

26 January 2017

European Central Bank
Secretariat to the Supervisory Board
"Public consultation on the draft ECB guidance on leveraged transactions"
60640 Frankfurt am Main
Germany

Sent by email: SSMPublicConsultation@ecb.europa.eu

Dear Sirs,

Consultation on Draft Guidance on Leveraged Transactions (the "Guidelines")

We are pleased to respond to the above consultation paper.

The Loan Market Association ("LMA") is the trade body for the syndicated loan markets in Europe, the Middle East and Africa ("EMEA") and was founded in December 1996 by banks operating in these markets. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 600 organisations across EMEA and consists of commercial and investment banks, institutional and other non-bank investors, law firms, rating agencies and service providers. Many of our members operate in the leveraged loan market, on both the buy and sell side. We have consulted with many of them to inform this response.

The LMA welcomes global regulatory consistency and the ECB's efforts to strengthen the level playing field for financial institutions by aligning supervisory expectations and practices. We also support the ECB's aim to ensure that banks conduct leveraged activities in a safe and sound manner with an emphasis on the regular monitoring of risk and credit quality of leveraged exposures. We appreciated your willingness to discuss the Guidelines with us at our meeting on 11 January 2017 and also at the public hearing on 20 January 2017. As mentioned at our meeting, we remain concerned about the scope of these Guidelines and have identified some areas of the Guidelines on which we would welcome amendment and/or clarification. In particular, there are a number of areas where we think that the Guidelines could benefit from further alignment with the scope and methodology of the US Guidance on

Leveraged Lending in order to maintain regulatory consistency and facilitate reporting and monitoring.

Scope

We note that page 3 of the Guidelines states that they apply to "*all significant credit institutions supervised by the ECB under Article 6(4) of the SSM Regulation*". This means that the Guidelines do not apply to banks based in EU member states which do not participate in the SSM and also do not apply to other banks outside the supervisory scope of the ECB. We are concerned that this would lead to an unlevel playing field as it would mean that a large part of leveraged loan market activity is not subject to the Guidelines. As a consequence, the Guidelines would impose a disproportionate burden on those it does apply to in comparison to the impact that they would have on the part of the leveraged loan market that they are applicable to. They could also result in the unintended consequence of the conduct of higher leveraged transactions being undertaken by institutions not regulated by the Guidelines.

In addition, we note that there is a reference on page 5 of the Guidelines to "non-investment corporate grade bonds" in the context of monitoring of transactions which generate a settlement risk. This reference has been inferred by some market participants to mean that the Guidelines also apply to bonds. We understand from our meeting and the public hearing that this is not the intention of the ECB and that bonds are not included in the definition of leveraged transactions. However, given the concerns raised with us by market participants we think it would be helpful to clarify in the Guidelines that they are not intended to apply to bonds and other forms of credit exposure, such as derivatives. This would align the Guidelines with the US Guidance which specifically excludes bonds and covers only leveraged loan origination.

Definition of leveraged transactions

Calculation of the debt-to-EBITDA ratio

We would recommend that the concepts of "Total Debt" and "EBITDA" used to calculate leveraged levels in the Guidelines are clarified in certain respects, in particular to align with the US Guidance.

One area on which we would welcome clarification is that the Guidelines do not specify whether Total Debt is to be calculated on a gross or net basis for the purpose of leverage calculations. In the interests of consistency, we would suggest that a similar approach to the US Guidance is adopted which requires that calculations for leverage levels be on a gross debt basis, and that cash should not be netted against debt for the purpose of calculating total debt.

It would also be helpful to clarify that leveraged calculations under the Guidelines include all committed debt at origination, including additional debt permitted under the loan agreement; this is the position under the US Guidance. Another helpful area of alignment with the US Guidance would be in relation to the impact of the Guidelines on deals with a leverage level in excess of 6x. The Guidelines currently provide that this would "*trigger a referral to the highest level of credit committee or similar decision-making level*". Whilst the 6x leverage test is consistent with the US Guidance, under the US Guidance this does not of itself trigger referral to the highest level of credit committee; the US Guidance does however state that such loans may receive additional scrutiny. A similar concept would be helpful to adopt in the Guidelines.

We also note that, unlike the US Guidance, the Guidelines define leveraged transactions on a Total Debt basis. This is in contrast to the US Guidance which also looks at the senior debt position and states that transactions where senior debt does not exceed 3x EBITDA would not be thought to be leveraged. It would be useful to have alignment between the Guidelines and US Guidance in this respect.

In terms of EBITDA, the use of unadjusted EBITDA in the Guidelines is a significant difference from the US Guidance, as the US Guidance acknowledges adjustments to EBITDA (although noting that enhancements should have reasonable support). We understand that there are differences in terms of access to information between the US and Europe (as noted at the public hearing) however we would recommend that reasonable non-recurring, exceptional and other one-off EBITDA add-backs should be allowed provided that they are consistent, properly justified, have credit committee approval, are supported by due diligence and documented.

