Introduction

On 4 June 2018, the Loan Market Association (**LMA**) held its flagship European Loan Operations Conference at One Bishops Square, London. As always this event was highly popular and the LMA was delighted to see over 200 market participants in attendance. The programme comprised an impressive line-up of speakers who shared their views on the key issues and challenges currently facing operations teams in the loans market.

Loan Operations Committee Introduction

The Loan Servicing sub-committee has focused primarily on producing educational pieces for the market. In February the sub-committee, in collaboration with the Agency sub-committee, published *An Agent's Guide to Handling Ancillary Facilities,* which seeks to provide an introduction to ancillary facilities and their treatment under LMA template documentation. Most recently, the sub-committee published the first of its desktop series, which aim to act as operational guides for teams to refer to when carrying out their day-to-day activities. The first four in the series looked at (1) types of facility in the syndicated loan market; (2) agent freezes; (3) re-denominations; and (4) letter of credit issuance. Polling the audience on which topics the sub-committee should focus on next, the results showed strong support for prepayments, fees, trades and breaks. The sub-committee hope that the take-up of the desktop series will lead to less delays and greater daily efficiencies. In addition, the sub-committee aided the drafting of a standard global administrative details form ("ADF"), which can be accessed via the LMA and LSTA websites. The sub-committee hopes that with time the Global ADF will serve as a building block towards the globalisation of documentation.

The Agency sub-committee, seek to provide a forum to facilitate discussion on a large remit of issues and affairs impacting agency teams across EMEA. Topics range from delays attributable to 'Know Your Customer' (**KYC**) practices, regulatory changes and common operational inefficiencies. Members of the sub-committee contributed feedback to the 2018 LMA re-write of Chapter 17 of the JMLSG's guidance, making sure the agency position was firmly represented. The sub-committee is now looking to standardise notifications, an interim solution until the FPML project takes grip of the market.

The Market Initiatives sub-committee has changed in format from last year. In 2017 the sub-committee focused on the production of educational pieces, focusing on the market's use of FPML, position reconciliation and identifies. Maintaining a focus on education, the sub-committee this year has elected to invite different vendors to meet the group once a quarter, to discuss their recently technological initiatives and answer any questions the sub-committee puts forward. These meets are not exclusive and anyone interested should reach out to the LMA to become involved going forward.

The Secondary sub-committee has been focusing on identifying impediments to settlement, both in the primary and secondary markets. Working collaboratively on a quarterly basis with the Buyside sub-committee, the Secondary sub-committee is looking to set in motion initiatives to tackle those impediments identified. By analysing settlement data, the sub-committees have already identified bottlenecks at trade allocation, KYC and the handling of trade terms and trade recaps. The sub-committee has also been looking into delays in primary settlement/allocation, which have had a knock on effect on secondary settlement times. The sub-committee has created a working group to focus exclusively on this problem, which is open to all members. This working group is having a kick-off meeting in July and will be looking at how behavioural changes could minimise knock-on delays.

Trends in the European market

This year's session on European market trends considered the current state of the EMEA syndicated loan market, as well as covering some of the issues and topics which market participants should keep a cautious eye on during the latter half of 2018. The panel discussion looked comparatively at the US and UK loan markets, before going on to provide a broader analysis of European market of trends.

It would be hard to argue that 2017 was anything but a great year in terms of EMEA loan volumes, with an c.$20bn jump on 2016. Throughout the second half of 2016 it would be fair to say that investor certainty fell considerably, and so too did deal volumes. This was a result of the shock results of the Brexit vote, exacerbated by the US election, which caused both primary and secondary market liquidity to become subdued. Market participants remained cautious throughout the second half of 2016, waiting to see whether the markets could ride out the economic and geopolitical turbulence.

