LMA Loan Market Association

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International Organization of Securities Commissions (IOSCO)
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Dear Sir / Madam

Loan Market Association

Response to IOSCO Consultation Report on Good Practices for Leveraged Loans and CLOs

The Loan Market Association (**LMA**) welcomes the opportunity to comment on IOSCO's proposed Good Practices for leveraged loans and CLOs.

The LMA has been working for over 25 years to establish sound, widely accepted market practice and guidance in relation to the primary and secondary loan markets, with the aim of improving liquidity, efficiency and transparency, and supports the aims of IOSCO in developing these Good Practices. However, bearing in mind that IOSCO principles are often translated into legislation or regulation in many jurisdictions, the LMA welcomes the opportunity to provide feedback on some of the key issues raised by the consultation and to comment on some of the assumptions and conclusions reached by IOSCO in the course of its research.

The LMA has over 850 members in 69 jurisdictions, covering the entire loan process from loan arrangers and syndicate members, including buyside, to traders, funds and borrowers, as well as advisors including law firms.

1. Key issues

We have set out below a summary of the key points raised in our response. We provide further detail on these points below in our extended responses to the questions raised by IOSCO.

- **Loans are not securities and should not be subject to regulation modelled on the securities markets**. In many jurisdictions (including the jurisdictions that are key to the syndicated lending market and per recently-adopted case law in the US), wholesale

lending is regulated in a very different way from the securities markets and it is necessary to maintain this distinction both in order to give sophisticated lenders a choice in how they deploy their capital and also to avoid recategorisation of leveraged loans as securities, borrowers as issuers and lenders as investors and the application of securities regulations that are not suitable for the leveraged loan market. The risks of informally subjecting an unregulated product to the regulations and features applicable to regulated securities markets are significant and could introduce material uncertainty around the interpretation and the scope of key legislation such as MiFID, something that would bring instability to financial markets. Some of the differences IOSCO has noted between (for example) the HY bond market and leveraged loans market exist precisely because of this distinction and are established features of the relevant markets rather than indicating a need for harmonisation.

We welcome IOSCO's statement that its consultation report offers a set of good practices for the consideration of market participants operating in the leveraged loan and CLO markets, and that the good practices do not comprise either standards or recommendations.

- **Participants in the leveraged loan and CLO markets are sophisticated and comfortable with negotiating terms to suit their commercial interests**. Buyers of leveraged loans in Europe – whether banks, insurance companies, asset managers, hedge funds, etc., are almost universally sophisticated institutions with end investors who expect - and require them - to be sufficiently experienced and diligent to be able to evaluate even the most complex lending opportunities. These are not retail markets – the participants in these markets are capable of making independent investment decisions based on their commercial interests and investment policies, are free to participate in a transaction opportunity or not as they see fit and, while development of good practices is welcome, these should be focussed on clarity and transparency rather than restricting lenders from making commercial decisions and/or directing them to rely on arranger disclosures.

- **The need to retain public-/private-side discretion**. We welcome IOSCO's recognition of the existence of both private and public side lenders on syndicated loan transactions (see for example footnote 68 on page 22 of the paper). However, we would also welcome a clearer reflection of this in IOSCO's proposed good practices, as some of these may create challenges for lenders who need to stay on the public side. For example, IOSCO suggests that a number of the measures could be addressed by better disclosure in the term sheet and/or loan documentation, in some cases relating to detailed financial information on the borrower and its projected/forecasted cash flows. Setting aside the question of whether these measures are appropriate or needed (for

example, it is likely that some of this information is already included in the financial model provided to lenders), we question whether the term sheet or loan documentation is the right place for such disclosure. Including such information in those documents may mean that lenders who need to stay on the public side either cannot receive those documents (which would not be a viable option as they must have an understanding of the loans that they are investing in), would need to receive redacted versions, or separate versions of core documents like term sheets would need to be prepared for the different sets of lenders, which is impracticable.

- **Any good practices should reflect the current role of arrangers and underwriters and should not impose inappropriate obligations on them.** A number of the recommendations for good practices would move the traditional relationship between arranger and the lending syndicate, under which lenders are provided with all material information and make their own assessment of the risks before committing. Arrangers of syndicated loan facilities do not owe fiduciary duties to participants in a syndication. The proposals would shift the burden to arrangers and underwriters to proactively identify documentary risks and "advise" lenders rather than expecting sophisticated market participants to review documentation, and make their own investment decision.

