Hogan Lovells

UK Infrastructure Bank's Guarantee to support UK infrastructure projects

A legal overview of the structure and documentation

February 2023

Introduction

The creation of UK Infrastructure Bank Limited[1] (UKIB) was announced as part of the government's National Infrastructure Strategy in 2020 as part of the government's plans to support private investment in infrastructure. His Majesty's Treasury (HMT[2]) published a 'Policy Design' document in March 2021 which provided details on the mandate and design of the new organisation, including the ambition for UKIB to be a long-lasting institution with a high degree of operational independence. UKIB's Policy Design included the expectation that UKIB would benefit from HMT backing, including the ability to issue sovereign-equivalent guarantees, whilst remaining operationally independent.

UKIB was launched in June 2021, with HMT as its sole shareholder. UKIB's Framework Agreement and Articles of Association define UKIB's core mission as partnering with the private sector and local government to increase infrastructure investment that meet its objectives to help tackle climate change and to support regional and local economic growth.

UKIB has initially been provided with £22 billion of financial capacity, including the ability to deploy up to £10 billion of guarantees to increase financing of infrastructure projects. With the support of HMT, UKIB will be able to issue sovereign-equivalent guarantees to crowd-in private sector financing on qualifying projects in line with UKIB's investment principles[3]. In order to achieve this, UKIB has received from HMT an irrevocable and unconditional counter-guarantee (called the Sovereign Infrastructure Guarantee (the SIG)) so that the beneficiary of a guarantee from UKIB will be paid by HMT if UKIB fails to pay a claim made by that beneficiary under the UKIB guarantee. The structure of the SIG outlined below is designed to, on the one hand, respect UKIB's operational independence to invest in line with its investment principles, whilst, on the other, ensure beneficiaries of the UKIB guarantee are ultimately able to benefit from HMT’s sovereign credit rating, which will maximise the policy impact of the product.

This overview

Hogan Lovells[4] have acted as legal counsel to UKIB in developing the structure and documentation of the UKIB guarantee and Hogan Lovells, in conjunction with UKIB, have prepared this overview to introduce market participants to the key elements of the UKIB Guarantee.

The aim of this overview is to provide a helpful introduction to anyone looking to be involved in any element of a UK project which may be supported by UKIB, but it should not be taken as legal advice, nor a substitute for legal advice[5], nor be taken as a substitute for a review of the relevant documentation.

Previous UK Guarantees Scheme

The structure and documentation of the UKIB guarantee is based on that of the previous UK Guarantees Scheme which was put in place in 2013 and was previously administered by the Infrastructure and Projects Authority (IPA). The administration and responsibility for the management of the UK Guarantees Scheme has moved to UKIB – as a centre of expertise for infrastructure finance.

Therefore, much of the structure and documentation of the UKIB guarantee will be familiar to market participants who are, or have been, involved in UK infrastructure projects supported by the previous UK Guarantees Scheme. The key difference between this scheme and the previous UK Guarantees Scheme’s structure is that UKIB provides a HMT backed guarantee to the beneficiary,

1 UKIB – UK Infrastructure Bank Limited, a private limited company incorporated in England and Wales (with company number 06816271) whose registered office address is One Embankment, Neville Street, Leeds, England, LS1 4DW

2 HMT – The Lords Commissioners of His Majesty's Treasury

3 Investment principles to be found at: https://www.ukib.org.uk/where-we-invest

4 Hogan Lovells – Hogan Lovells International LLP

5 Hogan Lovells accepts no liability of any kind to any person as a result of publishing this overview.

rather than HMT providing a direct guarantee to the beneficiary. This arrangement has been constructed to respect UKIB's operational independence, allowing UKIB the freedom to make its own investment decisions to deliver on its mandate, whilst benefiting from HMT's sovereign credit rating.

