EVERSHEDS SUTHERLAND

Transfer restrictions
NPL Portfolio Sales

December 2017

A variety of non-performing loan ("**NPL**") portfolios are coming to market in Ireland at present. A key issue which arises on these transactions is whether borrower consents are required before the loan transfers can be effected. This will depend on the provisions contained in the underlying loan and security documentation. There are obvious difficulties in obtaining borrower consents on NPL portfolio sales. While transfer restrictions can sometimes necessitate alternative structures such as sub-participation and trust arrangements, these are generally less attractive to bidders than acquiring NPLs absolutely.

Consequently, a prospective NPL acquirer will focus closely on the transfer provisions contained in the loan and security documentation. Unfortunately, the transfer provisions contained in some loan and security documents, particularly those in older formats, are not always straightforward.

What constitutes a "Financial Institution"?

Certain loan/security documents used by Irish banks contain restrictions on transfers. These include, in certain cases, provisions which permit transfers to *"any financial institution"*. In the absence of any guidance in the documentation as to what a *"financial institution"* constitutes, the recent judgment of the High Court in England in *Olympia Securities Commercial Plc (In Administration)* is significant, particularly as it concerned the transfer provisions contained in an Irish bank's loan documentation.

In this case, and following the rationale set out in an earlier decision of the English Court of Appeal, the Court found that to be a *"financial institution"* the entity concerned must be *"... a legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and whose business concerns commercial finance, whether or not its business included the lending of money on the primary or secondary lending market."* It is of particular interest that the Court found that once an entity fell within this definition, the fact that it is non-trading or is a special purpose or "vulture fund" vehicle would not be relevant.

Olympia Securities Commercial Plc (In Administration)

The case related to a facility agreement (the "**Facility Agreement**") and related interest rate swap entered into by Olympia Securities Commercial Plc ("**Olympia**") and Anglo Irish Bank Corporation Plc (now Irish Bank Resolution Corporation Limited) ("**IBRC**"). The loan and any sums due to IBRC under the swap were secured by a debenture granted by Olympia.

The Facility Agreement was included in a portfolio of loan assets agreed to be sold by IBRC to LSREF III Wight Limited ("**LSREF**"). Ultimately, at completion of the loan sale, all of IBRC's rights under the Facility Agreement were assigned to WDW 3 Investments Limited ("**WDW**") as LSREF's nominee. WDW gave notice to Olympia of the assignment. IBRC remained the counterparty under the swap, but on terms that WDW would have the benefit and burden thereunder. Similarly, the debenture was assigned to WDW, on terms that WDW held it on trust for itself (for the loan) and for IBRC (for any swap liabilities).

The key issue to be determined was whether the assignment of the Facility Agreement from IBRC to WDW was valid. This question turned on whether, as a matter of construction, WDW was a *"financial institution"* for the purposes of the Facility Agreement. The Facility Agreement provided that *"the Lender may... at any time transfer, assign or novate all or any part of the Lender's rights, benefits or obligations under this agreement to any one or more banks or other financial institutions"*. The term *"financial institution"* was not defined in the Facility Agreement.

Arguing that WDW was not a financial institution for this purpose, and therefore that the assignment by IBRC was invalid, it was suggested that to be a financial institution the entity concerned had to operate on its own behalf in the field of regulated finance. WDW had not traded prior to the date of the assignment and it was not a regulated entity either before or after the assignment. Indeed WDW's only purpose was to hold assets on trust for a third party.

Both sides relied, to an extent, on the decision of the English Court of Appeal in *Argo Fund Limited v. Essar Steel Limited* (the "**Argo Decision**") and that decision was heavily relied upon by the Court in its judgment.

The Court determined that the approach adopted by the majority in Argo should be followed, and concluded that to be a "*financial institution*" the entity concerned must be *"a legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and whose business concerns commercial finance, whether or not its business included the lending of money on the primary or secondary lending market"*.

It is not necessary for an entity to be operating on its own behalf in the field of regulated finance to be a financial institution as long as its business concerns commercial finance. The Court stated that the concept is intentionally widely drawn and will include, for example, commercial trust corporations, primary and secondary lenders and those who act as agents, trustees or fiduciaries either for buyers or borrowers on one side of a transaction or for the providers of services on the other and it would also include those who provide managerial services on behalf of the providers or users of financial products and services.

Helpfully the Court expressly considered WDW's nature as a special purpose vehicle, having been incorporated just two weeks before the assignment with a single purpose, namely to acquire a portfolio of non-performing real estate loans at a discount to their face value. In responding to the argument that WDW could not be a financial institution because it was a "*non trading £1 company*", the Court held that there was no justification for finding that the company's capitalisation precluded it from being a financial institution. It was also found that the argument that WDW was not trading at the date of the assignment "lacked reality" and was not relevant to the test to be applied.

The Court acknowledged that WDW was an entity which was commonly referred to as a vulture fund. This was irrelevant to the question as to whether it qualified as a financial institution for the purposes of the Facility Agreement. Arguments that vulture funds were not generally regulated, whilst banks and other financial institutions would be, were dismissed. Similarly, the assertion that a vulture fund might be expected to take a more aggressive approach to enforcement than a regulated bank or institution was immaterial. The regulatory status of the transferee did not matter so long as WDW was carrying on its business in accordance with the laws of its incorporation. The enforcement risk suggested was not established on the evidence. In any event, the Court was of the view that had the original borrower wished to protect against assignment by IBRC it should have negotiated more restrictive transfer provisions in the loan documentation.

Conclusion

Provided it is properly incorporated and operated in accordance with the laws of its place of incorporation, this decision indicates that an entity formed solely for the purposes of receiving the transfer of loan assets will be a "*financial institution*" for the purposes of transfer/assignment provisions of the sort regularly found in loan and security documents in Ireland.

It should be borne in mind that this is a first instance decision of the English High Court and so whilst the decision is of persuasive authority in Ireland, it will not bind the Irish Courts. Furthermore, it is not yet known whether the decision will be appealed. However, it provides comfort that the broad themes of the earlier Argo Decision continue to be applied by the Courts and gives further guidance to prospective purchasers of NPL portfolios that they can effect transfers through SPVs without falling foul of certain transferability provisions.

Eversheds Sutherland has vast experience advising a variety of sellers, bidders and funders on some of the most significant NPL portfolio sales in Ireland.

For further information, please contact:

Steve Rodgers
Partner

t: +353 1 6644 350
m: +353 86 601 4838
e: steverodgers@eversheds-sutherland.ie

Barbara Galvin
Senior Associate

t: +353 1 6644 940
m: +353 86 410 7104
e: barbaragalvin@eversheds-sutherland.ie

eversheds-sutherland.ie

EDUB.1562 12/17