Financial sponsors

The definition of leveraged transactions under the Guidelines includes loans made to borrowers which are owned by one or more financial sponsors. We do not think that ownership by a financial sponsor of itself should automatically result in a loan being categorised as leveraged. This does not take into account any quantitative leverage criteria being met or not met. This aspect of the Guidelines is also significantly different to the US Guidance which does not include control of the borrower by a financial sponsor as a factor defining leveraged loans. Instead, the US Guidance provides that banks relying on sponsor support for repayment of a leveraged loan are expected to establish guidelines for evaluating and monitoring the financial condition of sponsors. We would strongly suggest reconsideration of this criterion of the definition of leveraged transactions by the ECB and would encourage flexibility on this point.

Exclusions

Page 4 of the Guidelines lists a number of exclusions to the definition of leveraged transactions. We would suggest that these exclusions are made as consistent as possible with

the US Guidance and also with the statement made at the public hearing that the Guidelines are not intended to prevent access to funding by corporates.

In particular, we would propose that the exclusion for loan exposures below €5 million should be increased to €10 million in line with the US Guidance. We would further recommend that the ECB consider including a specific exclusion in the Guidelines for lending to SMEs. Whilst an increase in the level of excluded loan exposures to €10 million would assist with taking more SMEs out of the scope of the Guidelines, the Guidelines as currently drafted would capture a large proportion of loans to SMEs and therefore have the potential to discourage lending to SMEs. This would not seem to be in line with European legislative initiatives to promote access to finance for SMEs and the statements made at the public hearing that this was not the intention of the Guidelines.

In line with the US Guidance, we would also recommend that it be clarified that the Guidelines are not intended to restrict the provision of financing to borrowers engaged in restructuring (or "workout") negotiations. The US Guidance contains a specific recognition of this with the proviso that lenders document their efforts to strengthen the credits as part of a loss-mitigation strategy.

We would also recommend that the exclusions for particular industries and borrowers should encompass entities which do not have a conventional EBITDA and have different purposes to normal commercial entities. For example, we would recommend that loans to governments, government like entities, export credit agencies, multilateral agencies and other bilateral agencies, as well as loans guaranteed by any such entities are excluded. We would also suggest that loans to entities such as personal trusts, not-for-profit organisations and mutual funds are excluded.

The Guidelines contain an explanation of exposures that come within the Guidelines, which includes "...*gross direct commitments to a leveraged borrower, including ... committed exposures not yet syndicated or distributed*". It would be helpful to clarify that uncommitted and guidance lines are exempted from the Guidelines given that the nature of the exposure in such situations is non-committed.

Risk appetite standards

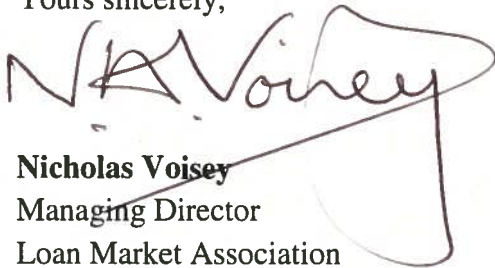
We note that the Guidelines indicate an expectation on credit institutions to "*define acceptable leverage levels as part of their risk appetite statement, including at industry sector level when relevant*" (emphasis added). We understand that the intention of this is to permit credit institutions to use their own justified framework of rules for certain industries (such as infrastructure, regulated utilities, insurance companies, etc) in order to determine whether such loans fall within the Guidelines. This would be similar to the approach taken in the US Guidance. However, we would appreciate confirmation that our understanding is correct and, if so, clarification in the Guidelines in this respect.

Status of the Guidelines

The questions and answers document published alongside the Guidelines state that the Guidelines are non-binding (although notes that significant credit institutions are expected to translate the Guidelines into their internal policies). It was also clarified in our meeting and at the public hearing that the Guidelines do not comprise a pass or fail test such that transactions are prohibited to the extent that they do not meet the Guidelines; rather the Guidelines are aimed at ensuring more stringent risk management is applied to leveraged transactions. It would be helpful if the non-binding nature of the Guidelines is made clear within the Guidelines themselves and it also emphasised that non-compliance with the Guidelines is not a barrier to transactions but that any departure requires justification. In particular, it would be helpful to clarify that transactions in excess of 6x are not by definition prohibited (as confirmed at our meeting and the public hearing), but rather require additional evidence of credit and management control.

We trust the above comments are helpful. If we can be of further assistance, please do not hesitate to contact me by email at Nicholas.Voisey@lma.eu.com or on 020 7006 5364. I would also be pleased to meet again to discuss the above at your convenience.

Yours sincerely,



Nicholas Voisey
Managing Director
Loan Market Association