Loan Market Association
the authoritative voice of the EMEA market

LMA NEWS

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LMA: Supporting the syndicated loan market through present and future challenges

With the UK referendum vote to leave the EU still very recent news, it is too early to speculate on the implications for the syndicated loan market. While a UK withdrawal from the EU will have a significant impact on the future landscape of the financial markets in the UK and Europe, in the vast majority of cases the referendum result does not bring about any immediate legal or contractual change. What the longer term impact will be remains to be seen, and much will depend on the form of negotiated exit. The LMA will be following closely developments in this regard, and will look to work with government and regulators on behalf of its members to address any issues that could impact the loan market.

Notwithstanding the impact of this event, and the time the LMA will have to devote to dealing with the consequences, we will of course be continuing our normal programme of activities. The LMA's members are situated, and do business, across EMEA and beyond, and we will continue to work on documentation, regulatory issues, loan operations, and our growing education programme. As our membership – now at a record 633 – continues to grow, we have further increased our events and training programme to cover more centres and add new events, including evening seminars in a number of centres outside the UK. Our webinar programme is also proving extremely popular, and allows us to offer training for all our members, wherever they are based.

Finally, at the end of this year the LMA will reach its 20th anniversary, a landmark we shall be commemorating in a number of ways, not least with the publication of a new LMA book. The financial markets have seen many remarkable events over the last 20 years, and, as it has done for its first 20 years, the LMA will continue to play its part in supporting the syndicated loan market through present and future challenges. ■

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View from the market

A cross-section of leading industry practitioners answer topical questions about the state of the syndicated loan market.

Keith Taylor
Head of Loan Syndicate, EMEA – Barclays

Q: To what extent has the European loan market been impacted by slowing growth and geopolitical concerns?

A: The world's economies have been navigating choppy waters lately. Concerns including a China slowdown, commodity weakness, challenged developing economies, US politics and lower growth prospects have contributed to a difficult geo-political and macro-economic backdrop that in turn has created volatility and broader uncertainty.

From a narrower perspective, European markets have not escaped this wider buffeting. The UK's EU referendum, continued tensions in Greece, Spanish elections and recent terrorist incidents have all contributed to an uncertain backdrop in which to conduct business, invest and take risk.

Slower market

The loan market has not been immune to this lack of conviction, and the signs so far this year both in deal volumes and numbers (see Figure 1) would suggest a rather muted start to the year. Borrowers (given a choice) naturally tend to prefer a degree of certainty before 'pulling the trigger'.

However, it is easy to see doom and gloom everywhere. There are undoubtedly pockets of stress in certain sectors (notably natural resources) and in regions more dependent on this sector, but overall loan loss provisions seem manageable and loan market conditions (for event-financing or otherwise) have continued to be supportive and competitive for borrowers in spite of wider volatility.

There is a theory that the European loan market was experiencing something of a cyclical shift in volumes anyway, with a growing dependence on lumpy M&A, bespoke financing and mid-market activity rather than core refinancing activity, as extension options and low cost amendments for higher rated borrowers have diminished the traditional refinancing cycle.

But reasons for optimism

As we move through 2016/2017, irrespective of macro clouds clearing, we should not forget some positive signs that may hint at better months ahead:

- Surveys of Eurozone bank lending were showing better activity levels
- Central Bank actions designed to stimulate market liquidity
- M&A has not gone away (consolidation, antidote to low growth, cross-border, activism, opportunistic)
- Leveraged markets appear broadly resilient
- Bond market conditions offer some support

The key question is how the market adapts to increasingly volatile conditions and potential macro shocks. Practitioners have arguably benefited from a prolonged period of relative stability, but an appreciation of market risk and pricing in that risk is growing in importance. The new normal may well be more 'known unknowns' as well as 'unknown unknowns' on a regular basis.

Q: Is the investor base changing to reflect the shifting balance of economic power?

A: Much has been made over the last few years of the shifting balance of economic power, as developing nations grow their share of global GDP at the expense of the developed world. We are all familiar with the original 'BRIC[1]' or 'BRICKS[2]' monikers, perhaps less so with derivative versions such as 'MINT[3]'.

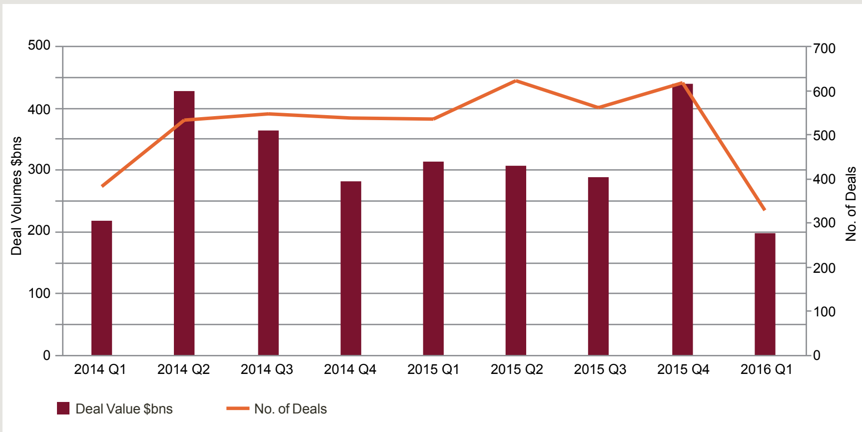
The point is that globalisation and interconnectivity have blurred the boundaries between new world and old with cross-border activity a dominant theme. Witness the recent growth in Chinese M&A activity in Europe, for example, to name but one recent phenomenon.

The question is whether this is having a discernible impact on the dynamics of the European loan investor base.

Subtle shifts

An analysis of EMEA market share by lender nationality 2010–2016 (ex Leveraged)[4] does throw up some interesting observations, which hint at a subtle shift in lender dynamics, but the

Figure 1 EMEA loan volumes and no. of deals



Source: Dealogic

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The key to successful leverage lending is cashflow and stability of cashflow.

picture is far from clear in pointing to one-way traffic.

- Chinese banks have nearly trebled market share, peaking in 2016 YTD at just over 2%
- Gulf banks have grown their presence reaching c. 4%
- Indian and Korean banks have grown their share but only marginally at <0.2% each
- European banks collectively have a lower share over the period
- Japanese banks have the biggest absolute gain of c. 4%

As can be seen by the numbers, the ‘new world’ shift is not material yet in the context of the aggregate lending volumes of more traditional EMEA lenders, but regional variations may be more pronounced. One parallel shift may well be a growing regionalisation of lender activity with an international bank overlay.

Other factors at play

These trends represent a worthy theme in an expanding and evolving lender universe in which the LMA is playing its part in encouraging new participants. Other current themes impacting investor dynamics may also be having as much impact: banks targeting growth outside home markets (e.g. Japan), ECB support/negative interest rates, together with growing non-bank interest in loans.

The key point is that the EMEA lender universe continues to be well diversified, segmented to a degree by sector, borrower or geography but fully functioning and perpetually evolving.

Understanding these dynamics both in the short and medium term is essential in pushing the boundaries of loan distribution and, ultimately, success in the loan market. ■

1 Brazil, Russia, India, China
2 Brazil, Russia, India, China, Korea, South Africa
3 Mexico, Indonesia, Nigeria, Turkey
4 Source Dealogic

Russell Holliday
Managing Director & Deputy Portfolio Manager – Alcentra

Q: Are regulators right to be concerned about increasing leveraged levels and covenant-lite structures?

A: The European loan market has seen some upward pressure on leverage levels and increasing use of incurrence based covenant structures (‘cov-lite’) since the financial crisis, which is indicative of the shift of terms in borrowers’ favour that we have seen across all credit markets as monetary policy continues to drive the hunt for yield. Leverage does, however, remain relatively low when compared to pre-crisis levels, is lower than the US (where leverage on LBOs peaked at 5.8x in 2014) and has slightly declined over the past couple of years, according to S&P data.

Regulators should also consider whether headline leverage levels are a good measure of credit risk, as I would argue the longstanding loan market phrase of “I’d rather lend to a good credit at high leverage than a weak credit at low leverage” remains as true today as it has ever been. The key to successful leverage lending is cashflow and stability of cashflow, as businesses with strong stable cashflow remain able to service their debt even in downside scenarios. I would therefore advise regulators, as well as those looking to invest in the loan market, to be wary of drawing any conclusions about the level of risk in a loan or bond other than based on detailed bottom-up credit analysis.

Similarly, while cov-lite loans have received significant attention, regulators should remember this is a covenant structure that has been used in the high yield bond and dollar loan markets for many years. There is also a broad range of different covenant packages within ‘fully covenanted’ and ‘cov-lite’. In particular, the detail of legal definitions, carve outs and baskets can materially change the strength of either type of covenant package. So while a well drafted maintenance covenant package can be of significant value to investors, to correctly assess the risk a full analysis of the legal documentation is required.

At Alcentra I see all of the leveraged loans that come through the market, and combining the strength of business, financial leverage and documentation, I continue to believe leveraged loans are generally well structured to provide the attractive risk adjusted returns they have done historically. There will always be some poor deals in the market, but these have tended to be businesses that are more challenged, and not simply those with the highest leverage level or just those with an incurrence based covenant package. It is also encouraging that, in general, the market has remained disciplined and those transactions have needed changes in order to clear the market.

Q: Is it a fair point to say that lessons learnt from the 2007/8 credit crisis have been forgotten in the structuring of leveraged loans?

A: I don’t agree that lessons have not been learnt from the credit crisis. Whilst leverage alone is not a good measure of risk, just looking at headline numbers, capital structures are significantly less leveraged than pre-crisis (LCD reports <5x on average in 1Q16 compared to 6.6x in 2007, for LBOs with EBITDA over €50 mn), and we are certainly not seeing some of the very high leverage levels on cyclical businesses that we saw in 2007. Fundamentally, balance sheets have been structured for a low growth environment and given the current outlook this is unlikely to change in the near term.

View from the market

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Importantly, the market has remained disciplined on the quality of business being financed. Losses during the crisis were largely made on loans to businesses with broken business models, or cyclical businesses with too much leverage. The most recent deals that the market has pushed back on have been where investors are unsure the business has a reason to exist in ten years' time, or where leverage is high given the underlying business dynamics.

Whilst covenant packages have undoubtedly loosened, we should remember virtually all European deals had maintenance covenants pre-crisis, but documentation drafting reduced the effectiveness of these packages. This is an area where the current market could benefit from an increased focus, as we are starting to see some weakening in the detail of documentation, but loans continue to benefit from stronger covenant packages than other credit investments.

It should also be remembered that the compensation paid to investors for owning leveraged loans in terms of credit spread is significantly higher than pre-crisis (c. 500bps in 1Q16 compared to c. 250bps in mid-2007, according to S&P), and so the combination of risk and return is significantly more attractive, and in my view very attractive compared to other asset classes.

The final point I would make is that leveraged loans actually performed reasonably well through the crisis on an underlying basis (ie excluding mark-to-market volatility), despite the exceptionally aggressive capital structures seen going into the downturn. Investors that suffered significant losses were those with high leverage which were forced to sell into a very technically weak market. The primary reason for this technical weakness was a growing trend for new loan funds using high leverage with mark-to-market triggers, which is not a trend we have seen to any significant degree since the crisis. ■

Alison Jenkins
Head of Loan Trading, DCM Loans – Commerzbank Corporates & Markets

Q: What are the main drivers impacting the secondary market in 2016?

A: Like many financial markets, the secondary loan market is feeling the impact of regulation. One key factor is the increased capital requirement for trading businesses, which is impacting trading desks' ability and appetite to hold risk. This is most keenly felt in times of market stress, when liquidity can come under pressure.

Other regulatory issues include Article 55 (Bail-In), and enhanced KYC processes, which are contributing to further trade settlement delays. This not only remains a frustration for all parties involved, but also gives rise to a number of practical problems, particularly for CLOs and fund managers, who need to be able to manage their cash positions with a degree of predictability.

Looking at supply and demand dynamics in the leveraged market, after a slow start to 2016 there has been a bounce-back in CLO issuance, with a total of €4.4 bn raised across 11 transactions YTD (May) and total annual volume forecast at c. €10 bn. The market has also seen a significant influx of cash into managed funds, which is underpinning demand for leveraged loans. A third demand-side factor is the level of loan repayments, returning cash to investors which they are then keen to reinvest. So far in 2016, repayments totalling €10 bn have already been announced or made and several more are anticipated.

In the Investment Grade arena, continued strong demand for quality assets is anticipated during 2016 as many bank portfolios remain underinvested. However, supply of IG loans has so far been limited. This may change if the market sees more event-driven transactions resulting in significant incremental corporate exposures for relationship lenders, but this has not been the case so far this year, e.g. the Chem China/Syngenta and the Shire/Baxalta deals saw little secondary activity.

For Emerging Markets deals, investors still appear to have money to invest, but the main themes affecting trading strategies will be commodity price volatility, development of the Russian sanctions situation and wider geo-political concerns. Regional differences in investors' funding costs may also play a part.

Q: To what extent is lack of primary issuance impacting secondary volumes?

A: Primary deal flow is a key driver of the secondary market for two main reasons. Firstly, investors wishing to participate in new deals may look to sell existing loans to free up cash, and secondly, (depending on deal size and liquidity) new transactions tend to trade most actively in the period immediately post-closing, as investors seek to adjust their positions. Primary issuance in the leveraged market thus far in 2016 has been patchy, and this has contributed in part to the stop-start pattern of secondary activity witnessed over this period.

The secondary market saw a healthy start to the year, with investors eager to put money to work early on. The leveraged primary pipeline built quickly, with €8.3 bn coming to the market in January and early February, split across 27 deals. As commitments became due, focus in secondary switched to the sell side in order to release cash and was mainly centred on lower yielding names

Primary activity is by no means the only driver of secondary volumes.

such as Telenet and Ista. The new primary transactions were, on the whole, favourably priced compared to the existing stock of leveraged loans, hence this also resulted in downward pressure on secondary prices.

