

LMA voices its concerns on the impact of CRD IV on the syndicated loan market

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The LMA is concerned that CRD IV is likely to have a negative impact on the syndicated loan market, and may depress a vital source of liquidity for borrowers.

Need for overarching impact assessment

The LMA has significant concerns relating to the absence of an integrated approach to regulation of the financial services sector. The LMA questions whether the interaction of CRD IV with other regulatory measures has been sufficiently considered, even on an intra-European level. The impact of all of these proposals on the industry is cumulative, and there is a real risk of significant unintended consequences – including the creation of perverse incentives within the regulatory system as a whole. This risk is magnified given that the composite effect of EU regulation must in turn be assessed in the context of global legislation, including both significant national legislation of non-EU countries (Dodd-Frank and FATCA) and supranational initiatives (such as the G20 and the FSB). The LMA believes that it is essential that this assessment is done effectively at a policy-making level within Europe and questions whether, even within the CRD IV proposal, the interconnections between capital requirements, liquidity requirements and the leverage ratio have been fully identified. The LMA strongly urges the European Commission to redirect efforts away from individual policy silos and towards the construction of a comprehensive assessment of the totality of these proposals on the EU economy and its financial services industry.

Impact of CRD IV on the syndicated loan market

The LMA has identified three key areas of specific concern which it has brought to the attention of the Commission that relate to the drafting/interpretation of CRD IV. These are as follows:

1. Risk weighting of exposures to "financial" counterparties

The Capital Requirements Regulation provides that exposures to "large regulated financial entities and to unregulated financial entities" will carry a higher regulatory capital charge than exposures to other entities. This raises difficulties when having to analyse which entities actually fall within these definitions. Specific concerns have been raised that the definition of an "unregulated financial entity" could capture non financial corporate groups with finance/treasury functions as well as lending to SPV structures expressly set up to on-lend monies to a non-financial corporate client.

2. Liquidity coverage ratio (LCR) and loan classification

The language used does not provide the guidance needed to classify whether a particular loan facility is a liquidity or credit facility. Wording should be added to make it clear that the term "liquidity facility" relates to facilities provided to borrowers to replace funds, where access is no longer available in the commercial paper ("CP") or short-term paper market. This would be in keeping with the spirit of the wording used in Basel III, which specifically refers to CP markets as being an example of a "financial market" and also with Basel III's focus on the 30 day maturity range in the context of liquidity backstop facilities.

Further, the liquidity requirements for backstop facilities for CP programs may ruin the economics of the CP market. That, in turn, may push borrowers in that market to other funding methods, possibly back to the loan market. However, the combined effect of new regulations (the new regulatory capital requirements in particular) is that the loan markets are likely to shrink.

In addition, the LCR provisions of CRD IV require that any facility granted to a "financial customer" is deemed to be 100% drawn – i.e. it receives the same treatment as a "liquidity facility". The definition of "financial customer" potentially captures unregulated treasury companies, since lending is a listed activity and the purpose of a treasury company is usually to provide financing to the remainder of its corporate group. Consequently, the LMA sees the same definitional issues here as mentioned earlier when discussing risk weighting and unregulated financial entities.

3. Leverage ratio and netting

The drafting of the Capital Requirements Directive imposes an absolute prohibition on the ability of lenders to set off a loan against any other item whatsoever, including deposits made for the purpose of discharging that loan. Amongst other things, this could stifle the use of cash collateralised fronting mechanics for letters of credit. This will have a detrimental impact on international trade.

In addition, rules regarding leverage could threaten the pricing benefits some borrowers obtain when lenders combine borrowers' debit and credit accounts. This is a long-established, legally accepted method which results in a service enabling borrower groups to manage their financings more efficiently. The removal of this right would ultimately have a detrimental impact for borrowers, who rely on the combining of accounts under overdraft facilities to obtain flexible borrowing across the group against lower costs.

Additional general observations:

The LMA has also raised various general observations about the impact of the requirements of the LCR on the syndicated loan market, which illustrates the need to carry out a more realistic and valid assessment of the risk associated with different credit lines.

The LMA has offered to assist the Commission with relevant drafting for its consideration and will make itself available for a technical meeting to discuss further.

Clare Dawson, Managing Director LMA, commented:

"The LMA firmly believes that the Commission should revisit the detail of the legislation and carry out an impact assessment of the net effect of CRD IV for lenders operating within the syndicated loan market, to avoid introducing a dangerous level of uncertainty to the loan market, and risking a marked decrease in the capacity of the market to provide this essential form of finance."

"Syndicated loans are a fundamental source of funding for corporates, and any diminution in the amount of liquidity available is likely to reduce the sources of credit that businesses rely on to function, which in turn will prevent or limit growth in the global economy."

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For further information, please contact:

Loan Market Association:

Clare Dawson, Managing Director 020 7006 6007
clare.dawson@lma.eu.com

Nicholas Voisey, Director 020 7006 5364
nicholas.voisey@lma.eu.com

MHP Communications

Andrew Nicolls/John Sarsfield 020 3128 8581/ 8530
andrew.nicolls/john.sarsfield@mhp.com

Loan Market Association

The Loan Market Association was founded in December 1996 by seven leading international banks in London. Its aim was to encourage liquidity and efficiency in both the primary and secondary loan markets by promoting market depth and transparency, as well as by developing standard forms of documentation and codes of market practice. Banks, law firms and other market practitioners/participants are welcome to apply to join the LMA.

The Association was established in anticipation of changing market conditions and of a perceived willingness on the part of the banking community to bring greater clarity, efficiency and liquidity to the relatively under-developed secondary market.

The LMA has gained recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the syndicated loan market in Europe vis à vis banks, borrowers, regulators and other affected parties.

For more information, please visit www.lma.eu.com.