- **Any good practices should also reflect the role of borrowers, sponsors and their legal advisers in the dynamics of syndication processes**. We also note the necessary and important role that sponsors and, often, also their legal advisers, play in the dynamics of the leveraged loans market and would welcome greater reflection of this role in the Good Practices, as they drive many of the deliverables and outcomes.

- **The LMA supports and encourages development of good practices regarding timely delivery of information and the level of detail and transparency to be provided**. The LMA strongly encourages development of good practices in syndicated loan markets (as noted in IOSCO's reference to the LMA/ ELFA's "Best Practice Guide for Term Sheet Completeness", published jointly with the European Leveraged Finance Association) and supports many of IOSCO's proposed Good Practices, and in particular the following proposals:

    - additional transparency around EBITDA definitions and for adjustments to be made on a reasonable basis (noting IOSCO's reference to the LMA/ ELFA's "Best Practice Guide for Term Sheet Completeness", which provides detailed guidance on best practice regarding disclosures on EBITDA).

- increased transparency in loan documentation and key marketing materials such as term sheets (noting the importance of preserving the distinction between private and public markets).

- developing practical solutions to assist with transferability, without undermining key features of markets that have developed for logistical and commercial reasons.

- all documentation to be provided in as complete a form as possible and for underwriters and lenders to receive the term sheet and full loan documentation as soon as possible. Ideally market practice would move towards more timely disclosure and more time to review documents, aiming for the timeframes specified in the Good Practices, without the need to specify fixed deadlines, given the wide variance in transaction types and complexity.

2. Responses to questions

Measure 1 – Debt repayment capacity test

Question 1: Would a consistent debt sustainability disclosure within the term sheet based on the borrowers' base case cash flow modelled projections assist investors during the negotiation and investor assessment phase? Should this debt repayment capacity test disclosure be based on 2 measures: both total committed and total funded debt?

Question 2: Should there be a further debt repayment capacity test based on permissible incremental debt and if so, should incremental cash flow generated from the incremental debt (if applicable as some incremental debt is used to pay out a dividend) also be included?

Question 3: To what extent should debt repayment capacity be linked to a financial covenant in a loan document and how should this be constructed? Does a debt service ratio covenant need to be reintroduced into loan documentation or adapted to measure debt repayment capacity test?

The LMA encourages and supports the development of good practices in connection with debt repayment capacity testing and disclosures on cash-flow based leveraged loans (they would not be appropriate for asset-reliant loans where debt repayment capacity tests are not a key credit consideration (e.g. in the infrastructure sector)). However, the good practices proposed in the paper raise a number of questions, including:

- IOSCO appears to intend to apply the proposed debt repayment capacity test to all leveraged loans within scope of the consultation. However, leveraged loans can include a wide range of transactions, including special situation loans and direct loans. The proposed test would make most sense in the context of loans that are intended to be syndicated to CLOs rather than to other classes of loan. We would welcome confirmation from IOSCO that this was the intention.

- Debt repayment capacity is a relevant metric but is only one of several relevant metrics. Additionally, for it to be meaningful and comparable across transactions it would rely on consistent definitions and/or calculations being applied which might not be the case for (for example) forecast base rate assumptions at different points in time.

- In relation to question 2, these tests already exist in most loans, via incremental/additional debt raising tests and restrictive covenants on the raising of financial indebtedness and distributions. The assumptions that would need to be made in order to inform such a test would be too arbitrary and inconclusive (e.g., the EV paid or EBITDA acquired for acquisitions) to be meaningful. It would also be necessary to show the average usage (and changes) of revolving facilities over time, which would confirm that debt repayment capacity is representative of actual use. Lenders should be able to make their own assumptions about potential incremental borrowing and the impact of repayment capacity.

- In response to question 3, debt repayment capacity is dependent on the underlying assumptions in the forecast. Linking debt repayment capacity to a financial covenant could have the adverse and unintended effect of influencing underlying forecast assumptions.

The key point to note is that it should not be necessary to require disclosure of debt repayment capacity in term sheets as the vast majority of transactions offer financial models with forecasted cash flows that allow lenders to assess debt repayment capacity in detail. A statement in the term sheet would not add anything to existing market practice, and may be misleading (e.g., it would be difficult to give a reliable statement of a projected repayment capacity), whereas a model-based approach would provide more relevant information. Similarly, we do not consider it appropriate to require disclosure of models, as some lenders do not wish to receive a detailed model but would prefer to develop their own.

