The independent review of corporate bond covenants for the sophisticated investor

European and U.S. Model Covenants: How Do They Compare?

Concern	Europe Approach[1]	U.S. Approach[2]
Change of Control *Can new owners bring undesirable leverage and / or operational changes?*	**Put Event:** Requires a Trigger Event or a sale of substantially all assets. [3] Trigger Event Change of control component: "person" or group acting in concert gains direct or indirect control of the issuer: • 50% voting power • Appoint or remove a majority of directors • Direct operating and financial policies [and] • No rating / insufficient rating Rating event: • The Notes "cease" to be "Rated" – technically undefined, but practically no longer investment grade by at least two of three Rating Agencies. • Windows: (1) Prior to Change of Control based on agency announcement / review and (2) X days after the Change of Control Put price: 101	**Change of Control Triggering Event:** Requires a Change of Control and a Rating Event[4] Change of Control definition has 5 triggers: • Sale of substantially all assets • Any person becomes beneficial owner of more than 50% of Voting Stock (measured by power rather than shares) • A merger in which existing shareholders do not own a majority of the surviving person • Continuing Directors test • Adoption of a plan of liquidation or dissolution Rating event: • The Notes "cease" to be rated Investment Grade by at least two of three Rating Agencies. • Windows: 60 day prior / 60 days after Change of Control, with extension during agency review Put price: 101

[1] Analysis of European Approach is based on the "Model Covenants in Sterling and Euro Bond Issues" drafted by The Bond Covenant Group. (June 2010).
[2] Analysis of U.S. Approach is based on "Improving Covenant Protections in the Investment Grade Bond Market" drafted by The Credit Roundtable. (December 17, 2007 and July 2, 2008).
[3] The ratings trigger is actually optional / discouraged, but in practice it is universal.

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Negative Pledge / Lien Subordination *Can new debt be given collateral that our bonds do not get?*	**Restrictions on Priority Borrowings** (liens <u>and</u> subsidiary debt) • Secured debt, subsidiary debt, and sale / leasebacks are all part of "Priority Borrowings" • No "equal and ratable" clause – unlimited secured debt not possible • Applies to the issuer and all subsidiaries and to all assets • Debt includes: (1) money borrowed; (2) financing and capital leases; (3) receivables financing; (4) derivative / hedging obligations; (5) redeemable shares; and (6) "any amount raised under any other transaction… having the commercial effect of a borrowing…" Allows "Permitted Priority Borrowings": • Permitted Secured Borrowings: (1) financing new asset / acquisition target up to €X; (2) legacy debt of acquisition targets *but* the security must be released within X months; (3) finance leases up to €X; (4) intercompany debt; and (5) scheduled / existing debt • Permitted Subsidiary Borrowings: (1) intercompany debt; and (2) scheduled / existing debt • Priority Borrowings: up to €X	**Limitation on Liens and Priority Debt** (liens <u>and</u> subsidiary debt) • Secured debt, subsidiary debt, and sale / leasebacks are all part of "Priority Debt" • No "equal and ratable" clause – unlimited secured debt not possible • Applies to the issuer and all subsidiaries, and to all assets • Debt includes: (1) money borrowed; (2) capital leases; and (3) preferred stock of a subsidiary; not hedging obligations Allows "Permitted Debt": (1) customary M&A; (2) financing new assets; (3) legacy debt of acquired entity; (4) intercompany debt, (5) liens on accounts and inventory (negotiable); (6) existing debt; and (7) general carveout of 10-15% Consolidated Net Tangible Assets

[4] The ratings trigger is actually optional / discouraged, but in practice it is universal.

Guarantees / Structural Subordination *Can new debt be given guarantees that our bonds do not get?* *Can the issuer's subsidiaries borrow money outside of the ordinary course?*	**Dealt with by Restrictions on Priority Borrowings (liens <u>and</u> subsidiary debt)** • Secured debt, subsidiary debt, and sale / leasebacks are all part of "Priority Borrowings" • <u>Un</u>secured subsidiary debt outside the ordinary course of business is considered as harmful as secured debt • Guarantees not expected	**Dealt with by Limitation on Liens <u>and</u> Priority Debt** • Secured debt, subsidiary debt, and sale / leasebacks are all part of "Priority Debt" • <u>Un</u>secured subsidiary debt outside the ordinary course of business is considered as harmful as secured debt • Guarantees not expected
Asset Sales *Can assets be sold outside of the ordinary course of business?*	**Restriction on Disposals** Transfers of assets outside the ordinary course of business limited within a 3 year period to €X or X% of Consolidated Net Worth / Consolidated Asset Value Allows "Reinvested Proceeds" for assets of "comparable or superior" type, value, and quality	No new covenant proposed No protection (unless "substantially all" assets being sold in which case Mergers covenant applies)
Dividends *Is there a limit on cash dividends or other payments to equity?*	**Restrictions on Disposals** Allows cash dividends, but would restrict large spin-offs	No new covenant proposed No protection
Information / Reports *What financial and business information is provided to bondholders, and how?*	**Information** • Annual and half year financial statements and a financial discussion (MD&A) • Mid-year financial statements • Covenant compliance certificate • Post reports to website • Holders can put question to the auditors and request documents • Documents: (1) Credit documents above €X; (2) documents given to	**Reports** When a public company: • S.E.C. reporting When not a public company: • Annual and quarterly financial statements and a financial discussion (MD&A) • Post reports to website • No exhibits, no periodic reports, no conference calls

[5] Can be met via U.K. Disclosure Rules and Transparency Rules.

	shareholders and to other creditors; and (3) reports, events, and information that would "be likely to have a significant effect" on the price of the bonds[5]	
Voting *How are covenants amended?*	No new covenant proposed	**Voting by Series** • Each series of bonds vote to amend its own provisions • Control setting series of bondholders against each other
Step-up Coupons *Can ratings changes affect the interest rate?*	No new covenant proposed	**Coupon step-up for downgrades** • Increase coupon by 0.25% for each notch downgrade below BBB- • Maximum 2% step-up[6]
Committee Expenses *How are bondholder challenges financed?*	**Committee Expenses** Issuer reimburses reasonable expenses of legal and financial advisers to the Holder Committee during a default	 No new covenant proposed; however, U.S. indentures have trustee reimbursement

[6] No pricing is actually proposed, but the 0.25% / 2% maximum is the typical usage. Similarly, below BBB-/Baa3 is where pricing typically changes, although White Paper step-up grid begins at BBB+ / Baa1.