As we moved into 2017, the overall resilience demonstrated by the debt markets brought about a spike in investor confidence. A backlog of latent investor demand, coupled with a high-liquidity environment, caused volumes in Europe to soar to the highest seen since 2015. Our panel expected this positive trend to continue throughout 2018 and into 2019; with Q1 2018 volumes having already reached over $10bn, our panel anticipated that the market is on track for another record-breaking year in the syndicated loan market. The tide of sponsor-led deals has brought about several changes to the shape and scope of the European syndicated lending market, as is evidenced by the increasingly 'covenant-lite' lending environment. This typifies the ongoing convergence between documentation for European-style leveraged instruments and that used for US-style 'Term Loan B' instruments.

Another key trend is the rise in more stringent borrower protections in the portability of their facility to 'loan-to-own' investors, as well as other provisions which makes it difficult for lenders to exit a transaction, except on a payment default. Lenders have, however, been pushing back against these trends – discussions between sponsors and lenders on the application of covenants within documentation has fast become a key issue in the negotiation process. These types of discussions are prevalent across the market regardless of the borrower's credit history, the sponsor involved or even the size of the deal. A prime concern for lenders is protecting the secondary market liquidity of their investment; depending on the size as well as the allocation prospects of a deal, lenders will push to ensure they maintain as much control as possible.

Looking to the future, it is anticipated that these trends will continue – the US and European markets, whilst still largely divergent in a number of areas, are converging with respect to their attitudes towards allowing a vast degree of flexibility in facility documentation. A great deal of the rigidity which characterised the syndicated lending market a decade ago has been forgone as a result of the sponsor-led, high-liquidity lending environment that continues to persist across the European and US markets.

Solving for KYC

More than 12 months on from the publication of a consultation by JMLSG in 2017 on proposed revisions to Parts II and III of its guidance on the prevention of money laundering and the financing of terrorism in the UK financial services industry (the "Guidance"), Chapter 17, which relates specifically to syndicated lending and which has been re-written by the LMA, has now been approved and published by the JMLSG board.

The production of the revised Guidance is the result of extensive consultation with numerous LMA members, including representatives of the LMA's Loan Operations Committee. It is reflective not only of the provisions of the latest Money Laundering Regulations published by HM Treasury on 15 March 2017 ("MLR"), but also includes specific amendments to ensure that market participants entering into a syndicated loan transaction, whether in the capacity of arranger, agent, lender (in the primary market) or seller, buyer, grantor or participant (in the secondary market) consider the risks that could arise from a money laundering ("ML") or terrorist financing ("TL") perspective.

The Guidance is intended to provide a clear description of the primary and secondary syndicated loan markets, an assessment of where the risks are most likely to arise when considering ML and TL, and to explain the different types of relationships that exist between the parties to a syndicated loan transaction and the instances where this will translate into a direct customer relationship between those parties. It also emphasises the generally low risk nature of the market from a ML and TL perspective, and sets out the reasons to explain why this is the case.

In addition, the revised Guidance now states that, although a syndicated loan is a tri-partite arrangement from a structural perspective and each finance party should, as part of an overarching financial crime risk assessment, take account of the risk profile of the transaction and of each party involved, none of the MLA, the agent or the security trustee should be viewed as having a direct "customer" relationship with each individual lender in the syndicate. Similarly, none of the agent, security trustee or MLA is a customer of that lender. Finally, in a secondary context, although the agent has a role to play with regard to effecting the transfer of loan commitments from a seller to a buyer, it will not have a customer relationship with that buyer.

The practical implications of this are that full "know your customer" checks need not be carried out in respect of those parties with whom no customer relationship exists, unless the facts and circumstances suggest otherwise. It is hoped that this will allow resources to be redirected to where the risk of ML and TL are most likely to arise and allow the market to operate more efficiently.

LIBOR – Operations challenges to transition

During this session, the panel took some time to consider the specific risks and issues that the transition away from LIBOR towards risk-free rates (RFRs) presents for loan operations. Some of these issues are already causing problems for market participants, whilst others are expected to remain latent until later down the line.