For refinancing transactions the owner does not always provide a new model (because lenders are familiar with the historic performance of the loan and arguably do not need a new model to recommit), and while banks would create their own models they should not be required to

provide these to the market. Lenders in this market are capable of making their own decision about whether or not to invest, even if a new long-term model is not provided.

Measure 2 – Dividend Recaps

Question 4: Should limitations be placed on the ability to effect debt-financed dividend recapitalisations e.g., based on minimum equity, total leverage, debt repayment test?

Question 5: Should dividend recapitalisations only be permitted based on an initial origination or full debt refinancing (and not be permitted using incremental facilities in which all existing loan investors may not wish to participate)?

We do not agree with IOSCO's proposal that it would be good practice to avoid dividend recaps where equity is less than 40% of the total capital structure, total committed leverage is greater than 6x or the debt repayment test is not met. If there are policy concerns about borrowers taking on excessive leverage or around the circumstances of dividend payments or capital distributions, these should be addressed in other ways (e.g., through local corporate law restrictions applicable to the borrower) rather than seeking to introduce these through restrictions on the loan market.

Corporates should be transparent in relation to their intentions, for example by displaying their dividend and dividend recapitalisation intentions based on pro-forma financials, which would allow lenders to subsequently compare historical activity against actual activity. Currently dividend recapitalisations are either regulated by covenants and test conditions for the incurrence of incremental/additional debt in the document known at the time of commitment, or by the presentation of a new financing, in which lenders can choose whether to participate or not. If lenders have concerns with the flexibility allowed to pay dividends in the future then they can either introduce limits in the loan documentation or make the decision not to invest.

IOSCO may wish to recommend that sponsors disclose the amount of original cash equity that is remaining in the business after the dividend has been distributed (as this information is usually requested during the marketing phase in any case).

In relation to IOSCO's statement that the use of incremental debt facilities to support dividend recapitalisations should be discouraged, we did not see the benefit of this restriction. Market participants have full discretion over whether or not to participate in a transaction with incremental commitments and tests/conditions for the incurrence incremental debt are a key area of focus at documentation negotiation stage, if they make a commercial decision to do so then they should be able to participate. For example, lenders may still want to participate even if minimum equity thresholds are not met, if they consider that the borrower is offering a

sufficient risk/reward trade-off for the lender to participate. This restriction would have the effect of limiting choice in the market rather than protecting lenders who are able to make their own risk-based and commercial decisions.

Discouraging the use of incremental debt facilities to support dividend recapitalisations could also push the cost of full refinancings on to borrowers. As mentioned above, lenders typically have the option of i) not participating in incremental facilities if they do not like the use of funds; and / or ii) selling out of their existing facilities if they do not want to support the financing post dividend recap.

Measure 3 – Enterprise Values (EVs)

Question 6: Would a clearer disclosure of the arranging banks' calculation of the borrower's EV, including high level methodology (i.e., Discounted Cash Flows / Income Method, Asset Valuation, Market Based etc.) and key underlying assumptions (i.e., EBITDA adjustment and total debt) assist investors to make more informed decisions?

Question 7: Should EV to EBITDA multiples be highlighted in term sheets and on which basis of EBITDA i.e., proforma, adjusted, historic or forward looking?

Question 8: Do you agree that the basis for EVs should be under-pinned by multi-year forecast cashflows and not simply based only on multiples of EBITDA comparable in other acquisitions or buyouts?

The LMA agrees that a clearer disclosure by borrowers of the underlying EV assumptions could be useful. However, we would like to make the following comments:

- Accounting terms, definitions and languages vary across several jurisdictions, making it difficult to prescribe a universal approach to these disclosures.

- Discounted Cash Flows are not commonly used given that (i) the result can be heavily influenced by underlying assumptions (e.g. discount rate) and (ii) the amount of time taken to calculate it is disproportionate to its usefulness. Usually EV multiples are supported by historical actual multiples across public and private markets, or market based comparables.

- EV to EBITDA multiples are not usually included in term sheets because these are not legally defined terms. The basis of EBITDA would depend on the underlying credit, with forward looking permitted in the case of contracted revenues, and pro forma in the

case of acquisitions with associated modest synergies. However, this would need to be assessed by lenders on a case-by-case basis.

- While multi-year forecast cashflows are a potentially useful metric, they also rely on forecast assumptions and so are not a complete solution. Arranging banks will typically provide lenders with detailed information on the borrower's credit profile in the normal course of business. This is usually followed by bilateral Q&A with lenders where all these points are usually addressed. Given the multiple methodologies to access the valuation of a company, we are of the opinion that it would add little value to standardise the computation.

