

## FUND FINANCE FRIDAY

**Subscription Finance Loan Agreement Series, Part 7 — Sanctions**

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An area of common interest to lenders, to the funds, GPs and managers to whom they make facilities available, and to the investors who invest in the funds and will ultimately be required to pay in their capital or loan commitments to repay any fund indebtedness is compliance with all applicable rules and laws covering sanctions. This is a sometimes controversial part of a Subscription Facility Agreement, not because the parties do not recognise or acknowledge the importance of compliance with sanctions but because of the difficulties of ensuring compliance with constantly changing – and sometimes contradictory – sanctions legislation and rules imposed by different national or supra national bodies.

This note does not attempt to analyse in detail all the relevant sanctions legislation or rules – and drafting and lender policies in this area often differ from lender to lender – but rather attempts to provide some brief background on some of the most commonly referenced sanctions authorities and sanctions rules and legislation, the possible effect of breaches of those sanctions, how these concerns are usually addressed in Subscription Facility Agreements, and some common areas of difficulty and contention.

The most common sanctions concerns in European Subscription Finance agreements are:

- U.S. sanctions (imposed by the Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury or by the U.S. Department of State). These sanctions are generally imposed on and in respect of "U.S. Persons" (which is widely defined particularly in the case of sanctions in respect of Cuba and Iran to include non-U.S. Persons in relation to transactions involving U.S. Persons or the U.S. financial system – referred to generally as "secondary sanctions"). Sanctions are applied both to specific countries and territories (and their citizens, residents and commercial enterprises) as well as to specific persons and entities listed on OFAC's Specially Designated Nationals and Blocked Persons list ("SDN List");
- EU sanctions imposed as part of the EU's Common Foreign and Security Policy and generally imposed on "EU Persons" (which generally includes EU nationals and any legal person, entity or body constituted in an EU member state or which conducts business in the EU). EU sanctions tend to be targeted more at designated individuals, groups or entities ("Designated Persons") or at specific industries or sectors. EU sanctions also generally prohibit EU Persons from making funds or economic resources available to or for the benefit of a Designated Person;

- Sanctions imposed by the United Nations Security Council (“UNSC”) – note that these are often also reflected in both U.S. and EU (and other) sanctions legislation;
- Sanctions imposed by individual EU member states (including UK sanctions administered by HM Treasury);
- Sanctions imposed by the Swiss government (administered by the Swiss State Secretariat for Economic Affairs (“SECO”));
- Sanctions imposed by non-EU jurisdictions specifically requested to be included by non-EU lenders participating in the syndicate (in particular, references to Canadian, Australian, Singaporean or other sanctions regimes when lenders or borrowers from those jurisdictions are participating).

The above sanctions are of concern to lenders for a number of reasons, but most relevantly (i) lenders can be subject to civil or even criminal penalties if they breach, or through making a facility available, enable a borrower to breach certain sanctions; (ii) the imposition of sanctions on borrowers (or investors) can jeopardise the repayment of any indebtedness under a facility; and (iii) lenders can incur reputational risk if they (or borrowers or other parties to whom they make facilities available) breach sanctions. Equally, borrowers will share many of these concerns.

So, any lender will look to address these concerns in the terms of the facility agreement. In terms of investors, lenders, at a minimum, will want to exclude investors which may be subject to sanctions from their leverage or borrowing base calculations. In terms of the fund, the general partner, manager and other parties to the facility documentation lenders will look to include representations and covenants to the effect that those parties are not themselves subject to sanctions, that they are and will remain in compliance with any sanctions legislation or rules, that they will not utilise any facility proceeds in a way which breaches any sanctions legislation or rules, and that they will inform the lenders promptly if they (or any investors) are in breach or alleged to be in breach of any such legislation or rules. The purpose of all of these provisions is obviously to reduce the risk to lenders of either they or their counterparties being found to be in breach of sanctions, and to allow for quick action to be taken (by way of draw stops or even acceleration and/or enforcement) if there are breaches. But as with any terms of this type, they cannot remove the risks altogether.

In general, all parties will accept that lenders generally need the sort of comfort that is provided by such terms, but there are issues that still cause difficulties. For borrowers, the primary concern is usually that the representations and covenants on sanctions are fairly wide-ranging and (particularly where lenders look as they often do – for example, for covenants or representations on the use of facility proceeds and/or to extend these covenants and representations to affiliates) difficult for borrowers to control (or, in some cases, even know about). For that reason, one of the principal areas of debate around these terms tends to focus on the degree to which borrowers are able to qualify these terms by reference to their degree of knowledge or control over events or entities which may breach sanctions. The other primary concern is that the sanctions regimes to which borrowers or lenders are subject can differ in different jurisdictions and, in some cases, be directly contradictory. The most well-known (but not the only) example of this is the contradiction between the EU Blocking Regulation and U.S.

sanctions imposed by OFAC in respect of dealings with Iran. How to deal with this in the facility documentation needs to be carefully considered on a case-by-case basis.

The interaction of differing sanctions regimes, policy considerations and issues around ensuring compliance makes sanctions a difficult part of any facility terms for both lenders and borrowers and often requires both to live with some compromise that may not be entirely comfortable for either.