However, primary activity is by no means the only driver of secondary volumes and many other factors can influence the market. In early February, volatility in wider credit markets and uncertainty over the CLO pipeline led to a severe dip in secondary activity and a significant fall in secondary loan prices. At its low point the average bid for leveraged flow names fell to 97.25, having started the year at 99.10.

Market sentiment reversed again following the printing of the first CLO of 2016 in the form of Blackrock's €410.2 mn deal, which priced on 9 February and gave rise to renewed confidence in the future CLO pipeline. Mario Draghi's (President of the ECB) comments on further ECB easing, incorporating an expansion into corporate bond buying, also contributed to a more positive environment and several managed fund accounts stepped back into the market to take advantage of the depressed secondary levels. This led to increased trading activity and a significant improvement in secondary prices. By the end of April, the average bid for flow names had recovered to 99.88, and a number of the best performing credits were once again trading well above par.

Figure 2 European flow names bid/offer

Source: S&P LCD Capital IQ

Q: Is it correct to state that the European secondary market is less volatile than the US?

A: It is fair to say that historically the US market has been perceived to be more volatile than Europe, however, more recently the disparity has been less marked.

A key factor is the fundamental difference in composition of the two investor bases. The US market is categorised by a significant portion of so called 'fast money', for example in the form of mutual (retail) funds and exchange traded funds (ETFs). These are very sensitive to broader market sentiment, which quickly translates into cash inflows and outflows, and in turn triggers the need to buy and sell loans to meet this demand. By contrast, Europe comprises a larger proportion of 'hold to maturity' investors such as CLOs and banks, albeit the latter are decreasing in number as the trend towards cov-lite structures intensifies. More recently, the proportion of Managed Funds in Europe has grown, which has increased the level of volatility, as these are mark-to-market vehicles and more focused on relative value, albeit they are usually backed by long-term institutional money, e.g. insurance/pension funds, unlike their US counterparts.

Another factor to consider is the different composition of the leveraged loan and high yield issuer universe in the US versus Europe. The US has larger exposure than Europe to cyclical industries such as energy and oil & gas, which experience significant volatility. This has been vividly highlighted in 2016, with huge swings in pricing of energy names in the high yield space impacting loan pricing via relative value trades.

The trend towards large cross-border deals with both USD and Euro tranches should in theory bring the two markets closer; however, technical influences mean that this is not always the case. In Europe the strong bias toward the demand side (for reasons previously mentioned, e.g. ECB policies, CLO pipeline) is in some cases causing a large disparity between the secondary pricing for the Euro and USD tranches of the same deals.

In conclusion, there are influences in Europe which are certainly increasing volatility, e.g. the growth of managed funds and relative value trades, but the two markets have not yet fully converged. ■

View from the market

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Sinead Murphy
Director, Head of Leveraged & Acquisition Finance Transaction Management – HSBC

Q: Is documentation and structuring of loans changing to reflect more challenging economic conditions?

A: The leveraged loans market has seen increased market volatility throughout 2015 and into the first half of 2016. The natural reaction would be to assume that this volatility would lead to documentation of leveraged loans tightening up in favour of Lenders. The reality has been more nuanced than that.

In the cycle of leveraged finance transactions completed post-credit crunch there has been a steady weakening of documentation terms to give Borrowers more flexibility. Looking at the evolution of financial covenants in the Term Loan B market illustrates this gradual weakening of the position for Lenders; we have moved from a standard set of four covenants, to two covenants, then to one leverage covenant ('covenant loose') to one springing leverage covenant only ('cov-lite').

Most recently, in the last few years, looser documentation terms have been driven by the use of High Yield/loan dual structures and the adoption of terms from the New York Term Loan B market (as discussed in more detail in answer to the next question). This convergence between the markets and a continued demand/supply imbalance has meant that Sponsors have been able to achieve very aggressive documentation terms.

Market volatility at the start of this year saw investors pushing back on some of the more aggressive documentation terms in some deals; tightening the ratios on Permitted Payments, requiring early ticking fees, requiring at least a 12 month margin freeze and limiting the steps on the margin ratchet. There was also a lot of focus seen around the ability of Borrowers to raise incremental debt and investors were looking to keep 'freebie' baskets below one times EBITDA and the ratio test inside opening leverage. Most Favoured Nations ('MFN's) needed to capture all-in-yield and in some deals they were looking for the sunset to be removed to preserve the MFN.

However, in the same period, we saw transactions clear the market with some of the most aggressive documentation we have seen in this cycle. We saw at least one transaction push the market beyond just importing New York-style Term Loan B terms, into importing full High Yield Bond style covenants into the facility agreement in the same way that you would typically see on a High Yield Bond/Super Senior RCF structure. That transaction was very successful in the market, despite pushing the documentation boundaries further.

These transactions have shown that there is still sufficient demand for paper from investors that they will accept further weakening of documentation terms from top-tier Sponsors. However, these deals show that these super-aggressive terms are only being accepted where the credit profile of the Borrowing Group is right. There is now an enhanced focus on the credit by investors and for the right credit, investors will accept even further documentation flexibility for Borrowers.

Q. What trends from other countries have been incorporated into documentation in the UK?

A. In the leveraged finance market the answer to this question is to look at the documentation trends which the European market is increasingly borrowing from the United States.

During 2013 we first saw European sponsors using New York Term Loan B documentation and execution to access US investor liquidity for European LBOs. Since then, the market has accepted a steady move to import New York terms into European transactions.

The degree of convergence has not been wholly consistent, and now in 2016 there is a range of documentation in the market – from traditional European facilities containing just distinct features of the New York market to full New York-style documentary architecture, which has Borrowers able to achieve equivalent flexibility to a New York execution but via an English-law European financing aimed at European investors.

Below are three main New York documentation trends which are now prevalent in the European market:

First, the financial covenant; a 'cov-lite' structure is the usual market position with one springing leverage covenant that is only tested if the RCF is drawn to a specified level (currently 35%) on the quarterly testing date. The covenant is for the benefit of the RCF lenders only, with the Term Loan B lenders having a right of cross-acceleration to it. In 2016 we have seen a number of deals with a New York-style cure mechanic on that covenant, allowing an EBITDA cure that can be exercised up to five times in total and twice in four quarters. That covenant is further weakened by US-style definitions of EBITDA with extensive add-backs and flexibility to pro-forma.

Second, the increased flexibility for a Borrower to raise incremental debt versus the traditional accordion facility mechanic; the inclusion of a 'freebie' basket and a ratio test means that Borrowers have flexibility to increase debt straight out of the box. Day-one lenders have MFN protection (50bps or 100bps on some 2016 deals) but that is being eroded by increasingly shorter sunsets and sponsors arguing for the MFN to apply to only margin, rather than all-in-yield.

Third, the flexibility on baskets throughout the documentation; the market has moved from traditional hard dollar baskets to incorporating the New York trends for all baskets to have 'growers' attached to them, debt incurrence governed by a ratio test only and restricted payment regimes incorporating 'builder' baskets.

The convergence of New York and European terms has been good news for Borrowers, but comes with its own legal issues. Importing New York conventions into the UK requires careful consideration of the intercreditor position, in particular to deal with the differences in insolvency regimes in Europe versus the US. ■

Trade finance and financial crime in the regulatory spotlight

Trade finance is perceived by regulators as being high risk.

There has been a swathe of regulation targeting financial crime in recent years, in developed and developing markets across the globe, and as gatekeepers to the global financial system, banks are very much on the regulatory front-line. At the same time, civil and criminal enforcement action by regulators has become increasingly aggressive, particularly from US agencies such as the Department of the Treasury's Office of Foreign Assets Control ('OFAC'). Over the past five years, banks have paid more than US$15 bn in fines for breaching US sanctions in various countries.

Trade finance has been coming under particular scrutiny. Regulators are concerned that, as banks improve their ability to combat more traditional forms and methods of financial crime, criminals may become more attracted to trade finance products. In the UK, the Financial Conduct Authority (the 'FCA') has conducted a thematic review to assess current and future risks in relation to banks' control of financial crime risks in trade finance, resulting in published guidance on good and poor practice for trade finance banks.

Why Trade Finance?

The term 'trade finance' covers a broad range of products. It includes documentary credits, factoring, forfeiting, structured trade finance and export credit agency ('ECA') covered finance. Trade finance is perceived by regulators as being high risk because:

- it is often high-frequency and high-volume, and can involve complex structures;
- it is a key source of cross-border liquidity, often involving multiple related transactions, spanning multiple jurisdictions with multiple cross-border payments being made;
- it is often used in high risk jurisdictions because of its ability to mitigate credit and jurisdictional risk; and
- banks have historically conducted limited due diligence on end customers or underlying transactions due to intermediation of correspondent banks and high frequency of trade flows (as reflected in industry rules such as UCP 600).

It is perhaps ironic that the success of many trade finance products in mitigating credit risk, therefore enabling banks to finance activities and persons in challenging jurisdictions without running into some of the difficulties faced by other global financial products, has now exposed banks to greater financial crime risk, and therefore to heightened scrutiny from regulators.

One size doesn't fit all

Banks are finding it challenging to comply with regulations that often appear to have been drafted without consideration or understanding of how the trade finance industry operates. They are imposing burdens on banks that may both be impractical and render participation in transactions not worth the effort or risk. Challenges include:

- issuers of trade instruments being unable to obtain detailed knowledge of underlying transactions and the parties;
- the frequency, volume and complexity of transactions;
- strict time limits for performance by banks, in particular in relation to documentary credits and collections;
- the involvement of sanctioned parties or vessels often not being apparent until documents are presented for honour or negotiation;
- difficulties in knowing whether goods may potentially have a dual-purpose; and
- banks being confined to a review of the documents presented, which may contain generalised or inaccurate descriptions of goods, or fail to identify the end users of goods.

Logan Wright
Partner – Clifford Chance LLP

Ashley McDermott
Senior Associate – Clifford Chance LLP

Regulators are concerned that criminals may become more attracted to trade finance products.

Sanctions: a moveable feast

The FCA's thematic review found that banks were actually doing reasonably well in terms of sanctions controls, although there was room for improvement in mitigating the risks of money laundering and terrorist financing.

However, since the FCA's review the sanctions landscape has become more complicated, with, on the one hand, the introduction of sanctions against a major and integrated world economy (Russia), and on the other hand, the easing of sanctions against a potential new world economic power (Iran). Moreover, compliance is becoming ever-more challenging, due to the growing use of sanctions as a tool of foreign policy: sanctions may be imposed in a gradual ratcheting up of pressure in response to political events, and what may be permitted today, might not be allowed tomorrow.

In addition, the sanctions themselves are increasingly sophisticated in nature, calibrated to influence political behaviour by hitting particular pressure points, while minimising collateral damage. This is very much evident in the Russian sectoral sanctions, which are targeted in terms of both sectors (for example, the energy and financial services sectors) and particular activities (for example, raising new medium or long-term financing).

The long shadow of OFAC

Divergences of approach between the main sanctions authorities (in particular, those in the EU and in the US) complicate matters further. This extends well beyond the countries and persons targeted by the different sanctions regimes or the willingness to license exemptions. There are significant differences in the scope and interpretation of sanctions, and the standards applied. For example, in considering non-compliance, OFAC apply a 'should have known' standard, whereas the EU allows a 'no reasonable cause to suspect' defence.

One particularly distinctive feature of US sanctions is their extra-territorial effect. In addition to 'US persons' (which, unlike EU sanctions, may include non-US subsidiaries of US companies), OFAC asserts jurisdiction over US-origin goods and services, and may (as was the case with Iran until recently) even assert jurisdiction over non-US persons under so-called 'secondary' sanctions.

However, perhaps most problematic for non-US persons is OFAC's jurisdiction over the use of the US financial system (even where there is no other US nexus). As US dollar wire payments generally involve a funds transfer through US-located correspondent bank accounts, this gives OFAC jurisdiction over the entire payment chain. Further, OFAC sanctions apply to US dollar payments between two non-sanctioned parties if those payments relate to an underlying OFAC-sanctioned transaction.

Iran: where angels fear to tread?

This extra-territorial effect remains a key

stumbling block for unlocking trade with Iran (and related financing) post-'implementation day', which occurred in January 2016 under the Joint Comprehensive Plan of Action (the 'JCPOA') agreed last year between Iran and key global powers, including the US and the EU. While the US has lifted its nuclear-related secondary sanctions, its primary sanctions remain in place, and continue to apply to not only involvement of US persons but also dealings with US-origin goods and the US financial system. This has the effect of discouraging both US banks from continuing correspondent relationships with non-US banks that wish to finance trade with Iran, as well as non-US banks with material US operations from financing such trade.

Moreover, the JCPOA contains a snap-back mechanism to enable the US and the EU to re-impose sanctions if they can demonstrate, through a 35-day arbitration procedure, that Iran has violated its JCPOA obligations. OFAC has advised that if snap-back occurs, US secondary sanctions could apply to contracts entered into before the snap-back. It is expected that the US probably would provide a limited period (typically 1 to 3 months) for the unwinding of such contracts after the snap-back, before the risk of a US sanctions designation would apply to them, but this is not certain.

This is in the context of a jurisdiction that remains very challenging from a financial crime perspective, far beyond the US nuclear-related sanctions. Iran remains the subject of various sanctions regimes targeting areas such as human rights abuses and terrorist financing, as well as to export controls on specific goods (including dual-use goods). And it continues to be a high risk jurisdiction for fraud, corruption and money-laundering.

Tiptoeing through the minefield

The FCA's guidance on good and poor practice is a useful starting point for banks working out how best to navigate the regulatory landscape. The guidance recommends (amongst other

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> Divergences of approach between the main sanctions authorities complicate matters further.