The panel provided a practical discussion as to how the transition can be effectively managed, looked at the views of borrowers at different levels of sophistication and the work being undertaken by national working groups. It goes without saying that LIBOR transition is a complicated undertaking, not least because the rate is produced for five currencies, seven tenors and is actively used in 114 jurisdictions. The key issues for the loan market, however, are the lack of certainty that the use of backward looking rates would cause for syndicated lending. Much of the structuring and flexibility of the loan product is tied directly to LIBOR. Various private and public sector bodies are looking into the potential creation of forward-looking benchmark rates (derived from RFR data) for the cash markets, but this work is still in its early stages.

LIBOR, compared to RFRs, measures an entirely different set of economic metrics; LIBOR includes term and bank credit risk and, as a result, varies according to confidence in the financial institutions system, whereas RFRs, by their very nature, cannot account for this same risk. To mitigate these differences, an adjustment spread will need to be added to RFRs to make them economically equivalent to LIBOR; how this adjustment spread will be determined will be a key issue for the loan market. On this point, the panel highlighted an upcoming ISDA consultation on the approaches to be taken towards the creation of a credit adjustment spread, and encouraged interested parties to submit a response.

A key operational challenge arises out of the increased complexity involved in calculating the interest payable under a given facility. This is not helped by the fact that publication timing differs across major currencies. This could cause cash-flow management issues, especially for less sophisticated or infrequent borrowers. Ongoing discussions raise further queries; it is unclear at this stage how the actual transition to RFRs will be managed between those affected, and for loan documentation the amendment process will be nothing but arduous. Given the lack of current suitable alternatives to LIBOR for the loan market, deals being documented now still refer to LIBOR, however, parties are building in flexibility to move to new rates once identified.

The LMA is involved in a variety of work-streams relating to the LIBOR transition, and remains focused on ensuring that it is undertaken in a coordinated and orderly fashion. That said, it is arguably too early to tell exactly how the transition to RFRs is to be managed in the syndicated loan market; a lot of what happens will depend upon RFRs' suitability for use in the syndicated lending market.

AnaCredit – a life force for identifiers

The next panel focused on AnaCredit, the project launched in 2011 by the ECB to create a new dataset with information on individual bank loans in the euro area. The panel began by noting that the reporting requirements capture a vast array of data points, including identifiers relating to the reporting entity, to the parent (if a subsidiary company), the obligors, the instrument and the protection provider, to name just a few.

In practice, this boils down to a large amount of work for compliance, IT and finance teams, and while in some situations it might be relatively easy, in others (for example across jurisdictions) it may prove a much more taxing task. Compliance will prove particularly arduous for those institutions whose internal systems are unable to 'talk' to one another, often due to a merger of two or more institutions whose back office systems have yet to be aligned, where data will either need to be entered manually or a (often hefty) payout will be required to update legacy technology to align systems internally. In terms of the reporting itself, the national central bank for each Eurozone jurisdiction will likely create a national template for institutions to fill, which will then be provided to the ECB on a monthly/quarterly basis.

Focusing on what this means for the market, it was considered whether AnaCredit could be a life force for identifiers, with the market looking to ISINs to act as the syndicated loan identifier. To date, there has been minimal uptake of ISINs in the European market and it was felt that mandatory reporting requirements may act as a push for greater uptake across the market. However, it was noted that the ECB had not identified a default identifier for institutions to use, and therefore it is yet to be seen what the market will select going forward.

Looking in greater detail at the market case for adopting ISINs (or another truly unique identifier), it was noted that the adoption of ISINs at facility and tranche level provides benefits for all market participants and improves transparency by:

- providing an essential facility/tranche reference for use as automation is increasingly introduced in loan operations/settlement;
- enabling a more orderly exchange of information and compilation of reporting in an automated environment;
- facilitating the implementation of STP messaging as a replacement for fax messages;
- allowing parties to a loan agreement to exercise more effective and precise administrative control;
- providing a common reference for facility agent messaging and related cash movements as well as vendor platforms;
- facilitating more efficient settlement allocation;
- allowing for more precise and instantaneous position reconciliation; and
- providing a focus for all related enquiries.

