basis, the issuer must meet the disclosure requirements set forth by the SEC, predominantly Regulation S-K, which governs what needs to be included regarding the description of the business, risks and trends, among others; and Regulation S-X, which governs what needs to be included in terms of financial statements. While a 144A deal with back-end exchange rights or a 144A for-life deal requires no SEC filing or approval at the time of issuing, in practice, the disclosure requirements are substantially similar, with certain caveats.

For example, a registered deal requires executive compensation information, which is burdensome and costly to put together. Most people take the position in a 144A deal that this information is not material to debt investors and, as a result, it is rarely included in the offering document.

Overall, however, the disclosure requirements applicable to a 144A deal as compared with a registered deal are the same. The key difference is execution and timing. Since a 144A deal is not subject to SEC review, it enables issuers to access the market more quickly and efficiently.

Use of proceeds

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

None, other than in violation of any anti-terrorism, anti-money laundering or similar laws.

Restrictions on investment

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

As noted in question 15, most high-yield debt securities are issued on a 144A basis. Rule 144A under the Securities Act of 1933 allows private resales to qualified institutional buyers. These securities are also often concurrently sold to non-US investors pursuant to Regulation S under the Securities Act of 1933. As a result, the type of distribution used for selling the securities will dictate the types of investors permitted to participate in the offering.

Closing mechanics

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

Closing mechanics in the United States are fairly uniform but can be complicated. In addition, in cross-border transactions or if securities are issued in a non-US dollar denomination, settlement will be increasingly more complicated. For a typical high-yield issuance, as noted earlier, once the securities are priced, they are actively trading and then they typically settle in three business days.

GUARANTEES AND SECURITY

Guarantees

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

The most common high-yield structure is to have an issuer with upstream guarantees from its subsidiaries. In certain instances where the issuer may not be the topco entity, there may be a downstream guarantee too. Most often, the guarantee structure will mimic the bank finance structure.

In general, unsecured guarantees are limited only by fraudulent conveyance issues. Under US federal bankruptcy law, the incurrence of indebtedness, the guarantee thereof or the grant of a security interest in collateral could be avoided as a fraudulent transfer or conveyance if the issuer or guarantor (i) incurred the indebtedness or guarantees with the intent of hindering, delaying or defrauding creditors; or (ii) received less than the reasonably equivalent value or fair consideration in return and, in the case of (ii) only, one of the following is also true at the time thereof:

- the issuer or any guarantor was insolvent or rendered insolvent by reason of the incurrence of the indebtedness or the guarantee;
- the incurrence of the indebtedness or the guarantee left the issuer or the guarantor with an unreasonably small amount of capital or assets to carry on its business;

- the issuer or guarantor intended to, or believed that it would, incur debts beyond its ability to pay as they mature; or
- the issuer or guarantor was a defendant in an action for money damages, or had a judgment for money damages docketed against it if, in either case, the judgment is unsatisfied after final judgment.

In addition, there are limitations associated with foreign guarantees. First, the provision of a guarantee by a foreign entity of the obligations of a US issuer can have serious economic consequences for the issuer. Under the US tax code, income earned abroad by companies that are organised abroad is generally not taxed by the United States. If, however, the assets of such a company provide credit support for obligations of a US affiliate, then the undistributed earnings and profits of the foreign entity may be deemed repatriated to the United States and become subject to US taxation as a dividend.

As a result, in the US market, issuers are typically not expected to take such a risk and guarantees from foreign subsidiaries are not commonly required. While the 2017 tax reform bill allows companies to repatriate foreign earnings back into the United States, there are still certain limitations in place that would encourage domestic issuers not to obtain guarantees from foreign subsidiaries. That may change in the future but, at this point in 2019, the structures have remained the same and the formal guidance has not changed.

Collateral package

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

Collateral that is typically used as security falls into two general categories: real property and personal property. Real property is governed by the law of the state in which the property is located and a security interest in real property can be granted pursuant to a mortgage or similar agreement. The creation of security interests in most types of personal property are governed by the Uniform Commercial Code (UCC), a form of which has been enacted in each state. Security interests in this personal property governed by the UCC can be granted pursuant to a single security agreement and perfected, subject to certain exceptions, by the filing of financial statements describing the collateral in the jurisdiction of organisation of the party granting the security interest.