Trade finance and financial crime in the regulatory spotlight

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> It is clear that effective due diligence is the key to ensuring compliance with financial crime regulation.

things) that banks (1) maintain clear policies in relation to financial crime and sanctions, (2) implement effective, enhanced KYC and due diligence procedures in respect of the entire transaction, (3) use manual rather than automated screening for submitted trade documentation and (4) include appropriate and specific terms relating to financial crime in documentation.

It is clear that effective due diligence is the key to ensuring compliance with financial crime regulation, and the FCA's list of 'good practices' include many aimed at ensuring appropriate (for which, in many cases, read 'enhanced') due diligence is conducted on the overall structure, including on the underlying counterparties and goods.

At the same time, although not a substitute for effective due diligence, documentary provisions can provide an important supplement to compliance efforts. Anti-corruption, anti-money laundering and sanctions-related clauses can help to tease out issues during the due diligence process (prior to and throughout the life of a transaction) and give the bank contractual remedies if financial crime risk arises.

However, including such clauses in trade finance documentation can give rise to some unique issues, beyond the more general difficulties in agreeing sanctions provisions that work for a range of banks in a syndicated structured trade financing but yet do not impose an unreasonable (or impossible) onus on the borrower.

For example, in the context of documentary credits, sanctions clauses can conflict with the principle that banks should make a determination on the face of the presented documents alone, without regard to the underlying transaction, and with the principle that a letter of credit, once issued, should be irrevocable. To this end, in 2014 the ICC released a guidance paper on the use of sanctions in trade finance related instruments. In summary, the ICC advocated against the use of sanctions clauses due to the increased confusion and uncertainty they create.

The ICC guidance appears to be based on the assumption that banks will include broad, catch-all 'policy' sanctions clauses, which are easy to attack on the grounds of uncertainty and unpredictability. It is harder to argue that sanctions language specifically referring to particular laws, regulations and/or regulators is uncertain, as it is more akin to the existing illegality defence for non-performance under ICC Rules, and it should therefore be possible to address compliance concerns without fundamentally altering the nature of the product.

Difficulties also arise in the context of guarantees and insurance policies from ECAs, which are often used in conjunction with trade finance products. Each ECA tends to have its own approach to documentary protections when it comes to financial crime-related matters, and an ECA's preferred language does not always cover the same risks as the clauses required by commercial banks. Therefore banks benefiting from ECA cover need to check that the provisions of their cover documents and their documentation with the borrower/exporter are aligned.

Moreover, many European ECAs are currently examining the extent to which they would be obliged to honour claims under their cover documents if a borrower is unable to repay as a result of sanctions levied by a third party country (for example, the US). It will be interesting to see how this develops as, if banks are not covered in such circumstances, it could have a material impact on the 'bankability' of ECA-covered transactions.

A life in the spotlight

Financial crime regulation, and its heavy burden for trade finance banks, is clearly here to stay. As the FCA has noted, London's position as a major financial centre could be severely affected if banks engaging in trade finance activity do not have appropriate systems and controls to prevent money laundering, terrorist financing and sanctions breaches from taking place.

While the FCA and other regulators seem to recognise some of the particular challenges for trade finance banks, and consultations with industry bodies continue, it seems unlikely that there will be a material lightening of the regulatory burden any time soon. Regulators continue to be on the lookout for non-compliance, and the risk of significant fines, and even imprisonment, remain for those who fail to appreciate and address these challenges. ■

Pan-European private placement market makes ground

At a time when investors are seeking higher yields and banks remain cautious in their lending, increasing numbers of companies in Europe are seeking finance in the fast-growing pan-European private placement market against a background of increasing harmonisation.

These are challenging times for both borrowers and lenders. Banks' lending appetites have been curtailed by the crisis and the regulation triggered by it, limiting the liquidity available to many companies. Meanwhile, investors are struggling to find attractive returns as interest rates and bond yields sit at record lows.

Against this backdrop, more and more mid-market companies in Europe – those with revenues of between €100 mn and €1.5 bn a year – are turning to the pan-European private placement market to raise finance, while increasing numbers of investors are also turning to these direct, private debt issues.

The issuance of private funding for companies in Europe grew from €18.4 bn in 2014 to €32.8 bn in 2015 – a staggering 78%. €19 bn of the 2015 total is attributable to the well-established and substantial German private placement market, called the 'Schuldschein' market.

The remaining €14 bn is made up by the so-called pan-European PP market – which includes French Euro PP issuance and private placements arranged across the rest of Europe, including the UK. Volumes doubled in 2015, up from €7 bn in the previous year.

However, more can be done to make these markets more user-friendly for issuers and investors. To this end, the Pan-European Private Placement (PEPP) Working Group has launched a number of initiatives designed to harmonise rules across markets within Europe.

As this shake-up in lending markets continues, many investors operating in private debt markets are increasingly in need of cost-efficient credit screening and analysis, supporting efficient due-diligence processes and price discovery across a more and more diverse European investor base.

Losing out to Europe: the USPP market

Yet the vigorous recent growth in transactions in the pan-European PP market has come at the expense of the US private placement market for cross-border Europe transactions, which lost its lead for the first time in 2015.

This market is of course considerably more mature, having been well established as a forum for investment grade companies to access long-term lending for more than three decades. In the US, the Private Placement Monitor (PPM) – with which S&P Global collaborates – has been tracking private placements since 1985, and the market has on the whole fared well, even through the crisis.

However, total deal volumes in the USPP market for cross-border Europe transactions have been steadily eroding since they peaked at €20 bn in 2012, to €17 bn in 2013, €16 bn in 2014, and just €12 bn in 2015. In 2014, four French companies tapped the USPP market for substantial deals – including business service firm Sodexo for a US$1.1 bn dollar deal – yet only one French company did in 2015.

Now that European private placement markets are coming into their own, it seems likely that French deals similar to Sodexo's will stay in Europe in future, instead of going to the USPP market. Meanwhile, issuers from the UK and Ireland accounted for an even larger fall in volumes on the USPP market than the French – they were responsible for €11 bn worth of transactions in 2014, and just €8.6 bn in 2015.

Bond markets' appeal diminishes for mid-market firms

A similar trend was evident across European bond exchange platforms, where there were fewer transactions – if higher average volumes – in 2015. ExtraMOT PRO, the fixed-income multilateral trading facility of the Milan exchange, saw a significant drop in issuances of bonds below €200 mn. 2015's 32 deals totalled €357 mn, down from 58 deals totalling €1.2 bn in 2014. There were three issuances above €200 mn, up from two transactions in 2014, showing that a higher number of larger deals get done in those

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€32.8 bn

Total issuance of private funding for companies in Europe in 2015.

Pan-European private placement market makes ground

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alternative markets even as smaller deals dry up.

This trend was also visible for the London Stock Exchange ORB and Alternext Brussels. Germany was a special case, with investors' appetite for mid-market bonds wiped out almost entirely by the spectacular insolvency of German Pellets, a manufacturer of wood pellets for heating.

Transactions dropped for both Entry and Prime Standards of the Frankfurt Stock Exchange in 2015, to six from 13 in 2014, and total volumes decreased to €279 mn from €662 mn. After last year's closure of the Stuttgart and Düsseldorf exchanges' mid-market bond segments, alternative financing via some form of private placement might be the only remaining option for mid-market companies besides tapping the still highly liquid bank funding market.

This seems to suggest that, in the longer term, Europe may not develop into a capital market dominated by public bonds like the US. Instead, the mid-market sector seems more likely to diversify its sources of funding into the pan-European private placement market.

> “The mid-market sector seems more likely to diversify its sources of funding into the pan-European private placement market.”

The pan-European private placement market

Over the last year of issuance in this market, volumes increased most markedly at the very top and at the very bottom ends of the corporate scale – showing that both large and small mid-sector companies are keen to take advantage of this market's potential.

The number of very large deals (over €150 mn) shot up from 8 deals worth €1.8 bn in 2014 to 21 deals worth €6 bn in 2015. Two of the largest were done by Spanish supermarket chain Hipercor SA (€600 mn) and Italian airline Alitalia (€375 mn).

However, the total number of very small deals (below €50 mn) also went up significantly. 33 deals in 2014 increased to 68 deals in 2015, with overall volume nearly doubling (from €0.8 bn in 2014 to €1.4 bn in 2015) – almost half of which was comprised of deals below €20 mn.

The German Schuldschein Market

The German 'Schuldschein' market is showing a similar pattern of growth, with a strong overall increase, particularly among smaller companies. Traditionally, the Schuldschein market has been dominated by transactions below €200 mn, which made up over 70% of all deals (75 transactions) in 2015, similar to 2014. In addition, 40% of first-time Schuldschein issuers in 2015 had annual revenues below €1 bn.

As a whole, the market rose by 65% from €11.5 bn in 2014 to €19 bn in 2015, while total transactions increased from 95 to 104. Mergers and acquisitions (M&As) were a major driver of expansion, accounting for more than half of all deals as the average deal volume swelled from €120 mn in 2014 to €180 mn in 2015.

Examples of major M&A deals done in 2015 were by automotive parts manufacturer Friedrichshafen AG (€2.2 bn), filter systems manufacturer Mann & Hummel (€1.1 bn), and specialty glass and plastics manufacturer Gerresheimer (€425 mn).

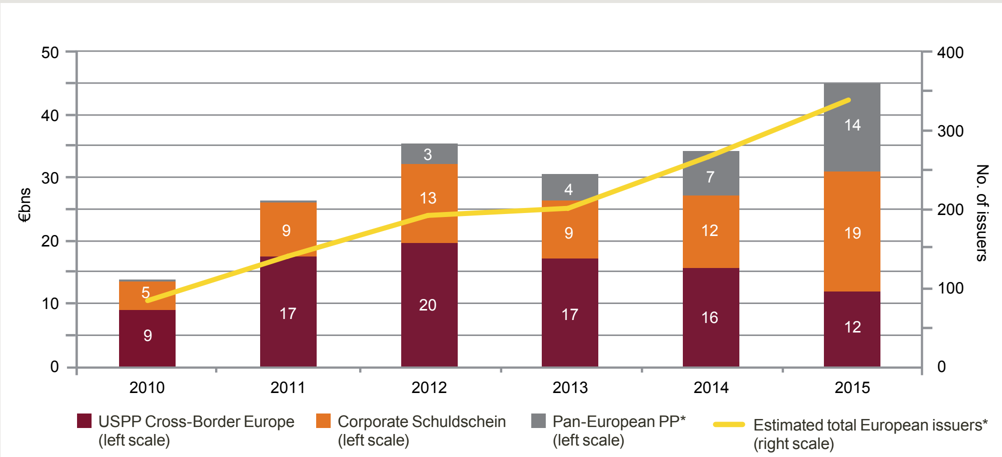
Reasons for the shift

Clearly, mid-sector companies – especially those at the top and bottom end – are seeking an alternative source of funding to classic bank lending and leveraged buy-out type direct lending on the one hand, and to the public bond market on the other.

For issuers, private placements can be relatively inexpensive, quick to put in place, flexible, and without onerous reporting requirements. They may therefore be preferred by companies seeking finance to an initial public offering, or to going to the public bond market.

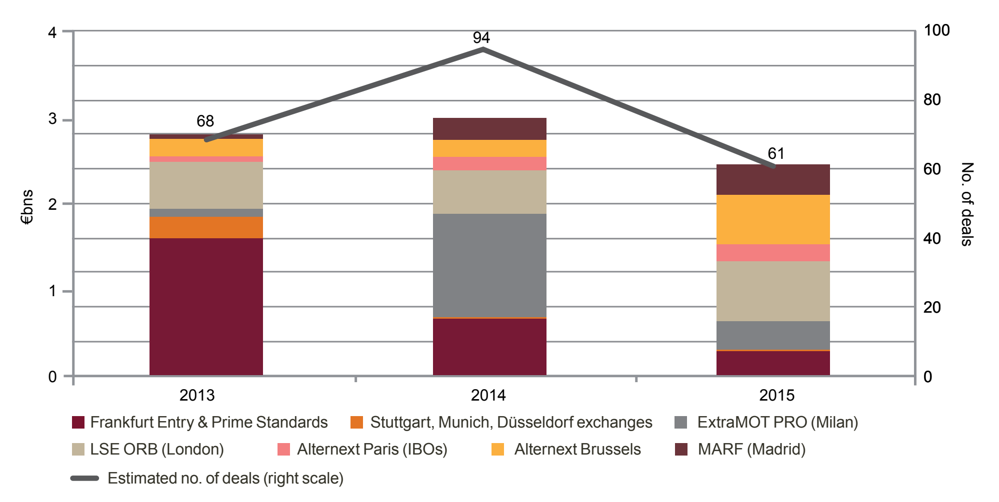
Confidentiality can also appeal to mid-market firms, as the increase in unlisted deals on the French Euro PP market demonstrates. An amendment of the insurance code in August 2013 made it easier for insurance companies to invest in unlisted transactions.

Figure 1 Estimated size of selected European debt private placement markets



*Includes both listed and unlisted deals done by French as well as other European issuers, and also includes non-agency direct deals. PP--Private placements. Sources: Standard & Poor's estimates, Private Placement Monitor, Barclays, BayernLB Research, LBBW, IKB, Société Générale, CMS Bureau Francis Lefebvre, l'Agefi, BNP Paribas, ICMA.

Figure 2 Estimated size of bond segments for small and midsize issuers on selected European exchanges



Note: Excludes deals of €200 mn and above (ExtraMot PRO, Frankfurt Prime Standard); excludes financial or public issuers (LSE ORB).
Sources: Standard & Poor's estimates, Exchange websites (bond listings as of 15 Jan 2016).
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As a consequence, the share of listed versus unlisted deals shifted to around 50/50 in 2015 from approximately 70/30 the previous year.