UKIB guarantee

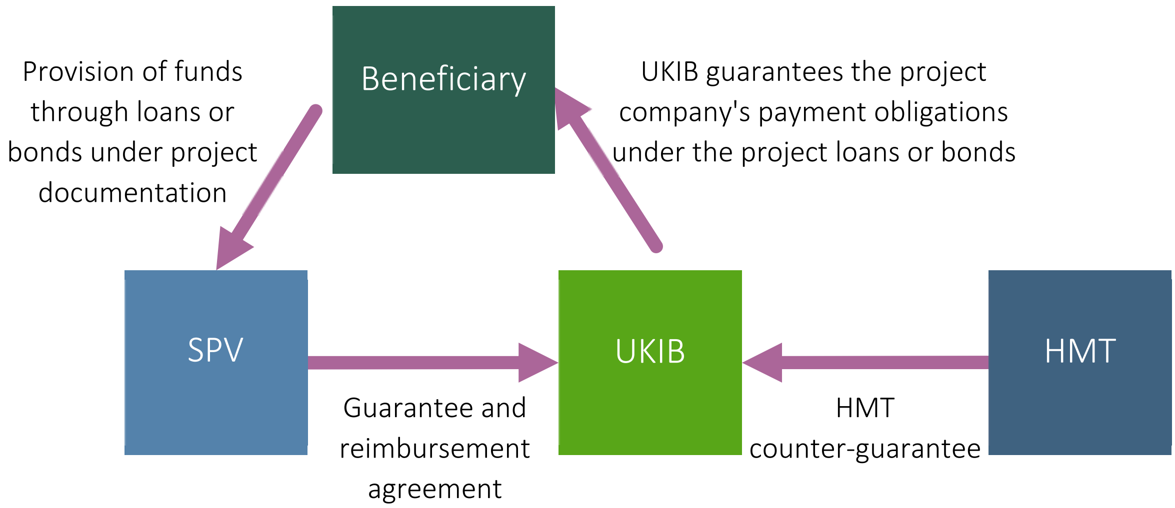
If approved, UKIB will issue guarantees to support eligible projects. Each guarantee will be backed by HMT.

The precise terms of each guarantee will depend on the relevant project and may vary from deal to deal. This overview, however, provides the general position.

UKIB will issue an irrevocable and unconditional guarantee of up to 100% of scheduled principal and interest of the debt financing (or one element of the overall debt financing). The UKIB guarantee is issued at the request of the relevant bond issuer or borrower in return for payment to UKIB of an ongoing guarantee issuance fee. The UKIB guarantee is a relatively straightforward instrument, to facilitate the debt providers' risk transfer analysis for the purpose of any credit rating assessment or regulatory capital treatment, with the relevant bond issuer or borrower being wholly or partly substituted by UKIB (and ultimately HMT).

The UKIB guarantee allows for claims to be made in relation to a default by the bond issuer or borrower in the payment of the relevant guaranteed amounts (including any breach of a pre-funding obligation relating to such guaranteed amounts which is determined (as part of normal financing mechanics) shortly before a principal and interest payment date). Principal and interest is covered, but subject to the original scheduled repayment cycle, ignoring any mandatory prepayment or acceleration of the UKIB covered debt following any default or insolvency of the bond issuer or borrower.

Claims on the UKIB guarantee will be paid by UKIB within five business days. In the event UKIB does not pay on the date specified under the UKIB guarantee, the bond issuer or borrower may claim on HMT directly and HMT will pay within two business days (further details on HMT involvement are set out in the diagram below – a more detailed structure diagram appears in schedule 1 below).



Project structures

A UKIB guarantee can be tailored for various forms of financing, but a typical structure will involve a project SPV[6] issuing bonds where the scheduled principal and interest (or coupon) payments due by the bond issuer to the bond holders are covered by the UKIB guarantee. In this structure, the bond issuer on-lends the bond proceeds to the project company SPV that builds and operates the project. The repayments under that loan are the source of funds for repayment of the bonds. The bond issuer will receive the benefit of the security package provided by the project company over the project assets to secure the loan (sharing such security (where relevant) with other direct creditors of the project company). In turn, the bond issuer provides a security package to the bond trustee (acting for the bond holders) and to UKIB which includes the bond issuer's rights to receive payments under the loan and its rights in the security package provided to secure the loan.