Secondary Conundrums

Deborah Neale spoke to the room on 'the how, what and why of key pieces of the documentation that effect a secondary trade', focusing primarily on the timing of signing trade confirmations. Deborah noted that when trading on LMA terms, the assumption is that parties will comply with the terms laid out in the secondary terms and conditions. Assuming this to be the case, Deborah noted that Condition 4 states that a trade confirmation should be signed up within 4 business days of the trade being made (usually by oral agreement), which is sufficiently binding under Condition 2.

Deborah noted, however, that there may be a number of reasons why execution of the trade confirmation is delayed. For example, it may be because companies need to complete counterparty KYC or push back on any deviations from what parties believe was agreed at the time of trade. However, it was noted that, assuming the LMA's standard terms and conditions, KYC should have been completed prior to trade date, and the trade confirmation not being an opportunity to further negotiate the deal.

Analyzing the Timeline

Since Q1 2017, medium settlement times have been worsening across the secondary loan market, with the Q1 2018 median par settlement time sitting at T+37.7, requiring institutions to undertake a significant improvement to meet the Secondary sub-committee's goal of T+20 by Q4 2018. In an effort to understand widening settlement times across the secondary loan market, the LMA constructed a secondary closing timeline for par trades, based off LMA documentation and the secondary closing principles matrix. The Secondary sub-committee, in collaboration with the buyside, has been working to indentify the bottlenecks in the settlement time, with the hope of tackling delays through behavioural change.

It is important to note that trade counts are up by 14% since Q4 2017, and up by 44% since Q1 2017, when the LMA recorded its lowest median settlement statistics of T+21. Consideration of volumes is paramount, as staffing and resourcing limitations will inevitably delay settlement. Furthermore, delays in primary are having an effect on secondary settlement, an issue that the European Loan Operations Committee is looking into.

On first look at the secondary closing timeline, the first discrepancy between the LMA recommended timeline and average timeline is at point of trade entry. The LMA timeline recommends a trade entry time of T+1, however the medium for trade entry is at T+4. The secondary committee agreed that trade contacts not being available on Clearpar likely contributed to this delay, with volumes also likely to add to the story.Trade allocation is also failing to meet the LMA's recommended time, and it was felt this was likely due to loan closing teams receiving inadequate amounts of information to proceed with the allocation. Institutions are addressing this problem by using market identifiers, which aids allocation on Clearpar. The take up of technology in this area, for example "opt in" auto allocation, has the potential to quash delays significantly.

There has been considerable discussion around the status on the trade confirmation amongst market participants, the trade confirm intended to reflect the terms of trade agreed at trade date. As stated in the earlier session, the LMA timeline envisages the trade confirmation being executed at T+4, however in real terms this is happening at approximately T+16. This is due in part to institutions refusing to sign the trade confirmation until KYC is completed, and also because parties are using the trade confirmation as an opportunity to negotiate the terms of trade, particularly where institutions have specific "house" requirements that the traders have not mentioned at the time of trade. To assist with this, there have been discussions of promoting the behaviour of sending out KYC packages as soon as institutions know a new vehicle is going to be trading in the market, instead of starting the KYC when the trade is live.

Many of the delays seen in the settlement timeline are behavioural or resource driven. When asking the audience on what they perceive to be the greatest obstacle to driving down settlement times (excluding KYC), 44% stated upstream delays and 33% blamed behavioural inefficiencies. If operational teams throughout the market keep maintaining a level a self-scrutiny over their settlement practices, small changes will drive down settlement times. Furthermore, technological advances across the market will see errors decrease and delays minimised. It should be noted that the published statistics are a median figure, which multiple institutions operating accordingly to the recommended timeline. It therefore is possible!