Private placements also offer longer maturities than bank debt or bonds, which may be helpful to many companies. The number of deals with a tenor of 11 to 15 years grew from €0.1 bn in 2014 to €0.8 bn in 2015, whereas issues with maturities below five years dropped from €0.8 bn to €0.5 bn (from 13% to 4% of the total).

For investors – provided they have a buy-to-hold investment policy – these deals can offer more attractive yields, helping improve financial performance and diversify risk. They also give them the opportunity to get involved at a relatively early stage in the growth of future corporate winners.

Securing the future

To further increase this investment base, it would help to strengthen current moves towards a more widely accepted institutional framework for private placements in Europe.

The PEPP Working Group's initiative to harmonise standards and documentation has already resulted in a framework of best practices for PEPP transactions and a market guide. Industry bodies, notably, the Loan Market Association and the Euro PP Working Group, have also produced standardised PP transaction documentation, for English law and French law respectively – which has doubtless already begun to forge a stronger pan-European private placement market.

Yet, for investors, credible credit assessments are perhaps the most important factor in making appropriate capital allocation and pricing decisions. Therefore, market participants need to also develop a consensus on the best way to achieve market-wide and consistent transparency on credit risk in private placement markets.

By their very nature, private financing markets are less transparent than public markets. At the same time, medium and smaller mid-market companies typically have higher credit risk. However, at present, there is no consistent approach to credit screening and analysis in the private debt markets.

Markets therefore need to develop a widely accepted institutional set-up that makes investors across Europe comfortable in their due diligence, price discovery, and deal execution. Providing investors with cost-efficient, reliable and consistent – i.e. market-wide – credit assessment ratings would, we believe, give them the transparency they require to make appropriate decisions regarding pricing and allocation of their capital.

Conclusion – a market nearing maturity

In 2015, European private funding markets made significant strides. This was best demonstrated by growth of 65% from 2014 to 2015 in the German Schuldschein market, while pan-European PP market volumes nearly doubled from €7 bn to €13.8 bn.

This growth appears to have been to the detriment of the USPP market and alternative public bond markets for mid-market European corporates. The USPP market suffered drops in issuance from European corporates, while smaller issues on the alternative public bond market fell significantly – most spectacularly in Germany after the default of German Pellets.

Meanwhile, the European private placement investment base is increasing as the markets become ever-more harmonised. Widely accepted and consistent approaches to evaluating credit quality are still missing – this would be invaluable in decreasing investment costs and further boosting the market.

Ultimately, if all these developments continue, it is possible that, in the long run, the pan-European private placement market might indeed become both companies', and investors', first choice. Meanwhile these markets are here to stay, and seem set to grow. ■

“” There is no consistent approach to credit screening and analysis in the private debt markets.

Bank deleveraging continues in Europe and new markets start to emerge

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Overview

Over €300bn of loan portfolio sales have been completed in Europe since 2013 as financial institutions continue to tackle €2 trn of non-core and non-performing assets. Whilst the loan portfolio market saw significant activity throughout 2015, H1 2016 has seen a slower start to the year, with activity expected to pick up significantly by year-end. The UK and Ireland once again led the way, with €45 bn and €23 bn of portfolios traded in 2015. Italy and Spain registered the next highest volumes with €17 bn and €12 bn respectively of completed deals. Italy's volumes were up 112% from 2014, while Spain was down 45%. Increased regulatory pressures and capital requirements are expected to continue to stimulate further activity through the ECB driver Single Supervisory Mechanism (SSM), Basel III and Solvency II. Equity markets themselves are forcing the financial sector to accelerate divestures of non-core businesses, emphasising the need to focus on home markets and core businesses.

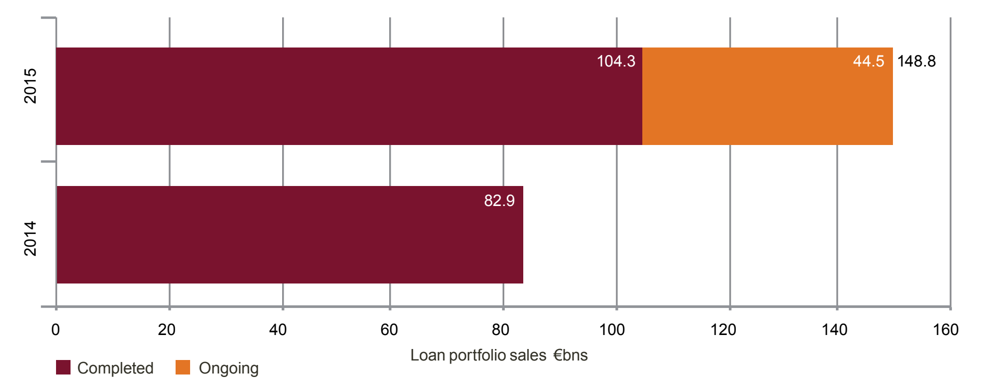
Investor appetite remains exceptionally strong, with significant fundraising and the availability of loan on loan leverage continuing to fuel activity. Buyers with strong track records in the market are expected to continue to dominate the transaction tables in 2016, as they did in 2015.

The focus on certain countries and asset classes continues to shift as the European loan portfolio market matures. This shift has led to a noticeable pick up in performing loan transactions, as financial institutions look to capitalise on investor sentiment and macroeconomic performance throughout the continent. As well as covering a range of European jurisdictions, this article also picks up on some of the key legal challenges in a relatively new market in Central and Eastern Europe ('CEE'), and highlights where the market may develop in the rest of the world.

Regulation

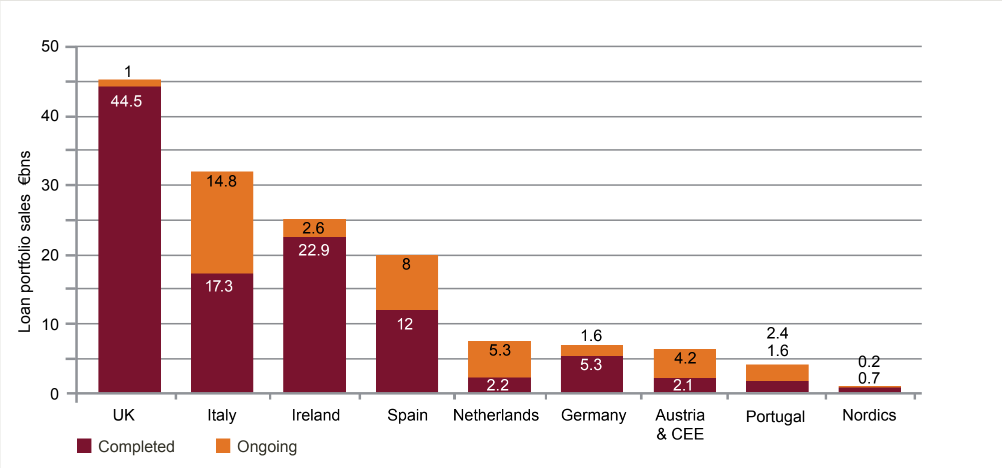
Governments and central banks, in Europe and globally, are increasingly recognising how NPLs continue to suppress credit supply and, in turn, overall economic activity. Late in 2015, the IMF

Figure 1 Activity by year



Source: Deloitte Research, December 2015

Figure 2 Activity by country in 2015



Source: Deloitte Research, December 2015

2.9%

NPL ratio for the UK, one of the lowest in Europe.

published a discussion paper outlining strategies for resolving problem loans in Europe through a three-pillared approach: (i) tightened supervisory policies; (ii) insolvency reforms; and (iii) the development of distressed debt markets. Subsequently, the ECB also published its SSM priorities, identifying that 'Elevated levels of NPLs deserve heightened supervisory attention'. It also stated that 'A task force on NPLs is reviewing the situation of institutions with higher levels of NPLs and will propose follow-up actions'. ECB stress testing has forced European banks to improve capital and provisioning levels. However, further deleveraging is required for banks where NPL levels remain critical and improvement is still required.

UK & Ireland leading the pack

The UK and Ireland together completed over €65 bn of loan sales in 2015. Disposals were historically dominated by Irish wind-down entities (i.e. NAMA, IBRC) along with UK banks seeking to 'right size' their balance sheets by selling portfolios in response to capital and regulatory constraints. Driven by the ongoing wind down of UKAR and the exit of GE from the majority of its GE Capital business, there is an increasing trend towards performing loan portfolio sales. We expect 2016 will see similar transactions in the UK, particularly given the £50 bn that remains on UKAR's balance sheet.

The effects of the Brexit referendum have caused some levels of uncertainty in the investor community. Whilst the UK has seen a reduction in portfolio transactions in H1 2016, it is unclear as to how much or if any of this relates to the referendum. Nevertheless, together with an improvement in macroeconomic fundamentals since the 2008–09 crisis, the successful deleveraging programme of UK banks over the last few years has led to a decline in total UK banking NPL stocks to a NPL ratio of 2.9%, one of the lowest in Europe.

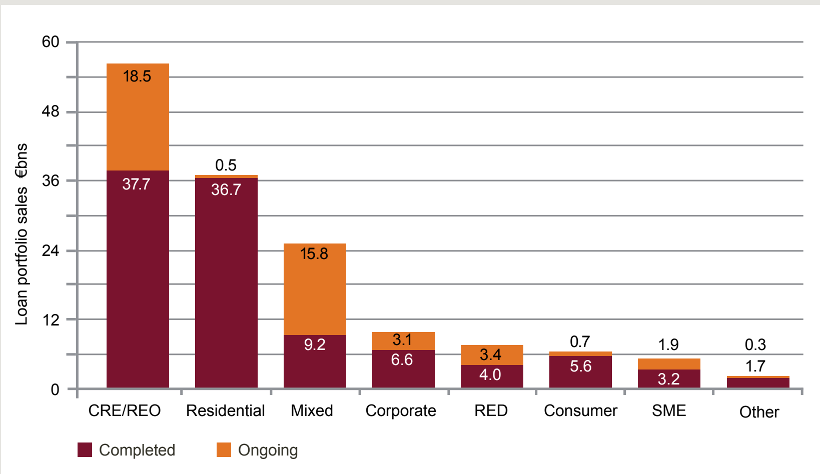
Ireland has witnessed highly successful deleveraging programmes in recent years, with completed portfolio trades exceeding €60 bn. Completed deals reduced by 19% to €23 bn in 2015, with the significant reduction primarily due to the completion of the vast majority of the IBRC portfolio sales in 2014. NAMA sold nearly half of the €23 bn in completed portfolios during 2015 and currently has €7 bn of live deals in the market. Ireland will continue to be an active market with volumes expected to exceed €15 bn in 2016.

Economic recovery stimulating Southern Europe

Italian government efforts to stimulate activity in the loan portfolio market, aimed at reducing NPL stocks, have been in the media spotlight during early 2016. Although the proposed state guarantee and securitisation structure has been met with scepticism by the market, there has been a marked increase in loan portfolio transactions, with over €17 bn of portfolios being sold in 2015 and nearly €15 bn ongoing at the beginning of 2016.

On top of the state guarantee scheme, the Italian government passed a further package of reforms

Figure 3 Activity by asset type in 2015



Source: Deloitte Research, December 2015

Bank deleveraging continues in Europe and new markets start to emerge

Continued from page 15

simplifying foreclosure and insolvency procedures, aimed at reducing collateral recovery times. This, together with improving macroeconomic conditions, should create an environment for further deleveraging.

With an estimated €200 bn of NPL volumes still on Italian banks' balance sheets, the size of the prospective deal flow in the coming years is attracting significant investor attention, with competition expecting to intensify across the market.

Spain confirmed its status as one of the most active portfolio loan sale markets in Europe as investors see continued attraction to the market, with improving economic growth more than double the Eurozone average. Since 2013, the Spanish market has transformed from a purely unsecured loan market to a market that is now almost exclusively loans that are secured by real estate. These assets are typically more attractive to investors and command substantially higher capital investment per transaction.

Of the approximately €20 bn of portfolios that were placed on the market in 2015, only c. 60% by transaction volume ended up trading. This reflected the fact that bank provisioning levels were still somewhat off market pricing expectations. Going forward, we expect a continued narrowing of the bid-ask spread as a result of an improving economy, more appropriate provisioning and more efficient portfolio packaging by the banks, which should lead to more successful transactions.

The Spanish market is proving to be quite active in Q2 2016 with c. €10 bn of live transactions in the market from players such as Bankia and La Caixa. In addition, Abanca and Banco Popular are anticipated to be preparing portfolio transactions for the second half of 2016. As with 2015, the market continues to be dominated by real estate development and real estate owned assets, and to a lesser extent SME/corporate debt portfolios, together with the resurgence of some sizeable unsecured trades.

A developing interest in Central and Eastern Europe

Although parts of Central and Eastern Europe (CEE) remain a new market for most international investors, improving economic conditions and deal pipeline are generating interest, as buyers seek out higher returns and less competition than in some of the more mature NPL markets. C. €2 bn deals completed during 2015, which remained generally in line with 2014. Towards the end of 2015, the volume of ongoing transactions increased significantly, more than doubling to over €4 bn.

The pricing gap between buyers and sellers has also markedly improved in recent months. The most pressing issue to international investors remains a lack of viable servicing options in the region. This has led to a trend of consortiums, comprised of international investors, regional investors and local servicers, working together to bid for portfolios in the region.

Whilst Romania has led the way in deal volume, we expect the number of transactions in other countries in the region to increase, particularly in Slovenia and Croatia, given that these two countries have some of the highest NPL levels in CEE. Croatia overhauled its bankruptcy law in late 2015, which should assist with accelerating asset recovery times and reducing the bid-ask spread.