Other financing structures can be supported, for instance when the bonds are issued directly by the project company, or the debt incurred by the project company is in the form of a bilateral or syndicated loan made directly to the project company by the relevant finance providers.

Where a project has more than one source of debt financing, a security sharing and intercreditor agreement will be entered into between the various providers of the debt financing, UKIB as guarantor, and the project company, so that the security package is provided jointly to all of them.

HMT support

In order for the UKIB supported bonds or loans to receive the most favourable credit rating and regulatory capital treatment that a direct UK government guarantee would receive (as was the case in the previous UK Guarantees Scheme), HMT will provide a counter-guarantee, in the form of the Sovereign Infrastructure Guarantee (the SIG) to cover the risk of UKIB's payment default and insolvency.

HMT has entered into the SIG with UKIB which provides a committed framework in which UKIB can present guarantees it has issued for automatic HMT cover (by delivering an inclusion notice attaching a copy of the relevant UKIB guarantee). A copy of the SIG is available to all project parties. Under the SIG, UKIB is entitled to call on HMT to fund any claim made under the UKIB guarantee. In practice, UKIB will not call on the SIG but will fund any claim received under a UKIB guarantee from its own resources and funding sources. If UKIB fails to pay a claim within the stipulated five business days, the SIG allows the beneficiary of the UKIB guarantee itself to submit a claim on HMT for the amount of UKIB's non-payment, following which HMT must within two business days pay the relevant amount directly to the beneficiary.

Although the SIG is an agreement only between HMT and UKIB, it uses the Contracts (Rights of Third Parties) Act to grant the UKIB guarantee beneficiary direct contractual rights against HMT to submit claims to HMT in the circumstances outlined above. HMT will also agree to pay in full without set-off or deduction.

When UKIB issues its guarantee, it will also enter into a security assignment in favour of the beneficiary of the guarantee where UKIB assigns its rights to receive any claim proceeds from HMT under the SIG which relate to the UKIB guarantee. Upon issuing the UKIB guarantee and entering into the security assignment, UKIB will deliver a written notice of assignment to HMT instructing it to pay all claims relating to that UKIB guarantee directly to the beneficiary. HMT will acknowledge receipt by email to UKIB to evidence that the notice of assignment has been correctly delivered. The legal assignment which is created by the security assignment and notice of assignment, and the provisions of the SIG itself, provide the assurance to the bond holders or lenders which provide the relevant financing that in all circumstances, including if UKIB were to enter into insolvency proceedings, payments by HMT would be made directly to the UKIB guarantee beneficiary.

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[6] SPV – special purpose vehicle

Guarantee and reimbursement agreement (GRA)

UKIB will issue its guarantee pursuant to a guarantee and reimbursement agreement (the "**GRA**") entered between UKIB and the bond issuer or borrower. In the agreement, the bond issuer or borrower will request UKIB to issue the guarantee in the form agreed between all the relevant project parties (including the bond holders or lenders) and set out in a schedule. UKIB will be committed to issue the guarantee provided certain conditions precedent are met (being essentially the same conditions precedent to the bond or loan financing).

A separate fee letter will set out the ongoing guarantee issuance fee which the bond issuer or borrower will pay UKIB on a regular basis during the life of the project.

There will be an obligation on the bond issuer or borrower in the GRA immediately to reimburse UKIB upon a claim being made on UKIB under the UKIB guarantee.