Looking forward five years in loan agency

This panel took a look forward at how the agency role might be subject to change as a result of continuing rapid technological growth. The core topics examined during this session were the impact of digitisation, standardisation and integration with respect to agency functions. Technologically speaking, in many senses EMEA still lags behind the US market (given the success of the latter in commoditising debt products), which has an overall easier time simultaneously absorbing the disruptive impact of new technology whilst maximising the benefits (and is therefore faster in terms of overall adoption), but work is under way in EMEA to ensure that future technological improvements can be widely implemented with respect to the function and process management of loan syndicates by agents.

A variety of trends continue to change the way in which agents go about their role with respect to the support they provide within syndicated lending transactions. Globalisation has led to increased standardisation of agency operations worldwide, and target operating models are becoming increasingly aligned to improve efficiency and administrative capacity. Technological advancements now allow agents to improve integration between various systems to allow for data to be transferred automatically and securely between different platforms. The combined impacts of technological growth and globalisation has, in recent years, provided a more hospital marketplace for third-party agents to gain a secure foothold in the market, despite them not being able to benefit from the same synergies as in-house agency teams in established institutions.

In terms of upcoming changes in agency, a central concept is the increasing digitisation of functions and processes, as well as the use of artificial intelligence to automate various processes which do not benefit from human involvement. However, whilst there is no denying that further change is on its way and several barriers still exist which prevent further acceleration of this process. Despite investment by banks into financial technology being at the highest level ever, many institutions will simply not front the cost of adopting new technologies until either it becomes viable as a market standard or it becomes a necessity.

Legislation, therefore, could be a key driver for technological change within agency; Anacredit, whilst not a complete solution to the issues surrounding the use of identifiers for financial instruments, is an example of where legislation has been used to accelerate the adoption of a new standard across the EMEA marketplace. Other than this, the market-wide push towards greater levels of standardisation in respect of processes and functions is expected to assist with respect to achieving the level of digitisation necessary to begin implementing some of the more radical technological solutions, such as distributed ledger technology, for agency functions and processes.

Over the next five years, our panel predicted that the deployment of technology within agency will continue to accelerate. This sentiment was mirrored by an audience poll in which the majority of respondents felt that their agency operations will be fully digitised by 2025. Financial institutions will doubtless continue to invest heavily in technological solutions across the board, driving the market forward and increasing overall efficiency with respect to agency functions, as well as driving further change within the debt markets as a whole.

Collaborative Creations

The final panel of the day was centred on collaboration, and the discussion began by debating what collaboration is and whether and why it is important. The panellists all agreed that collaboration meant creating the future together and everyone coming together and contributing. It was also noted that this included both external collaboration (for example partnering with competitors) and also internal collaboration, for example not having a divide between the front and back offices. Looking at the importance of collaboration, the panel noted that it was a key requirement for success. Taking into account the high pace of change in the market, it is a case of collaborating and getting a better outcome, or isolating oneself from the market and getting left behind. The panel also felt that collaboration was vital to scaling successfully.

In the context of organisational change, horizontal and lateral thinking should come before vertical collaboration, and the focus should not just be on technology. Parties should be mindful of internal processes and how these made be adapted to maximise efficiency. Attention should be given to how best to measure success, particularly when parties are working across product lines, or teams.

Throughout this session the panel had set a number of polls for the audience to complete, revealing that 40% of attendees weren't currently testing disruptive technologies within their teams, but 75% of attendees being aware of their firm having a digitisation strategy. With technology in mind the panel went on then to discuss some examples of collaboration in technology; IBM Watson's incorporation into LoanIQ and the DLT Cash initiative “Stax” being two.

In terms of how people and businesses can get more involved with collaboration, particularly when there are so many solutions available, the key is to try things out and not being afraid to fail. Start small and iterate to an initial solution quickly that delivers benefits. It is important to show stakeholders initial “value on the table”, because that gives you further/continued opportunity to develop your solution. It should be kept in mind that there is no 'holy grail' solution which makes it all the more important to embrace what is available, as well as getting to know people in the industry and contribute and collaborate in that way as well. Also vital is to optimise the technologies and systems you already have to ensure that you have full visibility of what is missing and to trial new technologies before buying.