Key legal challenges in Central and Eastern Europe

The transactional risks for investors working in the CEE region brings into focus a number of key legal challenges which are more prominent compared to Western Europe. Knowledge of the local legal environment is a key factor when determining investor appetite for NPL transactions across the different CEE jurisdictions, including considerations such as:

- a rather uncertain legal framework and frequently changing regulatory environment, including personal insolvency laws, give-in-payment laws and a highly protective EU framework on consumer credit agreements;
- strict local requirements regarding the transfer of security, particularly real estate mortgages;
- lengthy and expensive judicial proceedings which are processed in overloaded court systems;
- less efficient national insolvency and enforcement regimes;
- inconsistent and unpredictable court rulings with limited court precedent on loan transfer agreements;

“ ”

...the future looks bright for the overall NPL resolution environment in Greece over the short to medium term.

For further information please refer to recent Deloitte publications:

Deleveraging Guide 2015–2016
www2.deloitte.com/uk/en/pages/financial-advisory/articles/deleveraging-europe-market-update-h2-2015.html

NPL markets gathered momentum – Full steam ahead
(CEE NPL research report)
www2.deloitte.com/hu/en/pages/finance/articles/npl-study-2016.html

Deloitte Legal Central Europe – Guide to transfer of NPLs
www2.deloitte.com/global/en/pages/legal/articles/npl-transfers-in-ce.html

– potential applicability of TUPE regulations in relation to the seller's employees wholly or mainly engaged in servicing or supporting the NPL portfolio; and
– potential applicability of anti-trust regulations (depending on jurisdiction, nature of assets and deal size, etc.).

Whilst these challenges may deter some international investors, the comparatively appealing returns on offer may entice some players who are able to get comfortable with the issues above.

A brighter future for NPL resolution in Greece

The political and economic events in Greece have been well publicised in recent months. Data produced early in 2015 suggested that the four largest Greek banks, which account for 95% of the banking system, held over €100 bn of sub-performing or non-performing loans, which represented an NPL ratio of 42%. The ECB stress tests and the Asset Quality Review of Greek banks in late 2015 further highlighted the issues faced by the Greek banks.

Low provisioning and capital levels have limited the ability of banks to commit to effective deleveraging programmes, but the successful capital raising of €14 bn has provided some optionality. As reliable servicing solutions develop and with the resolution of other regulatory and non-regulatory constraints, the future looks bright for the overall NPL resolution environment in Greece over the short to medium term.

Opportunities beyond Europe

China is now experiencing its slowest economic growth in 25 years at c. 7% per annum, following previous highs of c. 14% per annum in 2007. Growth has been excessively dependent on rapid increase in credit. China's debt to GDP ratio rose by 78 percentage points between 2011 and 2015 to over 250%, with total debt growing to over US$30 trn. Historical trends have shown that countries with debt rising at China's rate may be subject to financial shocks. Official data at the end of 2015 put total on-balance sheet non-performing loans at US$195 bn and special mention loans at US$443 bn, which is an overall increase of 144% since 2013. The NPL market, however, still continues to be dominated by Chinese banks selling to Chinese Asset Management Companies ('AMCs') as stipulated by regulation. However, in the past year there has been a small number of transactions between AMCs and international investors, along with new strategic alliances on the ground.

The slowdown in the Chinese economy has also resulted in an increasing level of credit stress globally and across Asia where the economies and financial system are somewhat intertwined. The level of stress is particularly high in the commodities sector and ancillary supporting sectors, with some notably large restructuring opportunities across the region. Generally across Southeast Asia, local banks are also seeing increasing levels of NPLs across the board, albeit many banks currently seem to be reasonably well capitalised to weather further downturn.

Recent measures by the Reserve Bank of India ('RBI') to get banks to correctly classify and provide for loans has resulted in the Indian banking sector's stressed assets increasing 100% from the 2013 levels to an estimated c. US$150 bn. The RBI has also stepped up pressure on the banks to take action against delinquent debtors as well as implementing a new loan provisioning approach, which are positive actions towards reforming the way in which stressed assets are managed. Equally important, the change in regulation allowing 100% foreign ownership of Asset Reconstruction Companies (as the primarily licensed vehicle to acquire non-performing assets in India) has led to a number of domestic and international investors applying to set up such vehicles. These significant changes in the regulatory and legal environment both from a banking and asset management perspective provide the fundamental features necessary to facilitate a buoyant NPL market.

Conclusion

NPL and non-core levels across Europe remain a critical issue for banks and regulators alike. The allocation of capital against these portfolios limits the available capital for lending, which can stem the credit supply into the economy. In addition, these portfolios occupy valuable bank management time and resources that could be redeployed on core banking activities.

The impact of regulatory and market forces continue to combine to see ongoing activity. We expect the European market will remain exceptionally buoyant with transactional volumes likely to break the €130 bn mark in 2016 as banks seek to capitalise on investor demand. ■

Impact of recent developments in the Nigerian Foreign Exchange Market on the Nigerian loan market

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The significant decline in the price of crude oil from US$115 per barrel in June 2014 to under US$30 per barrel by February 2016 has adversely impacted the economies of most oil-producing countries. With respect to Nigeria, as oil revenues account for over 80% of Nigeria's foreign exchange earnings, the impact of the global decline has been very severe. There has been a significant depletion in the country's foreign reserves from US$39.07 bn in July 2014 to US$26.7 bn in June 2016.[1] Correspondingly, given the strong correlation between these reserves and the value of the Nigerian Naira, the worsening revenue trend has precipitated a sustained decline in the value of the Naira, together with a rise in both domestic interest and inflation rates.

In response to the foregoing, the Central Bank of Nigeria (the 'CBN') introduced a number of regulatory measures, via various circulars, with the objective of curtailing the decline of the Naira as well as maintaining macroeconomic stability. Below is a summary of some of these circulars that have impacted the Nigerian loan market.

Regulatory response

By virtue of a circular titled 'Prudential Regulation for the Management of Foreign Exchange Risks of Banks' issued on 24 October 2014, the CBN directed that the aggregate foreign currency borrowing of a Nigerian bank's (excluding inter-group and inter-bank) borrowings should not exceed 75% of its shareholders' funds unimpaired by losses.[2] The circular further provided that Nigerian banks should borrow and lend in the same currency (natural hedging) in order to avoid currency mismatch associated with foreign currency risk. Also, on 18 December 2014, in a bid to prevent round-tripping, the CBN directed[3] that funds purchased from banks by their customers on the autonomous/interbank foreign exchange market must be utilised within 48 hours from the date of purchase, failing which such funds must be returned to the CBN for re-purchase at the Bank's buying rate.

Further, on 20 February 2015[4], the CBN undertook a tactical devaluation[5] of the Naira when it declared the closure of the retail Dutch Auction System (rDAS) and wholesale Dutch Auction System (wDAS) foreign exchange windows (i.e. the official windows for the sale and purchase of foreign exchange by the CBN); and stated that all demand for foreign exchange should be channelled to the interbank foreign exchange market ('IFEM'). Although the CBN fixed the interbank exchange rate at US$1:₦197–₦198 at the time, this rate was not truly reflective of the value of the Naira, as between February 2015 and June 2016, the Naira traded at the parallel markets for about US$1:₦280–₦360. In view of the huge disparity between the interbank exchange rate and the parallel market rate, the Nigerian government has been under immense pressure to devalue the Naira. However, prior to June 2016, the President of Nigeria, President Muhammadu Buhari had maintained a resolute stand against the said devaluation.

On 17 April 2015, the CBN issued a circular titled 'Currency substitution and Dollarisation of the Nigerian economy', which stated amongst others that it is illegal to price or denominate the cost of any product or service (visible or invisible) in any foreign currency in Nigeria and no business offer or acceptance should be consummated in Nigeria in any currency other than the Naira. Subsequently the CBN issued a clarifying circular in May 2015 (which superseded the April 17 Circular): (a) reiterating that any person who refuses to accept the Naira as a means of payment is guilty of an offence; and (b) excluded certain agencies and companies in Nigeria whose business transactions necessarily involve payment transactions in foreign currency, from the CBN's directions.

The foregoing are a handful of the several circulars issued by the CBN in its bid to protect the value of the Naira. However, of all these circulars, the circular which most Nigerian loan practitioners agree has been the most impactful, is the circular titled, Granting of Foreign Currency Loans to Non-Dollar Generating Businesses, issued by the CBN on 4 August 2015 (the 'August Circular'). The August Circular directs that foreign currency loans should only be extended

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A large number of borrowers are finding it difficult to source foreign currency to repay their obligations.

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to customers with foreign currency generating business. It further states that Nigerian banks are banned from redenominating Naira loans to foreign currency loans for customers who have no foreign currency generating business.

On 15 June 2016, the CBN undertook a further 'tactical' devaluation of the Naira by the introduction of a flexible IFEM, pursuant to its issuance of the 'Revised Guidelines for the Operation of the Nigerian Inter-Bank Foreign Exchange Market'. Essentially, through the introduction of a flexible interbank foreign exchange rate, the CBN dispensed with the erstwhile uniform interbank rate of US$1:₦197 and instead established a foreign exchange market which will operate as a single market that is purely market-driven[6], with the CBN participating through interventions[7]. Whilst the flexible interbank exchange rate is aimed at reviving transactions at the IFEM[8] and consequently increasing liquidity, its actual implications, will only be revealed in the coming months.

Nonetheless, in this Article, we focus on the impact of the August Circular on loan transactions in Nigeria and also examine the general impact of scarcity of foreign currency on loan transactions.

Impact of the scarcity or non-availability of Foreign Currency on loan transactions in Nigeria

Following the closure of the rDAS/wDAS foreign exchange windows, the IFEM became the sole official foreign exchange window in Nigeria. This consequently raised the demand pressure on the interbank window and till date market participants and customers are finding it increasingly difficult to perform foreign currency denominated transactions. Although it is hoped that the recent introduction of the flexible IFEM will help increase activity in the market, until Nigeria is actually able to boost its foreign reserves and there is increased liquidity in the IFEM, the current situation of scarcity of foreign currency is likely to continue to be the case.

The depreciation in the value of the Naira and the restrictions on foreign exchange imposed by the CBN has hindered borrowers' ability to service their foreign currency loans. Essentially, a large number of borrowers are finding it difficult to source foreign currency to repay their obligations and as a result, there have been defaults on a number of foreign currency denominated loans. In view of the foregoing, not surprisingly, there have been a significant number of loan restructurings with borrowers invoking redenomination clauses, where the facility agreements allow for them.

The insufficiency of foreign currency to transact has equally constrained the capacity of Nigerian banks to open foreign currency Letters of Credit ('LC') as they are unable to guarantee that they will be able to obtain the foreign currency needed to fulfill such LC obligations. Given the current foreign exchange environment in Nigeria, it is common for banks with subsisting foreign exchange LC obligations to ask clients for letters of indemnity to hold the bank harmless from any inability to source foreign currency from the interbank market.

The unavailability of foreign currency to meet loan obligations has now raised questions as to the 'real relevance' or otherwise of a Certificate of Capital Importation ('CCI'). Typically, at the point of importing investment capital to Nigeria, a foreign investor is required to specify the Nigerian beneficiary of the investment funds (i.e. loan or equity) and the purpose therefore; and an authorised dealer[9] is required to issue a CCI, evidencing receipt of such investment capital within 24 hours of receipt of imported funds.[10] A CCI assures the unhindered repatriation of investment capital and income

Impact of recent developments in the Nigerian Foreign Exchange Market on the Nigerian loan market

Continued from page 19

> Nigerian investment banks are not left out of the impact of scarcity of foreign exchange.

thereon, in any convertible currency, and guarantees unconditional transferability of yield on investment funds in freely convertible currency. Remittance of these monies is usually at the prevailing official exchange rate of the Naira on the relevant date (i.e. the interbank market, following the closure of the CBN's official window of the Nigerian foreign exchange market).

Currently however, the ability of foreign investors to repatriate funds is now dependent on the amount of foreign currency that is available to authorised dealers for cash repatriation. Most authorised dealers have a scale of preference that guides their provision of foreign currency to their customers. For example, most authorised dealers would give priority to foreign currency required for certain imports, national projects, education and health and then subsequently deal with requests for cash repatriation. Indeed, even with respect to foreign currency that may be available for cash repatriation, these authorised dealers themselves have their own foreign currency obligations[11] and are likely to also use such available foreign currency for the same. The result therefore is that for equity investors, many have been forced to re-invest their yield capital in Nigeria. However, loan investors are faced with default scenarios or resorting to alternative sources of foreign currency, including the parallel markets (i.e. the black markets). This calls into question the relevance of a CCI if foreign investors cannot repatriate foreign currency as and when they want to do so. Notwithstanding the foregoing, the ideal position is to have a CCI so as to guarantee repatriation of foreign currency from the official foreign exchange markets. Regardless of the scarcity of foreign exchange, there are still many foreign investors that will not want to be associated with dealings on the parallel markets. However, it is noteworthy that many foreign investors who hitherto would not consider the use of the parallel markets are now considering them. Indeed, there are increasingly more transactions being consummated in the parallel markets.

Nigerian investment banks are not left out of the impact of scarcity of foreign exchange. Most Nigerian investment banks now find it extremely difficult to arrange foreign currency denominated financing even for companies that generate foreign currency income. The oil and gas firms have resorted to forward sale transactions and offtaker financings to finance their development programmes.

The impact of the August Circular on loan transactions in Nigeria

As mentioned above, the August Circular prohibits Nigerian banks from granting foreign currency loans to customers that do not generate foreign currency receivables from their

operations. The CBN also prohibited banks from redenominating existing Naira loans, where the borrower in question does not also have foreign currency receivables. In light of the above, Nigerian companies who do not generate foreign currency income, but who require foreign currency for certain transactions, have resorted to borrowing from foreign banks.

Furthermore, we are also witnessing a change in the investment patterns of private equity firms, as private equity firms are engaging in more debt capital investments than previously. Interestingly, despite the high inflation, devaluation of the Naira and the exchange control restrictions in Nigeria, private equity firms remain optimistic about making further investments in Nigeria on account of its population of approximately 180 mn, relatively fast growing economy – despite the recent decline in GDP growth - and potential for high investment returns.