Limitations

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

See question 20.

Collateral structure

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

There is no single typical collateral structure in the United States. While it is certainly common to see crossing lien deals between high-yield debt securities and bank agreements, that is not the only structure. Typically, lenders take a first lien on the hard assets and the bonds get a first lien on personal property. Then the lenders would take a second lien on the personal property and the bonds would get a second lien on the hard assets. It is also possible for secured bonds to rank pari passu with the bank debt. In addition, while uncommon, there are deals where the bonds obtain a second lien on all of the collateral.

Legal expenses

23 Who typically bears the costs of legal expenses related to security interests?

While the underwriters generally pay underwriters' counsel for their legal expenses, the costs of legal expenses related to security interests are generally paid by the issuer. In the United States, borrowers typically pay the legal expenses associated with counsel to the lenders and, since the work related to security interests is really more akin to a credit agreement, it is customary for issuers to pay for the legal expenses of counsel to the underwriters for this work.

Security interests

24 How are security interests recorded? Is there a public register?

Similar to the creation of the security interest, the UCC governs the perfection of a security interest in most types of personal property. Perfection occurs through:

- the filing of UCC financing statements with the relevant state office;
- the filing of intellectual property security agreements with the relevant federal office;
- the execution of control agreements with respect to cash and cash equivalents held in a depositary bank, or in certain circumstances, with a securities intermediary;
- the possession or delivery of certain personal property;
- the recording of mortgages with the relevant state office; and
- other filings or actions in the case of other special category assets.

25 How are security interests typically enforced in the high-yield context?

There is no real distinction between high-yield debt securities and other debt in terms of enforcing security interests. A secured noteholder that forecloses on collateral outside the bankruptcy process generally takes that collateral subject to any other potential liabilities against which the collateral is subject.

Typically, on the filing of a petition for bankruptcy reorganisation (a Chapter 11 proceeding) or liquidation (a Chapter 7 proceeding) under Title 11 of the US Bankruptcy Code, an automatic stay arises, which prohibits all collection and enforcement efforts, subject to certain exceptions for the right to close out most securities and financial contracts, criminal proceedings and the exercise of regulatory powers.

Generally, all interest accruals stop as of the petition date, unless a debtor is solvent and covenants are not enforceable once a petition is filed. Under certain circumstances, a secured noteholder may be able to obtain relief from the automatic stay to enforce remedies against collateral.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Rank of high-yield debt

26 How does high-yield debt rank in relation to other creditor interests?

There is no distinction between high-yield debt securities and other debt in terms of ranking, and it depends on the capital structure of the company. In general, the high-yield debt securities rank equally in right of payment with any existing and future senior debt, are effectively subordinated to all secured debt to the extent of the value of the collateral and are senior in right of payment to any existing and future subordinated debt.

Regulation of voting and control

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

This depends on the structure and the answer to question 22. In general, each tranche of debt has its representative. For example, noteholders are represented by a trustee, which will sign the intercreditor agreement; and the bank lenders are represented by the administrative agent, which will sign the intercreditor agreement.

Typically, control resides with the party that holds the most senior piece of debt or, if the different tranches of debt rank pari passu, then, typically, voting and control will reside with the biggest tranche of debt.

TAX CONSIDERATIONS

Offsetting of interest payments

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Generally, in the United States, interest should be deductible in accordance with the issuer's method of accounting. Interest expense on indebtedness issued with original issue discount is deductible on a constant yield to maturity basis, even if the issuer is on a cash method of accounting.

There are many interest deduction rules with which a US issuer may require guidance. In addition, one special consideration for the high-yield market is the application of the high-yield discount obligations (AHYDO) rules. If a debt obligation is issued with original issue discount and the AHYDO rules apply, a portion of the interest expense may be deductible only when paid in cash and, as a result, a portion may be permanently non-deductible.

Tax rulings

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, a typical high-yield transaction does not require issuers to obtain a tax ruling in connection with the issuance. In certain circumstances, however, relating to tax-free spin-offs and the issuance of high-yield debt securities in connection therewith, a tax ruling may be required or desired by the issuer.

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