IOSCO appears to suggest that the arranging banks should be calculating the borrower's EV. This implies a degree of reliance on arrangers by lenders on a key diligence matter, which is more appropriate for regulated bond markets and inconsistent with the unregulated nature of loans, in particular as regards specific risk factors and disclosures to be made to lenders. This would also be inconsistent with the role that the arranging banks undertake. We would not support requiring the arranging banks to share their internal EV calculations with lenders – these would not form part of the marketing materials for the loan as the basis for the calculations is subjective and renders them unsuitable for consumption by lenders (potentially also exposing the banks to liability including claims for misrepresentation). The company or current owner would usually disclose an illustrative valuation, and lenders would perform their own assessment of this valuation.

In a securities offering, participants do not publish projections and EV calculations. Given that the loan market is a private and sophisticated market, it does provide projections and the LMA agrees that it could be helpful to provide more detailed and harmonised projections. However, putting the onus on the arranger in this instance would be beyond even what is expected in securities markets and does not fall within the arranger's role or responsibilities. Even in the public markets, the arrangers are not responsible for the accuracy and/or completeness of the borrower's information and the appropriateness of documentation terms. There is a difference between banks that handle M&A transactions and debt-arranging banks, and if both were the same, there would be strict information barriers in place to manage the risk of information transfers.

Measure 4 – EBITDA complexity and opacity

Question 9: What key disclosures would assist market participants to come to a more accurate view of pro-forma EBITDA and projected leverage (e.g., what key assumptions should be disclosed in relation to proforma adjustments, should there be a disclosure of a

more prudent pro-forma adjusted EBITDA with the exclusion of synergies and costs savings)?

Question 10: Is a 25% cap based trailing EBITDA or previous year EBITDA an appropriate cap for add-backs based on cost savings and synergies?

Question 11: Is 24-months an appropriate threshold for the exclusion of add-backs based on cost savings and synergies?

The LMA supports IOSCO's proposal to encourage additional transparency around EBITDA definitions and for adjustments to be made on a reasonable basis. If there is sufficient transparency around the definitions and adjustments to be made then it should not be necessary to require disclosure of a "more prudent pro-forma adjusted EBITDA". As noted in IOSCO's paper, many lenders rely on their own EBITDA projections in any event.

The LMA also welcomes IOSCO's reference to the LMA/ ELFA's "Best Practice Guide for Term Sheet Completeness", which provides detailed guidance on best practice regarding disclosures on EBITDA.

Disclosures could show cases both including and excluding synergies and cost savings. This would also help to clarify any assumptions that low case/base case/optimistic case for synergies/cost savings are being used.

Most new leveraged buyouts include or incorporate due diligence supporting the opening adjustments which lenders then have the option to access (but note that due diligence is not usually made available to lenders opting to "stay public"). It may also be helpful for companies to report more detail in adjustments on an ongoing basis, given that often there is not a clear obligation to break out the adjustments in quarterly reporting.

The LMA understands that including an overall cap on adjustments to EBITDA is typically well received by the market. Caps up to 25% seem to be a number that the market is willing to accept, although the range can go from tighter caps to the absence of a cap, and it can depend on factors such as the size of the business, the sector, the acquisition track record, sponsor involved, sign off on adjustments by due diligence / the CFO, etc.

While a timetable of 12-24 months seems to be realistic to achieve such savings and/or synergies, it depends on the nature of the proposed cost-savings/synergies and on when the facility has been put in place. However, 24 months, generally speaking, has become the de facto market standard and is broadly accepted by borrowers and lenders as being reasonable

but depending on the characteristics of the transaction this may range from shorter tenors to no tenor restrictions.

Where we reference market standard caps and timetables above, we are primarily referring to the larger syndicated loans that we understand are the main focus of IOSCO's proposals. These limits are likely to be too restrictive in the context of smaller mid-market loans.

Measure 5 – Transparency on covenants' limitations

Question 12: Would a disclosure of the calculation of the marketed leverage ratio assist investors in analysing borrower credit risk?

Question 13: Do you agree with the Measure 5 good practice, and what are the other key term-sheet disclosures that would enhance investor analysis of borrower credit risk?