The August Circular has also heavily impacted loans that have not been fully disbursed, as the Nigerian banks have had to refrain from further disbursement to customers that do not have foreign receivables. These banks have therefore

had to restructure their loans and, where the relevant loan documentation permits, redenominate such loans, as they are now precluded from further disbursing events, regardless of the fact that the relevant loan arrangements were entered into prior to the August 2015 Circular.

Provisions of the LMA Facility Agreement that may be triggered/ impacted by the current Nigeria Foreign Exchange Market

Given the current foreign exchange environment in Nigeria, borrowers and lenders may be unable to honour their respective contractual obligations and accordingly, from a loan documentation perspective, we note that certain provisions of the LMA Facility Agreement (highlighted below) could therefore be invoked.

For instance, the LMA Facility Agreement defines a 'Defaulting Lender' as a lender 'who has failed to make its participation in a Loan available or gives notice that it will do so; a lender which has rescinded or repudiated a Finance Document; a lender which is an issuing bank which has failed to issue a letter of credit, or which has given notice that it will not issue a letter of credit, or which fails to pay a claim on a letter of credit; or a lender with respect to which an Insolvency Event has occurred and is continuing.' As many Nigerian banks are finding it difficult to source foreign currency to honour their funding obligations, there is a possibility that they may become Defaulting Lenders.

The LMA standard provision of a 'Disruption Event' in the LMA Facility Agreement, contemplates a 'material disruption to the payment or communications system or financial markets'. It is now being considered whether or not a case for the current period of scarcity of foreign currency in Nigeria may constitute a material disruption to the financial markets. Indeed, we are aware of a transaction where a borrower relied on the general unavailability of foreign currency as a Disruption Event to make a delayed payment on its loan obligations.

As the August Circular prohibits banks from providing foreign currency loans to companies that do not generate foreign currency loans, for transactions where the loans had not been fully disbursed, it became illegal for Nigerian banks to provide further disbursements. Under the LMA Facility Agreement, the illegality clause contemplates that where it becomes unlawful for a Lender to perform any of its obligations as contemplated under the loan agreement, the borrower shall immediately repay such Lender's participation therein. However, from a practical perspective, many lenders have been reluctant to invoke this clause as it requires borrowers to mandatorily prepay the entirety of the loan to the Lender. Instead, the parties are resorting to loan restructuring.

In conclusion, there is no doubt that the recent developments in the Nigerian foreign exchange market have affected loan transactions in Nigeria and continue to do so. Lenders are aware of the challenging environment in Nigeria, and are cognisant of the inability of borrowers to meet their foreign exchange loan obligations because of foreign exchange issues. Whilst for reputational and commercial reasons, lenders will be reluctant to immediately invoke the default provisions of the facility agreement, mindful that borrowers are also customers whose revenue flows the banks hope to retain, the banks still have a business to run and must also maintain relevant capital adequacy ratios, in order to continue to be in business. In the final analysis, one can only remain hopeful that the policy shifts being implemented by the federal government of Nigeria (e.g. anti-corruption drive, successful recoveries of some looted public funds, removal of subsidy in, and deregulation of, the oil sector and the introduction of a flexible IFEM) will ultimately result in a revamp of the Nigerian economy, following which the foreign exchange loan markets, alongside Nigeria's other financial markets, will become vibrant once again. ■

1. www.tradingeconomics.com/nigeria/foreign-exchange-reserves
2. The 75% limit supersedes and overrides the 200% limit specified in section 6 of the Guidelines for Foreign Borrowing for on-Lending by Nigerian banks issued on 26 November 2001.
3. CBN Circular on the 'Utilisation of funds purchased from the autonomous/interbank foreign exchange market by authorised dealers' dated 18 December 2014.
4. The CBN issued a Press Release on 20 February 2015.
5. Having allowed two adjustments from August 2014 to February 2015, the CBN decided to manage the Naira-Dollar Exchange Rate at about ₦197/US$ till 15 June 2016, when it introduced a flexible interbank exchange rate market, pursuant to its issuance of the 'Revised Guidelines for the Operation of the Nigerian Inter-Bank Foreign Exchange Market'.
6. Exchange rates will now be determined by market forces. Authorised Dealers in foreign exchange are now permitted to buy and sell foreign exchange among themselves on a two-way quote basis via the FMDQ Thomson Reuters foreign exchange trading systems (TRFXT- Conversional Dealing), or any system approved by the CBN.
7. The CBN will intervene directly in the inter-bank market or through dynamic 'Secondary Market Intervention Mechanisms'.
8. Foreign exchange transactions have been at a stalemate because the CBN imposed interbank rate of US$1:₦197 was not truly reflective of the value of the Naira and so most investors awaited an official devaluation of the Naira prior to investing in the country.
9. (a bank or financial institution authorised by the CBN to deal in foreign exchange)
10. In practice however, a CCI is issued within 24–72 hours of funds inflow and Electronic CCIs are now being issued by Nigerian financial institutions authorised to deal in foreign exchange.
11. For example, some Nigerian banks have Eurobond payment obligations that they also require foreign currency to meet.

What is Green Lending?

In March 2016, Lloyds Banking Group hit the headlines with their pledge to 'offer £1 bn in cut-rate loans for green buildings'. This comes at a time when buzzwords such as 'green buildings', 'green lending' and 'sustainability' are becoming ever more prevalent in the lending space. But what exactly do they mean?

On 11 May 2016, Lesley Wan, Katherine Sherwin, Ciarán Londra and Richard MacDowel took to the stage at the Loan Market Association's fourth Real Estate Finance Conference to explain exactly that.

The Green Agenda

In 2011, David Cameron declared he would lead the "greenest government ever", intending to deliver big cuts in carbon emissions, domestic flights, waste and water usage. This is all part of the global 'Green Agenda', in which national bodies are looking at developing and implementing local sustainable development strategies and plans with active involvement of the different sectors in the local community where the process is conducted.

The Green Agenda is not a new concept, so why is it only now being actively discussed in the real estate lending sector? The energy from fossil fuels consumed in the construction and operation of buildings accounts forms approximately half of the UK's emissions of carbon dioxide, with housing alone generating 27% of UK emissions. With the UK's target to reduce its carbon emissions by 80% by 2050, it seems obvious that Government will target Real Estate heavily as part of its general clampdown, and the Committee on Climate Change has already set targets for the reduction of emissions in residential and non-residential buildings.

It is therefore incumbent on the real estate sector to lead from the front, and align its policies with the aims of the Green Agenda, as failure to do so could result in increased regulation and increased costs for those who fail to meet Government policy.

As Lesley Wan stated on 11 May, "as an industry, we can see the greenification of property as a stumbling block, which is costly, disruptive and difficult to implement. Or, we can see it as an opportunity to take the lead and to help the industry achieve its goals, not just because we all hope to see benefits through innovation, but because it is the right thing to do."

Key drivers for embracing the Green Agenda

Sustainability initiatives are being embraced in a number of sectors, in part due to the evolving legislative framework in this area. There are a plethora of regulatory initiatives in existence, including the Carbon Reduction Commitment, the Energy Savings Opportunity Scheme, Minimum Energy Efficiency Standards and changing Buildings Regulations, and it is a challenge in itself for institutions to stay on top of these, let alone ensure compliance with them.

However, compliance aside, one of the key drivers is the global focus on sustainability initiatives. At the annual Conference of Parties (COP), held last year on 7–8 December at COP21 at Stade de France in Paris, 195 countries adopted the first-ever universal, legally binding global climate deal. But as Katherine Sherwin stated on 11 May, "Not only are nations adopting sustainability goals, but corporates are as well and they increasingly expect their advisors, lenders, investors, and so on to be able to assist them in meeting their goals." This is best demonstrated by the growing use and influence of GRESB, being an industry-driven organisation committed to assessing the sustainability performance of real assets around the globe, including real estate portfolios (public, private and direct). In 2015, GRESB launched a Debt Assessment tool, specifically tailored to the functions and processes of real estate lenders and debt portfolio owners, which seeks to enable institutional investors to extend ESG integration to their real estate debt investments.

In addition, there are financial incentives for adopting green policies. The market is starting to see a trend in added value for those real estate initiatives adopting a more sustainable focus, with green buildings offering better collateral for investors to lend against. This is coupled with the risk of devaluation for those properties which do not look to implement sustainability measures.

The trend is moving in favour of pursuing green objectives and peers cannot afford to be left behind.

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So, what is Green Lending?

There is currently no dictionary definition for green lending, but it is effectively lending that is dependent on environmental criteria for the planned use of funds.

Richard MacDowel explained that, at Lloyds Banking Group, clients that achieve a certain green score on an internally created scorecard, would qualify for a green loan. The scorecard looks at, amongst other things, a client's sustainability strategy as well as the underlying sustainability risks in the real estate collateral. Those qualifying for a green loan will be offered discounts of up to 20 basis points on loans of £10 mn or more, and will be required to meet agreed green covenants (for example, around carbon efficiency targets) for the lifetime of the loan in order to continue receiving the improved loan margin.

Why is Green Lending only now coming to the fore?

As Ciarán Londra put it on 11 May, "because the market is now ready for it."

Taking a step back, the evolution of the Green Agenda in the real estate sector has been, at best, confused, with no clear leader looking to set the pace whether that be from Government, industry or the EU. However, Ciarán has seen through his work at BLP an increased drive from some quarters to push this agenda along and noted that some groups have taken it upon themselves to better educate the market to drive the Green Agenda forward.

Most notably, there is the Better Buildings Partnership (BBP), being a collaboration of the UK's leading commercial property owners, who are working together to improve the sustainability of existing commercial building stock. The BBP has a dedicated commercial real estate lending working group, of which the LMA is a party, which provides a forum to share and develop best-practice around sustainability considerations for commercial real estate lending. Specific areas of focus include how legislation and market forces impact on new lending decisions and considerations for existing loan books; stakeholder reporting of sustainability information and the role of lenders in driving the sustainability agenda.

In addition, there is an opportunity for lawyers to step up and work with their clients to educate them on how best to apply, and benefit from, the myriad of initiatives coming out of the European Union and their respective national governments. It is also an opportunity for lenders to support, and develop, better relationships with their clients by helping them to enact green strategies. This is the key driver behind Lloyds Banking Group's decision to invest £1 bn in green lending.

> "It seems clear that the greenification of property is only going to continue and build momentum."

A developing market

Green lending is very much a developing concept in the lending market. As Richard explained, there is currently a lack of detailed granularity in the existing benchmarks to test properties/developments against. Defining what 'green' looks like across different lending scenarios remains challenging. The aim going forward is to create a consistent methodology to apply in every transaction, but this has yet to be developed and agreed across the market. It should also be remembered that borrowers do not always have control over the properties they own – lease agreements need to be analysed, and where possible, adapted for green lending purposes.

In comparison, in the bond market, the concept of a 'green bond' is a more developed concept. The International Capital Market Association, with the support of issuers, investors and intermediaries in the Green Bond market, has produced Green Bond Principles ('GBP'), which provide guidelines that recommend transparency and disclosure, and promote integrity in the development of this fast growing market by clarifying the approach for any issuance of a Green Bond. The GBP are intended for broad use by the market: they provide issuers with guidance on the key components involved in launching a credible Green Bond; they aid investors by ensuring availability of information necessary to evaluate the environmental impact of their Green Bond investments; and they assist underwriters by moving the market towards standard disclosures which will facilitate transactions. In addition there is also a Climate Bonds Initiative, which seeks to promote large-scale investments that will deliver a global low carbon and climate resilient economy. Similar to the GBP, a Climate Bonds Standard and Certification Scheme is in place.

The way forward for the lending market may therefore be the establishment of guiding principles on which to base the foundations of green lending. From there, the market can look to establish standard clauses to be incorporated into finance documents, lease agreements and so on.

The future?

Green lending is here to stay and it seems clear that the greenification of property is only going to continue and build momentum as Government tries to guide an industry that contributes to nearly half of the UK's CO_2 emissions to become more efficient with its energy use.

But the Real Estate industry is clearly anticipating where Government is heading and is constantly innovating in its own right - stretching the boundaries of design, streamlining the efficiency of operations, and more increasingly generating renewable and low-carbon power on-site. There is no doubt the industry has the capacity to become even more creative going forward, and it is likely that the clamour for greener, more resource efficient properties is here to stay. Now it is for the rest of the real estate finance community to catch up and play its role in shaping the way forward. ■

LMA conferences

We hosted our third annual Developing Markets Conference in April at The Grange Tower Bridge Hotel in London. Attended by over 300 delegates, it provided an ideal forum for members active in developing market jurisdictions to listen to senior market practitioners discuss key current trends and issues to be considered when lending into these markets, specifically focusing on CEE, CIS, Russia and both North and Sub-Saharan Africa.

Despite recent market volatility, developing markets continue to offer attractive investment opportunities. Speakers spoke of the barriers in lending to these markets, as well as identifying potential solutions to such challenges and opportunities for growth. This included sessions on alternative lending solutions in Sub-Saharan Africa, structured trade and commodity finance, and plugging the developing market infrastructure gap.

For further information on this conference, please visit our Developing Markets microsite.