Security sharing and intercreditor arrangements

Although UKIB will need to consider the specific structure and documentation of each project and its financing on a case by case basis, UKIB is likely to require that it is given the same secured position as the financing that it is guaranteeing. The UKIB guarantee, and the GRA, provide that UKIB will, upon making a payment under its guarantee, be subrogated to all of the rights of (including in any security package held by) the beneficiary of the UKIB guarantee and the relevant bond holders or lenders. However, in addition to those subrogation rights, UKIB will require the security package provided by the bond issuer or borrower also to be given to UKIB to secure the bond issuer or borrower's reimbursement and guarantee fee obligations to UKIB under the GRA.

Depending on the structure, UKIB will also enter into a security sharing and intercreditor agreement with other parties to the underlying transaction establishing UKIB's agreed level of priority in the negotiated payments waterfall following any payment by UKIB under its guarantee. Whilst these arrangements will vary from project to project, in some structures, UKIB is likely to have controlling creditor status (before the occurrence of certain guarantor trigger events) with regard to the debt that it guarantees, meaning it will be able to vote (the exposure of) that element of the debt package as part of the relevant senior creditor group's intercreditor decision-making arrangements, including in relation to the granting of consents or waivers, agreeing amendments to the financing documents and deciding on restricting or taking of enforcement action, subject to typical entrenched rights / reserved matters of different creditor classes.

Credit rating agencies

The SIG and the UKIB Guarantee have been designed to facilitate credit rating agencies to rate the UKIB guaranteed bonds or loan on the basis that they are ultimately supported by HMT. Where required by the project, a rating agency will be engaged to rate individual HMT-supported UKIB guarantees on a transaction-by-transaction basis.

UK CRR[7] and Solvency II[8]

Whilst the bond holders or lenders may be commercially comfortable taking solely UKIB payment risk, those which are subject to regulatory capital requirements, in particular UK or EU banks and insurers, will want to be able to treat their exposure under the UKIB covered bonds or loan as directly covered by the SIG in order to benefit from reduced regulatory capital requirements in respect of the up to 100% portion of the bonds or loan covered by the UKIB guarantee. In order for the UKIB supported bonds or loans to receive a reduction to the regulatory capital requirements the SIG should have the effect[9] of enabling the UKIB guarantee combined with the SIG to be treated as sovereign equivalent for purposes of CRR or Solvency II.

In order for UK and EU banks and insurers to treat their exposure under the bonds or loan as directly covered by the SIG, both the UKIB guarantee and the SIG must individually and together meet certain eligibility criteria. The eligibility criteria are very similar under UK CRR and Solvency II. In particular, the arrangement (and each of the UKIB guarantee and SIG) must be 'legally enforceable', 'direct', 'incontrovertible' (ie a clear, unambiguous, with simple demand and payment mechanism) and 'timely' (ie it pays out quickly).

The ability of the UKIB guarantee beneficiary (following a payment default by UKIB) quickly to make a direct claim on, and receive direct payment from, HMT under the SIG should be sufficient to meet the requirements[10] for the unfunded credit support being 'direct' and 'timely'. For instance, HMT's obligation to pay is not conditional on UKIB being insolvent or having entered into insolvency proceedings, or the UKIB guarantee beneficiary having first attempted to pursue enforcement action against UKIB.

Any legal analysis would need to consider whether UKIB or HMT benefit from immunity from legal proceedings, which we understand neither has for this type of arrangement pursuant to the Crown Proceedings Act 1947.

Given all the relevant documents are governed by English law, the legal enforceability of the UKIB guarantee and the other relevant documents (like the UKIB security assignment and the SIG) would need to be verified by an English legal opinion.

Structure diagram

A structure diagram is set out in schedule 1 below.

List of documents

A list of documents is set out in schedule 2 below.

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7 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 (as amended) on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as it forms part of the law of England and Wales by virtue of the provisions of the European Union (Withdrawal) Act 2018, as amended by the European Union (Withdrawal Agreement) Act 2020 (the "**UK CRR**").

