

FINANCE NEW HORIZON



Middle East lenders invoke Market Disruption clause

By Ian Chung

Globally, the last six months have been an extraordinary period of time in the financial sector, as lenders' relationships with many of their customers have become increasingly strained. The cost of credit (across almost all sectors) has increased as markets focused on stronger banking capital ratios, and more conservative credit assessments.

In the asset finance and corporate lending sectors, this has led to many lenders activating (where their

documentation permits) the 'Market Disruption Event' (MDE) clause.

Middle East borrowers have not been completely immune, particularly as many international banks that operate in the region, or which target the offshore markets (and which typically lend in US Dollars or Euros), have had difficulty securing matched funds in the inter-bank markets.

Typically, an MDE clause operates in loan

documentation where the borrower pays the lender interest made up of three parts: A cost of funds equivalent which, in floating rate loans, is often linked to some prescribed inter-bank rate for a selected interest period (i.e. 3 month LIBOR); the margin; and any additional costs.

Invoking a MDE:

The most common form of MDE clauses can be invoked by a lender when there is a disruption event and allow them to change the cost of

Middle East lenders invoke Market Disruption clause - *Continued*

funds component to a mutually agreed rate. The usual reasons that permit a lender to invoke market disruption are:

Firstly, by reason of circumstances affecting the inter-bank market generally, adequate and reasonable means do not exist for ascertaining the selected interest rate.

Secondly, the rate at which deposits in the desired currency are being offered to the lender in the inter-bank market would not adequately reflect the cost to the lender of making the loan.

Or, finally, by reason of circumstances affecting the inter-bank market generally, deposits in the desired currency are not available to it in sufficient amounts in the ordinary course of business.

Any lender invoking such an event will need to consider the consequence of doing so to its reputation and perceived standing amongst its peers.

Lenders have been cautious when invoking these provisions particularly given the potential commercial, operational, and legal consequences. Calling an MDE also makes it more difficult to manage the relationship with the customers, particularly when the request for more money was viewed against the lowering of interest rates by the central banks.

Alternate mechanisms

Invoking the MDE clause is only the first step, and alternate mechanisms for setting the costs need to be found and agreed. Initially,

many lenders were of the view that this disruption was temporary and that eventually the credit markets would ease as liquidity returned.

Many MDE clauses provide that the lenders and the borrowers should negotiate in good faith to resolve problems and consequently, many lenders have agreed alternate rates of financing that were short term in nature (such as 1-month LIBOR) in the hope that when that period expired the MDE would cease and lending would revert to normal.

Unfortunately, the markets have not yet reverted to their previous state and the problems of the MDEs continue. There are also complications on the horizon, particularly if it is the case that markets have structurally changed to the point that the current conditions are no longer unusual.

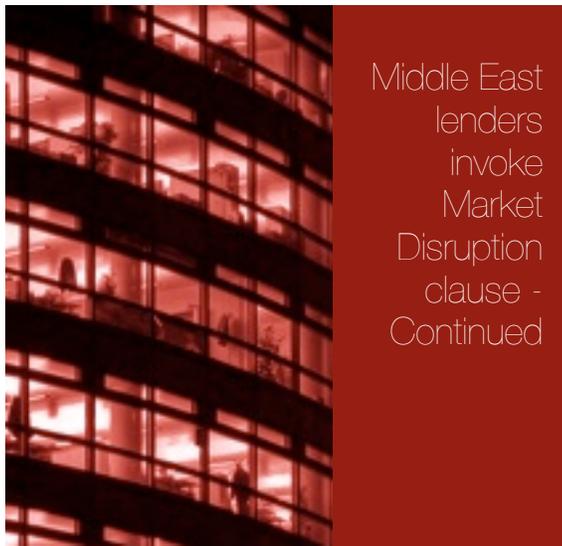
Customer confidence

From the perspective of many lenders, who are trying to return to relationship banking, some mechanisms need to be put in place which give confidence to their customers (whilst also giving them certainty of cost), and which also protects the lenders from having to disclose to the borrower their own cost of funds.

While the borrower may have to acknowledge that the lender is entitled to activate the clause, the borrower needs to know that what they are paying is fair and transparent and that lenders have tried to find publicly available information that is appropriate for using as reference rates for their funding costs.

Borrowers also need to see that there have been discussions over possible alternate sources such as using credit default swaps indexes and blended rates quoted by specialist inter-bank brokers.

Given the current uncertainty on the determination of interest rates, there is value in ensuring that any new loan documentation provides as much clarity as possible for borrowers in relation to MDEs so that it is clear on whom the burden of the increased costs falls on and the level of transparency that can be expected.



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BCGCM Bahrain

01 April, 2009

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the managing partner of BCGCM Bahrain explains that In today's global environment, it is more important than ever to be as efficient as possible. Private Equity firms in the middle east are witnessing a global market shift, while the opportunity to be the new leaders of investment banking is growing, but to be worthy of such position these firms need to become more productive by allowing accurate analysis of investment leads, with faster turnaround of reply to decision makers and better portfolio management. The targeted productivity of the PE firm can be achieved by adopting best practices in financial analysis and process flow



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Contact Mr. Kieran Murphy for more information or inquiries about this service.

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In today's global environment, it is more important than ever to be as efficient as possible.

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By Trenz Pruca

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