1. **Reinventing the wheel: alternative lending solutions in Sub-Saharan Africa:** from left to right
   Franklin Amoo – formerly at Mizuho Securities, David Damiba – Helios Investment Partners, Douglas Bennet – GuarantCo, Jonathan de la Pasture – Liberty Group and Henry Kikoyo (chair) – Brown Rudnick
2. **Easing the burden: risk mitigation tools for lenders:** from left to right
   Tinashe Makoni – Trinity International, James Cunningham – Miller Insurance Services, Mark Gubbins – Gallagher London and Claude Brown (chair) – Reed Smith
3. **Keynote address: Developing markets – what is going on?**
   Simon Quijano-Evans – Commerzbank
4. **Plugging the developing market infrastructure gap:** from left to right
   Michael Delia – EBRD, Adil Kurt-Elli – HSBC, Michael Emery – IFC and Clive Ransome (chair) – Milbank
5. **Bank lending in developing markets: overcoming barriers and discovering new opportunities:** from left to right
   Raouf Jundi – BTMU, Eric Zimny – SMBCE, Vladislav Chiriac – UniCredit, Thomas Lambourn – Citi, Charles Corbett – Standard Chartered Bank and Logan Wright (chair) – Clifford Chance

REF Conference
11 May 2016
London

We hosted our fourth annual Real Estate Finance Conference in London in early May. The conference was attended by over 400 industry professionals, making it one of our largest events aside from our annual conference for members in September. The programme spanned a wide range of topical issues impacting the commercial real estate finance market both domestically and globally. An impressive line-up of experienced market practitioners commented on the outlook for CRE markets, the key economic and geopolitical challenges ahead, as well as key opportunities and a vision for the future. This included a focus on the rise of alternative non-bank lenders, non-performing loans (NPLs) and Green Finance.

For further information on this conference, please visit our Real Estate Finance microsite.


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1. **The rise and rise of non-bank lenders:** from left to right: Elena Sabinina-Rey (chair) – Brown Rudnick, Jamil Farooqi – M&G, Nick Kilbey – Pramerica Real Estate Investors, Neil Odom-Haslett – Standard Life Investments and Timothé Rauly – AXA Real Estate
2. **Development deficit? Outlook for development finance in real estate**: from left to right: Damian Perry (chair) – Clifford Chance, Andrew Antoniades – CBRE Capital Advisors, John Cole – Cain Hoy Enterprises, Fiona Freeman – FTI Consulting and Paul Stallard – Canary Wharf Group
3. **Nearing the peak? Outlook for CRE markets in 2016:** from left to right: Simon Kildahl (chair) – Simmons & Simmons, Michael Acratopulo – Wells Fargo, John Feeney – Lloyds Bank, Pierpaolo Iasci – Société Générale and Sharon Quinlan – Barclays
4. **Borrower Interview:** from left to right: Stephen Powell – Slaughter and May and Karen Toh – Grosvenor
5. **In-depth focus: Intercreditor Agreements:** from left to right: Arthur Dyson (chair) – Allen & Overy, Alistair McGillivray – Clifford Chance, Kumar Tewari – Lloyds Banking Group and Steve Smith – Linklaters


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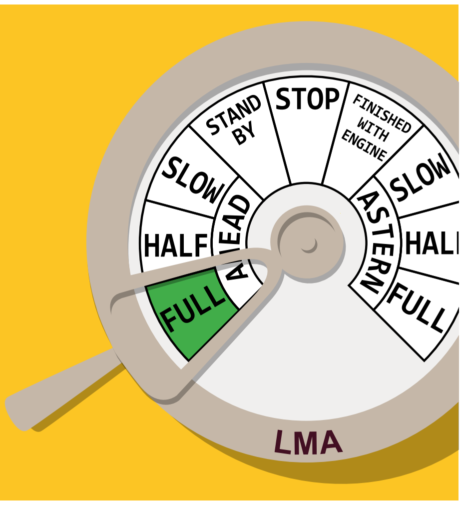
Loan Operations Conference
21 June 2016
London



Full Steam Ahead

We hosted our second conference dedicated entirely to loan operations in June this year. The conference was hugely successful and received positive feedback, with over 200 delegates attending. This event provided an ideal forum for market participants to discuss the challenges facing loan operations teams, in the hope that it can pave the way to bring about increased efficiencies in the loan process as a whole.

The LMA is engaged with some of the most experienced professionals in the operations arena who share a common goal of affecting change. At the conference experienced market practitioners spoke about the challenges in promoting efficient practices, operational and documentation issues impacting the loan operation teams, delays to settlement times, the impact of IFRS 9 and Block Chain, and an outlook into the future. The LMA Loan Operations Committee spoke of their initiatives to date and how they look to tackle current challenges.

For further information, please visit the LMA website.

1. **Addressing operational issues – The LMA Loan Operations Committee:** from left to right: Gemma Haley – LMA, Brian Fraser – Lloyds Bank, Steven Connolly – JPMorgan, Robert Brodie – Citi and Nigel Houghton (chair) – LMA

2. **Pipeline for 2016 and onwards:** from left to right: Craig Scordellis – CQSM, Madeline Jones – Oaktree Capital Management, Charles Bennett – Credit Suisse and Alison Jenkins (chair) – Commerzbank

3. **Operational matters impacting the agent:** from left to right: Diane Roberts – Ashurst, Maud Joffrain – SG CIB, Antony Girling – Barclays and Sean Tai – Ipreo

4. **Tackling delays to settlement – is delayed settlement comp the answer?** From left to right: Nigel Houghton – LMA, Doug Laurie – Barclays, Justin Conway – Jones Day, Ellen Hefferan – LSTA and Gemma Haley (chair) – LMA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News in Brief

Documents & Guidelines

27 January
10 February
17 February

Real Estate Finance
We published a new term sheet on 27 January for use with the German law real estate finance facility agreement for multiproperty investment transactions, which was launched last November. We also published an English law term sheet for real estate finance single property development transactions on 17 February. On 10 February we launched a form of Insurance Broker Letter with User Guide, intended for use in real estate finance multiproperty investment transactions.

18 February

Administrative Details Form
We launched a standard Administrative Details Form ('ADF') on 18 February as part of our ongoing commitment to support operational efficiency initiatives across the market. The ADF template is the result of considerable collaborative work by the LMA Loans Operations Committee and other operations practitioners and seeks to provide a standard format for communicating key administrative detail.

09 March

Publication of revised German law Investment Grade Facilities Agreement
On 9 March, we published revised versions of our German law LMA Investment Grade Facilities Agreement and respective Users Guide, containing certain statutory updates as well as amendments made for clarification and editorial purposes.

07 April

Publication of revised LMA Bail-in Clause Users Guide
On 7 April, the European Commission adopted a Commission Delegated Regulation with regard to certain regulatory technical standards ('RTS') under the Bank Recovery and Resolution Directive ('BRRD'), including the RTS relating to the contractual recognition of write-down and conversion powers. The Users Guide was updated to refer to the latest RTS.

01 June

EURIBOR Intraday Re-fixing Policy
On 1 June, we updated our note on 'ICE LIBOR Error Policy and LMA facility documentation' to reflect EMMI's EURIBOR Intraday Re-fixing Policy.

14 June

Incorporation of changes for IFRS 16 in LMA facility documentation
We incorporated drafting in respect of IFRS 16 into each of our template facility agreements. IFRS 16 is a new accounting standard relating to the accounting treatment of leases. It takes effect from 1 January 2019 and introduces a single lessee accounting model.

Updated Guide

Insolvency in the Loan Market
The June 2016 edition of this Guide (updated from the 2014 edition) is intended to provide a summary of where the law currently stands in the diverse legal systems that operate across Europe, summarising the output from recent initiatives which have sought to amend the underlying insolvency regimes across Western Europe.

LMA appoints new Board Directors

The following new Directors were elected at the LMA's AGM held on 29 June 2016:

Annie Barthélemy – Natixis
Peter Hanrott – BTMU
Thomas Kilpatrick – Babson Capital
Itziar Letamendi – Banco Santander

LMA Surveys

To date we have conducted the following surveys on particular sectors and geographies of the loan market with the assistance of our membership.

They have looked at trends, challenges and the outlook for the:

Developing Markets published April 2016
European Real Estate Finance Sector published May 2016
Nordic Loan Market published May 2016
German Loan Market published June 2016
German Real Estate Finance Sector published June 2016

All survey results can be found online on the LMA website.

Membership Update

633
Organisations are currently members of the LMA

49
New members have joined to date in 2016

55
Nationalities within the LMA's membership

Spotlights

Video interviews on topical issues impacting the loan market

As a new initiative for 2016, we have introduced a series of 'Spotlight' video interviews on topical issues impacting the loan market. The first of this series was a 'Spotlight on Article 55, BRRD – contractual recognition of bail-in' interviewing Mark Campbell, Partner at Clifford Chance LLP. The interview includes commentary on the LMA recommended form of bail-in clause and also considers the impact of the PRA announcement of its modification by consent of the contractual recognition of bail-in rules.

The second of this series is a 'Spotlight on European cov-lite loans: key structural issues' interviewing Christopher Kandel, Partner at Latham & Watkins LLP, which considers some of the key structural issues that can arise with European cov-lite loans.

Our third spotlight on 'IFRS 16: The impact of new lease accounting standards on loan agreements' interviewing Toby Mann, Senior PSL at Clifford Chance LLP, is due for release in early July 2016.

From left to right: Kam Mahil – LMA and Toby Mann – Clifford Chance LLP

Christopher Kandel – Latham & Watkins LLP

Webinar Programme

In 2015, we launched our highly successful webinar programme, which has given members around the world easy access to training by senior market practitioners on a range of LMA documents. We have created a dedicated webinar homepage on our website, where past webinars are available to watch on demand, and any upcoming new webinars are advertised. There is also an FAQs page to assist with any questions you might have.

Webinars available to watch on demand

Introduction to Syndicated Lending*
Toby Mann, Senior Professional Support Lawyer – Clifford Chance

Introduction to Secondary Trading*
Jacqueline Allen, Partner – Mandel, Katz & Brosnan

Introduction to Real Estate Finance
Simon Roberts, Partner – Allen & Overy

Overview of the LMA Leveraged Facilities Agreement
Edward Aldred, Partner – Linklaters

Introduction to the LMA Leveraged Intercreditor Agreement
Toby Mann, Senior Professional Support Lawyer – Clifford Chance

Introduction to Syndicated Lending (German)
Eva Reudelhuber, Partner – Gleiss Lutz

Introduction to the LMA Pre-Export Finance Facility Agreement
David Leggott and Andrew Taylor, Partners – Hogan Lovells

Types of Facilities in the Suite of LMA Primary Documentation*
Simon Roberts, Partner – Allen & Overy

The OHADA regime and its relevance to the loan market* (English and French)
Thomas Kendra, Counsel; Olivier Fille-Lambie, Partner; Louis-Jerome Laisney, Senior Associate; and Alex Bebe Epale, Associate – Hogan Lovells

Direct lending and non-performing loans: the Italian solution
Riccardo Sallustio and Michael Bray, Partners – Grimaldi

Introduction to Syndicated Lending (French)*
Benjamin de Blegiers, Partner, and Bénédicte Levier, PSL – Clifford Chance

*Please note that for African Single Jurisdiction Members, in line with availability of documentation and relevance to the market, a selection of the webinars will be made available. In particular, the starred webinars above are currently available to view on demand and more will follow.

Filming of Introduction to Secondary Trading Webinar

Filming of Overview of the LMA Leveraged Facilities Agreement Webinar

Frequently asked questions

I cannot view the webinar on the scheduled release date. Will the webinar be made available on demand?
Yes. Webinars will normally be made available on demand two weeks after the initial release date.

Are the slides available to print before the webinar?
Yes. A link to the slides is included in the reminder emails. The slides will also be made available on the viewing platform under the 'Resources' tab.

Are webinars free to access?
Yes, webinars are free for LMA members.

Webinar Contact

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Webinar Homepage

www.lma.eu.com/events_webinars.aspx

Events Programme H2 2016


Leveraged Documentation Training 2016


East African Syndicated Loans Conference 2015


Syndicated Loans Conference 2015

South African Syndicated Loans Conference 2015

KEY

- Conferences
- Courses
- Early Evening Seminars
- Seminars
- Training

July

1 July
REF Training Day,
London

11–15 July
Certificate Course, London
£1,850 + VAT

12 July
South African Syndicated Loans Conference,
Johannesburg

13 July
South African Syndicated Loans Training, Johannesburg

August

10 August
Early Evening Seminar,
Johannesburg

16 August
East African Syndicated Loans Conference, Nairobi

17 August
East African Syndicated Loans Training, Nairobi

September

7 September
LMA Syndicated Loans Conference, London

8 September
LMA/APL REF Evening Seminar, London

13 September
Dublin Seminar

13 September
Southern Africa Syndicated Loans Conference,
Zimbabwe

14 September
Southern Africa Syndicated Loans Training, Zimbabwe

21 September
Regional Training,
Edinburgh

22 September
Early Evening Seminar,
London

28 September
Early Evening Seminar,
Amsterdam

October

6 October
Warsaw Training (am) & Seminar (pm)

10–14 October
Certificate Course, London
£1,850 + VAT

18 October
Early Evening Seminar,
Munich

19 October
Early Evening Seminar,
London

19 October
Early Evening Seminar,
Brussels

26–27 October
Syndicated Loans Course for Lawyers, London
£950+ VAT

November

1–3 November
Loan Documentation Certificate Course, London
£995+ VAT

2 November
Early Evening Seminar,
Johannesburg

8 November
LMA/APL REF Breakfast Seminar, London

8 November
Paris Seminar

9 November
Paris Training

16 November
Early Evening Seminar,
London

November TBC
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Regulatory challenges to the US loan market

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Ever since the financial crisis, the U.S. loan market has found itself under intense regulatory pressure on many fronts. The Dodd-Frank Act, passed in 2010, gave us the Volcker Rule, which prohibited banks from holding CLO debt securities unless the only assets the CLO held were loans and cash equivalents. (It almost prohibited banks from engaging in proprietary trading of loans, but the LSTA was able to persuade the agencies to exclude loans from that prohibition). The 'Hire Act' produced FATCA, a complex regime that requires CLO managers to report to the IRS information about their noteholders (and, until the LSTA was able to persuade the IRS to carve them out, was meant to apply to legacy CLOs that had no way to do such reporting). In 2013, the federal banking agencies revised the Leveraged Lending Guidance and imposed intrusive reporting requirements on banks with respect to their leveraged loan portfolios but, far more importantly, imposed strict limitations on the kinds of loans banks could underwrite and originate. These guidelines are having a profound impact on the market, resulting in reduced leverage levels and disintermediating banks from participating in loans that exceed the limits imposed by the guidelines (to the benefit of non-bank brokers and direct lenders).