The LMA supports increased transparency in loan documentation and key marketing materials such as term sheets. We strongly agree that legal terms should be drafted in a clear, concise and effective manner and that standardised documentation helps to ensure that all participants have a common understanding of standard terms, and we have developed a wide range of standardised documentation and guidance in order to support this goal. In this regard, we welcome IOSCO's reference to the LMA/ ELFA's "Best Practice Guide for Term Sheet Completeness", which sets out the key term sheet disclosures that the LMA would recommend.

We also note that this approach is widely followed, with disclosures typically showing a clear bridge between reported EBITDA and structuring EBITDA.

We would like to comment in particular on one of the proposed good practices under Measure 5 (Transparency on covenants' limitations), which suggests that "risk factor disclosures" capturing "all the risks that could conceivably occur" under the documentation could be considered for inclusion in term sheets as a method to support increased transparency. This is a departure from how the market currently operates and is not a concept that exists in the syndicated loan market (or indeed the bond market). It requires arrangers to flag specific documentation risk which is inherently subjective (and raises concerns about what would happen if certain risks were not flagged, and whether arrangers would be considered to be providing legal or other advice to the lenders, or whether they may be deemed to owe a fiduciary duty to the lenders) as opposed to expecting lenders to independently review documents and make their own investment decisions.

Measure 6 – Transparency and fairness during underwriting and syndication

Question 14: Do you agree with the proposed good practices outlined in Measure 6 regarding circulation of a comprehensive term sheet no less than 48 hours before the bank meeting?

Question 15: Do you agree with the proposed good practices regarding time for underwriting entities (minimum 2 weeks) and investors (minimum 5 days) to review the full loan documentation?

Question 16: What other good practices have been or could be put in place to provide transparency and fairness to investors during underwriting and syndication?

The LMA agrees that all documentation should be provided in as complete a form as possible and that it would be useful for underwriters and lenders to receive the term sheet and full loan documentation as soon as possible. Timely provision of full information and documentation is a goal that the market should aim to achieve.

It may be helpful to develop good practices regarding a particular timeframe within which the term sheet should ideally be distributed after the bank meeting (e.g., not later than 48 hours following the bank meeting). However, the LMA considers that such timeframes should be indicative only, rather than binding, given that these timings are deal-specific and affected by their particular timetables. For example, in some cases the launch of a transaction is often less than 48 hours before the bank meeting meaning that providing lenders with a term sheet before the meeting is not feasible (whereas providing it on the day of the bank meeting or shortly thereafter is more feasible). The ability to provide a term sheet within a specified timeframe will depend on a number of factors including time zones, the various bank holidays of the syndication participants, responses from legal counsel, and how complicated the transaction documentation is.

Even in highly regulated and standardised markets (e.g., securitisation) there are no set time limits regarding the publication of required pre-transaction documentation. For example, European manufacturers of securitisations are required to upload a substantial amount of information to a website prior to pricing. The rules are extremely prescriptive regarding the information to be provided, and this often amounts to more than 1,000 pages of information. However, there is no requirement to provide this information within a specific timeframe.

In relation to question 16, it may be appropriate to specify that it is good practice for banks to attempt to disclose as much information as they have received when underwriting the transaction. However, imposing an obligation on the arranger to monitor and drive this timeline

is not the right way to approach the issue, and where information is not available from arrangers, conversations could be held with sponsors.

Measure 7 – Alignment of interest between underwriting entities and investors

Question 17: Do the considerations as set out above accurately reflect the key issues regarding alignment of interests between the underwriting banks and investors?

Question 18: Do you agree with the measures proposed to help strengthen the alignment of interest between underwriting entities and investors?

Question 19: What other good practices have been or could be put in place to strengthen risk management of leveraged lending activities by underwriting entities?

Question 20: Do the considerations as set out above accurately reflect the key issues regarding the practice of designated counsel being chosen by the sponsor?

The LMA does not consider it necessary or appropriate to require underwriters to take specific steps to align their interests with those of lenders, and we welcome IOSCO's statement that it is important to note that banks typically underwrite the entire loan on a firm commitment basis and are therefore exposed to the risk of not being able to distribute it or having to distribute at a lower price. We would oppose a blanket requirement for underwriters to have to take additional steps to align their interests with those of lenders (and this would include any blanket requirement for underwriters to disclose how they have aligned their interests with those of lenders, as this is likely to have a similar effect).

If there are specific concerns in specific areas of the market (as there was in the context of securitisation following the global financial crisis), these should be addressed in best practices for those markets.