8 "Solvency II" means Directive 2009/138/EC of the European Parliament and of the Council of the European Union on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and any regulation, directive, enactment, statutory provision or other legislation implementing that directive, in each case as it forms part of English law and applies in the United Kingdom either directly or by virtue of the European Union (Withdrawal) Act 2018, and any associated rules and guidance issued by the Financial Conduct Authority or the Prudential Regulation Authority pursuant to Part 9A of the Financial Services and Markets Act 2000

9 Individual bond holders and lenders must have to make their own independent assessments and seek the relevant legal advice and opinions.

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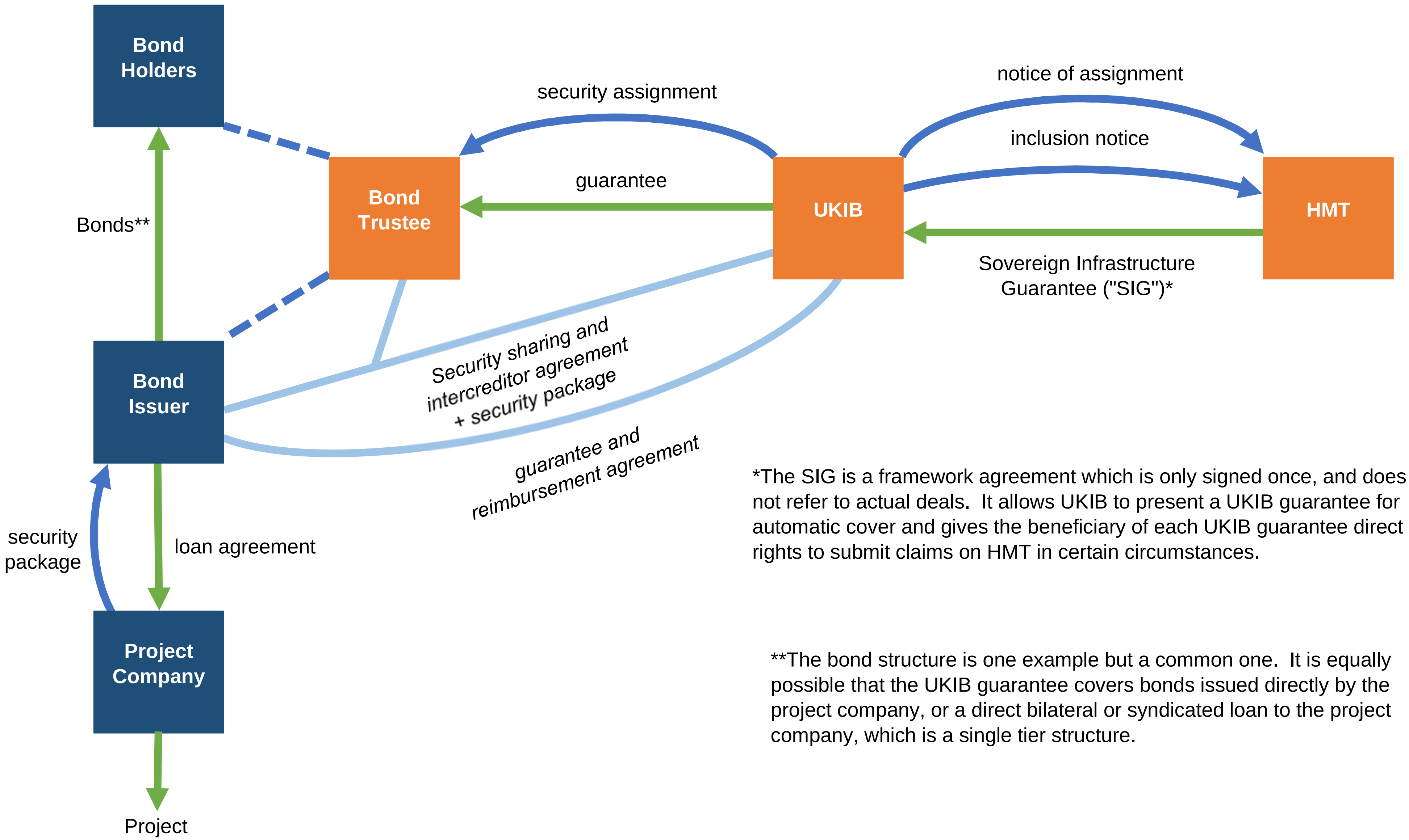
Schedule 1 – Structure Diagram