This article, however, will focus on two other important regulatory efforts, one old and one new. The risk retention rules, another offshoot of Dodd-Frank, don't even become effective until December 24, 2016, but are already having a significant impact on the loan market. Rules recently proposed by the Securities and Exchange Commission for open-end loan mutual fund liquidity have the potential of turning that market on its head.

Open-End Loan Mutual Fund Liquidity

In September 2015, the SEC proposed new liquidity rules that – however reasonable in principle– could challenge the operations of the US$15 trn open-end mutual fund industry if they were put into practice in their current form. Closer to home, the challenges could be particularly profound for the US$100 bn of open-end loan mutual funds.

In January 2016, the LSTA responded to the SEC's proposal. Perhaps to the surprise of some, the LSTA agrees with many tenets of the SEC's proposal. However, in a number of places, the proposal veered toward prescriptive requirements that many funds – including loan mutual funds – would be hard-pressed to meet. In this article, we discuss the SEC's proposal, what we agree with – and what we respectfully disagree with. In addition, we briefly recap our research in two areas: tracking mutual fund redemption performance in three volatile periods and stress testing loan mutual fund flows. (Detailed analysis is in Section I (E) and I (F) of the comment letter.)

What is the SEC's Open-End Mutual Fund Liquidity Proposal?

In September 2015, the SEC released a proposal to strengthen open-end mutual fund liquidity risk management programs. As the SEC correctly noted, meeting shareholder redemptions – and managing liquidity risk to ensure that redemptions are met – is critical to open-end fund management. To ensure that liquidity risk management gets proper attention, the SEC made three major proposals. First, it would require each fund to prepare a liquidity risk management program that would i) assess and manage the fund's liquidity risk; ii) classify and monitor each portfolio asset's level of liquidity, based on the days it would take to convert the asset to cash; and iii) designate a minimum amount of portfolio liquidity. Second, the proposal would require each fund to make public the liquidity classification of each individual asset, information about redemptions and swing pricing if applicable. Third, it would permit mutual funds to use swing pricing in their shares. In addition, the Proposal would codify the long-used definition of 'illiquid asset' as an asset that could not be sold within seven calendar days at approximately the value ascribed to it by the fund.

How does the proposal affect loan mutual funds…and what is the LSTA's response?

Open-end loan mutual funds would be required to meet the liquidity, disclosure and reporting requirements of the SEC proposal. It is important to note that, as proposed, syndicated loans would not be included in the 15% illiquid asset bucket.

The LSTA believes it is entirely appropriate that open-end funds have adequate policies and

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procedures to address meeting investor redemption requests. In turn, we strongly support the SEC's requirement that open-end funds and Exchange Traded Funds (ETF) have formal liquidity risk management programs designed to address and manage liquidity risk, classify and monitor liquidity of investment portfolios, and maintain a minimum level of liquidity. We also support reporting to the SEC and other regulators regarding portfolio liquidity. We support the 15% illiquid asset test, as proposed. (Caveat: we oppose any change that might alter the definition of 15% illiquid assets to a 'convert to cash' concept. To that end, we discuss how loan funds' liquidity facilities bridge any gap between when a liquid loan is sold and when the cash is available from settlement.)

Despite our general support, some of the rule's components have the potential to significantly (and negatively) affect all US$15 trn of open-end mutual funds, including the US$100 bn of open-end daily liquidity loan mutual funds. Areas of concern include the proposed liquidity classifications, the three-day liquid asset minimum, and public disclosure of liquidity determinations. The following is just one example of how the principle of the rule clashes with market realities. Under the rule, the manager must determine if it could convert an asset to cash – without materially affecting the asset's price – within i) 1 business day; ii) 2-3 business days; iii) 4-7 calendar days; iv) 8-15 calendar days; v) 16-30 calendar days; or vi) in more than 30 calendar days. In reality, it can be difficult to determine whether an asset sale by an investor has been responsible for any price movement, even after the sale. It would be even more difficult to make that prediction prior to the sale and put the asset in exactly the right day count basket based on that prediction. This process presumes a divination ability that simply does not exist.

How have open-end loan mutual funds performed in periods of stress?

Loan mutual fund managers proactively and effectively manage liquidity; this is why funds have weathered significant periods of stress and have always met investor redemptions. In just the past 10 years, there have been three significant periods of stress. Between July 2007 and December 2008, loan mutual funds experienced more than US$15 bn of outflows – a very substantial proportion of their assets. In August 2011 alone, thanks to global turmoil and the Fed promising to keep interest rates low for two years, open-end loan mutual funds experienced US$7 bn of outflows – or 13% of their assets. In 2013, expecting interest rates to rise, investors put significant money back into loan mutual funds. Once it became clear in early 2014, however, that interest rates still were not going to rise in the near term, open-end loan mutual funds saw more than US$38 bn – or 20% of their assets – redeemed between April 2014 and January 2015. In all of these cases, open-end mutual funds met redemptions.

How do open-end loan mutual funds meet three-day redemptions in stress periods if loan settlement is 12 days?

So loan mutual fund managers successfully met redemptions in stressed periods – but how is that possible? After all, commentators have observed a gap between the time that loan sales settle – a median 12 days – and mutual fund investor redemptions that must be met in three days. There are two key facts here. First, the industry is working to reduce settlement times – and in fact they have fallen two days since 2014. Second, managers have developed techniques to manage their portfolios in light of extended loan settlement periods. In particular, loan mutual fund managers i) hold cash, ii) invest in securities that settle in three days (T+3 securities), and iii) secure a line of credit from banks to ensure access to liquidity. In an August 2015 survey, the LSTA collected information from open-end funds and ETFs with a total of US$72 bn in assets; this is over half the open-end loan fund and ETF universe. The median fund had 3.5% of assets in cash, plus another 6.1% in T+3 securities – and a material line of credit with a bank. Thus, managers have considerable access to liquidity to bridge any gap between when loan sales settle and when investor redemptions must be met.

How can open-end loan mutual funds ensure that they will perform in future periods of stress?

History indicates that loan mutual funds have met redemptions in periods of stress in the past. However, that doesn't necessarily guarantee that funds will meet redemptions in the future. And that is why loan fund managers typically stress test their portfolios to ensure that they can meet redemptions in volatile markets. The LSTA comment letter included stress tests of two types

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of managers: i) one with large cash and T+3 securities holdings, but a smaller line of credit and ii) one with small cash and T+3 securities holdings, but a larger line of credit. The stress tests included two scenarios; i) a short fast shock of a one-day 10% redemption, and ii) two consecutive months of record 13% outflows. In both cases, both funds were able to show the ability to meet investor redemptions. Through stress tests like these, as well as active management, open-end loan fund managers demonstrate the ability to meet redemptions in foreseeably stressed scenarios.

What has the LSTA done since the submission of its comment letter?

The LSTA, joined by loan mutual fund managers, has met with the staff of the Investment Management Division of the SEC as well as the chief of staff for the Chair of the SEC, one of the SEC Commissioners and a senior staffer of the other SEC Commissioner (there are currently only two sitting Commissioners and two vacancies at the SEC). We discussed the loan market in great detail and explained how managers have historically managed liquidity and redemptions both in normal times and in times of great stress.

It is not clear when the SEC will publish final rules, but the LSTA will continue to engage on this important issue.

CLOs: Risk Retention

The LSTA continues to work on getting a reasonable solution for CLO risk retention both on the legislative front and in court.

The legislative front

On March 2, the House Financial Services Committee passed H.R. 4166 (the "QCLO" bill) 42-15. Importantly, the support was bipartisan, with 10 Democrats backing the measure. While the passage of this bill through the House Financial Services Committee is good news, it is important to note that, to become law, the bill would still have to pass the full House, the Senate and be signed by the President. Long story short, this remains a steep uphill climb.

As a reminder, a Qualified CLO (or QCLO) incorporates six categories of restrictions: i) Asset Quality, ii) Portfolio Diversification, iii) Capital Structure (at least 8% equity), iv) Alignment of Interest of Manager and Investor, v) Manager Regulation and vi) Transparency and Disclosure. If a CLO meets these six criteria, then the manager could purchase and retain liabilities equivalent to 5% of the equity.

In late February, LSTA EVP Meredith Coffey testified on the QCLO bill before the House Financial Services Subcommittee on Capital Markets and in the first week of March, the full Committee marked up and voted on the bill. In the mark up, both sides can propose amendments and Representative Foster (D-IL) submitted an amendment that made three changes to the bill. First, in the Asset Quality Protection, the minimum cash and loan amount was increased from 90% to 100%. (This is because lawmakers wanted to ensure that all assets were, in effect, senior secured loans and not high yield bonds.) Second, the amendment required each borrower to submit unaudited financial statements within 45 days of quarter-end and within 90 days of year-end. Third, and most substantively, the amendment tweaked the retention formula for a QCLO manager. The original QCLO bill required the manager to purchase and retain 5% of the equity. Representative Foster was concerned that this aligned the manager too much with the equity and not enough with the debt tranches. So, instead of having the full amount of the retention in the equity, the amendment intends to require retention equivalent to 5% of the equity, with 3.5% in equity and the remainder distributed ratably in the higher rated debt tranches. Thus the QCLO retention would be in an L-shaped structure to align the manager with all the investors.

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The next step is that the full House will vote on the bill, though the timing of that vote is not clear. Assuming it passes the House, it would next go to the Senate and be taken up by the Senate Banking Committee. If passed by the Senate – and that already is a steep climb – the bill would

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have to be signed by the President in order to become law. While all of this is a tough climb, the current rule requires far more than the 5% of the credit risk required by Dodd-Frank and is very harmful to smaller managers. Thus, the LSTA and SFIG (who is also involved in this process) believe that, long odds notwithstanding, it is an important effort.

The litigation front

In November 2014, the LSTA filed a lawsuit against the SEC and the Federal Reserve Board in connection with their final rules on risk retention for CLOs. The LSTA alleged that the Agencies exceeded their rulemaking authority in three ways. First, they misconstrued the plain language of Section 941 of Dodd-Frank by concluding that CLO managers were ‘securitizers’ under the statute. The statute defines a securitizer as the party that initiates a securitization by selling or transferring assets to the securitization vehicle, but CLO managers purchase assets on behalf of a securitization. Second, the Agencies misconstrued ‘credit risk’ by requiring equity retention to be 5% of the fair value of the securitization, which far exceeds the 5% of the credit risk required by the statute. Finally, the Agencies did not consider alternatives proposed by commenters that would have met the statutory requirements and policy goals of the statute in a less burdensome manner, such as the QCLO proposal or SFIG’s proposal to require horizontal risk retention in an amount equal to 1% of the fair value of a CLO.

In early March, the U.S. Court of Appeals for the D.C. Circuit held oral arguments. The judges focused on three issues in the oral argument: i) whether the higher court had original jurisdiction to hear this case or whether the District Court (the lower federal court in DC) must first consider it; ii) whether managers transfer assets to CLOs; and iii) whether the Agencies exceeded their authority by imposing equity risk retention of 5% of the fair value of the CLO, which is much greater than the statutory requirement of 5% of the credit risk. Unfortunately, because the issue of jurisdiction was so complex, it dominated the proceeding. While Section 941 of Dodd-Frank (which authorizes risk retention) requires cases to go the lower court first, the SEC and Fed also relied on other statutes, which say that appeals should go to the Circuit Court. While both the LSTA and the Agencies agreed that the higher court was the proper venue, the judges were not convinced that they had original jurisdiction and expressed the view that the case belonged in the lower court. And, not surprisingly, Circuit Court indeed ruled that it lacked original jurisdiction to directly hear the LSTA’s challenge and transferred the case to the District Court. While the transfer is unlikely to affect the ultimate outcome of the case, the final resolution is likely to be delayed by at least a year. The LSTA immediately initiated steps to expedite the case to the extent possible. First, the LSTA filed a motion requesting that the Court transfer the lawsuit to the District Court immediately rather than waiting the 45 days that would otherwise have been required. The Court granted that motion on the next day. Then, the LSTA moved to have the District Court accept the briefs that had been filed with the Court of Appeals rather than require new briefs. The District Court quickly granted that motion and final briefs were submitted to the court on April 29.

So what happens now?

The District Court judge will read the briefs and review the record and render a decision. (He could ask for oral argument prior to rendering a decision). There is a good chance the District Court will decide the case during the summer of 2016. If the court decides in our favor, the judge will likely vacate the rule as it applies to managers. If the court rules against us, the rule will go into effect as scheduled absent intervention by the Court of Appeals (as described below).

No matter who wins the case, the other side is likely to appeal to the Court of Appeals. Unfortunately, the process would then start anew. Briefs would be submitted and a new three-judge panel would be assigned to the case. Oral arguments on the merits would be scheduled and the court would ultimately render a final decision. The process after the District Court decision could take a year to eighteen months (although we would request expedited treatment in light of the quickly approaching effective date of the rule). Were we to get a favorable District Court decision, the risk retention rules will likely not go into effect unless and until the Court of Appeals reverses the ruling. If the District Court rules against us, we would likely ask the Court of Appeals to stay the effective date of the rule pending their resolution of the case. If they deny that request, the rule would go into effect as scheduled. Finally, the case will ultimately be resolved by the decision of the Court of Appeals (and is very unlikely to be appealed to the Supreme Court).

In conclusion, it is safe to say that the loan market is likely to see continuing regulatory challenges both known and unknown. The LSTA will continue to focus its efforts on addressing these challenges as they arise. ■

LMA Syndicated Loans Conference London, 7 September 2016

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