*The SIG is a framework agreement which is only signed once, and does not refer to actual deals. It allows UKIB to present a UKIB guarantee for automatic cover and gives the beneficiary of each UKIB guarantee direct rights to submit claims on HMT in certain circumstances.

**The bond structure is one example but a common one. It is equally possible that the UKIB guarantee covers bonds issued directly by the project company, or a direct bilateral or syndicated loan to the project company, which is a single tier structure.

Schedule 2 – List of documents

All documents governed by English law and put in place on completion of the relevant financing (save that the SIG is a framework / master agreement and is only signed once, and which is generic and not deal specific).

(This list uses terminology which assumes that the UKIB covered financing is a bond issuance where there is a bond trustee acting for the bond issuers. Equally the list could apply to a syndicated loan where there is facility agent and security trustee acting for the syndicate of lenders.)

Item no	Document	Parties	Description	Remarks
1.	SIG (Sovereign Infrastructure Guarantee)	HMT UKIB (but certain direct rights given to beneficiaries of UKIB guarantees)	Allows for claims to be made on HMT if UKIB fails to pay a valid claim under a UKIB guarantee.	Framework / master agreement and is only signed once, and so generic and not deal specific. A public document – a copy is disclosed to project participants.
2.	Guarantee and Reimbursement Agreement (GRA)	Bond Issuer UKIB	In which the Bond Issuer requests UKIB to issue its guarantee, and the Bond Issuer agrees to reimburse UKIB for any payment made under the UKIB Guarantee.	
3.	Fee Letter	Bond Issuer UKIB	In which the Bond Issuer agrees to pay an ongoing guarantee issuance fee on a regular basis to UKIB.	
4.	UKIB Guarantee	UKIB Bond Trustee (on behalf of the Bond Holders)	Up to 100% guarantee of non-payment of scheduled principal and interest under the bonds.	
5.	Inclusion Notice	UKIB (given to HMT)	UKIB notifies HMT of the UKIB Guarantee it has issued. Such notice results in that UKIB Guarantee being automatically covered by the SIG.	A copy of the UKIB Guarantee is attached to the notice, and a copy of the notice is given to the Bond Trustee. Receipt will be acknowledged by HMT by email to UKIB.
6.	UKIB Security Assignment	UKIB Bond Trustee	UKIB assigns by way of security its rights to receive payments from	

Item no	Document	Parties	Description	Remarks
			HMT under the SIG in relation to the relevant UKIB Guarantee as security for UKIB's obligation to pay claims under the UKIB Guarantee.	
7.	Notice of assignment	UKIB (given to HMT)	UKIB notifies HMT of the assignment of its rights to receive claim proceeds under the SIG.	A copy of the notice is given to the Bond Trustee. Receipt will be acknowledged by HMT by email to UKIB.
8.	Security Sharing and Intercreditor Agreement	UKIB Bond Trustee Bond Issuer Other deal specific entities such as other debt providers	In which, subject to deal specifics, UKIB typically has controlling creditor status (before the occurrence of specified triggers relating to the guarantee (eg invalidity/ non-payment etc)) because of its up to 100% guarantee cover. Also deals with the sharing of security.	
9.	Security Package	Bond Issuer (in favour of UKIB and Bond Trustee, and possibly other project debt providers)	Includes, among other things, all of the Bond Issuer's rights under its loan to the Project Company and the security package over the project assets given by the Project Company to the Bond Issuer.	