Regarding the practice of designated counsel, we agree with IOSCO's statement that underwriters and lenders could obtain independent and impartial legal advice if they wish to do so (noting that this would result in additional transactional costs), and we recognise that unwelcome market practices have developed in some cases. However, we do not consider that it would be appropriate for IOSCO to give more detailed guidance than this because the provision of legal advice is a regulated profession in most jurisdictions and already subject to strict conduct rules which address, among other things, conflicts of interest risk. This is not a consumer market, and lenders participating in leveraged loans are sophisticated and are in a position to obtain separate legal advice if they consider it appropriate to do so (and IOSCO notes in its consultation paper that some lenders in the direct lending portion of the market do

in fact appoint their own legal counsel alongside the lender counsel designated by the sponsor). If there are policy concerns about the independence of legal advisors, these concerns would be better addressed in other ways (e.g., through specific provisions in bar association rules or other regulation of legal advice in relevant jurisdictions).

One potential solution could be for the borrower to propose a list of counsel for the arrangers to choose from, although any suggested framework should take into account the practicalities of coordinating a borrower group counsel between them.

Measure 8 – Reducing restrictions on transferability of loans

Question 21: Do the considerations as set out above accurately reflect the issues surrounding transfer provisions in the LL market?

Question 22: Do you agree with the proposed good practice to ease restrictions on the transferability of LLs to support liquidity in the secondary market? Is there a justification for transferability to be more limited in the LL market as compared to the HY bond market

The LMA is strongly committed to improving liquidity, efficiency and transparency in secondary loan markets, and supports IOSCO's statement that "*transferability of loans within a pool of potential investors should be as broad as possible to support a liquid secondary market*".

However, we would note that while we support broadening of the pool of potential lenders and providing transparency on any restriction at as an early a stage as possible, we would caution against specifying a point in time when transparency must be provided. For example, it may be challenging to comply with IOSCO's proposal that an agreed list of approved lenders should be provided in the term sheet, as these lists are often finalised later in the syndication process.

We note that IOSCO draws parallels with the HY bond market, commenting on the need for price transparency in loan markets and asking if there are reasons for more limited transferability in the leveraged loan markets compared to the HY bond market. While there are some parallels between these two markets, they are very distinct markets with very different structures and participants. In particular, leveraged loan terms are highly negotiated and transaction-specific, meaning that while price transparency is useful information for participants in the leveraged loan market, it is not a key factor in developing a liquid market as it is for HY bonds. Similarly, as leveraged loans are privately negotiated instruments, it is beneficial for a borrower to be able to have some visibility over who its capital providers will be, which is not something that can be achieved in the HY bond market.

There is also a sensitivity regarding control of confidential non-public information in the context of leveraged loans that does not typically exist in the context of HY bonds. HY bondholders will generally receive public information only (without budgets or other forward-looking information), while leveraged loan syndicates will generally receive private non-public information as well (unless lenders identify themselves as public side only). This means that sponsors will be more concerned to maintain a level of control over changes in lender syndicates, particularly in relation to stressed or distressed borrowers where there are concerns about distressed debt lenders buying in for the purpose of accessing private non-public information. There are standard practices across market players to ensure and protect against misconduct. Further, the borrower may wish to exercise a certain level of control over who their lenders are given the nature of the instrument.

In addition, the transferability of HY bonds is fundamental to their nature and is a key factor in their regulatory characterisation in many jurisdictions. While increased transferability in leveraged loans would be a useful development and would help support liquidity in this market, seeking to make leveraged loans as freely transferable as HY bonds would fundamentally alter the nature of the market and also potentially alter the regulatory characterisation of leveraged loans (with significant implications for licensing requirements, application of securities regulation and market documentation). The good practices that IOSCO suggests (e.g., expanding the pool of potential lenders, ensuring that there are clear reasons for using lists of approved or disqualified lenders, discouraging removal of names from an initially agreed list) should not have this effect, but the LMA would caution against drawing too close a comparison between HY bonds and leveraged loans, or seeking to align the two markets.

Measure 9 – Managing conflicts of interest where PE sponsors also act as lenders

Question 23: Do you agree with the proposed good practice to mitigate conflicts of interest which may arise from PE groups investing in the debt and equity of the same borrower?

Question 24: What other good practices have been or could be put in place to help manage conflicts of interest arising for the reason described here?

The LMA agrees with the proposed good practice to mitigate conflicts of interest that may arise from PE groups investing in the debt and equity of the same borrower. In most cases we would expect information barriers to exist between the equity trading and debt trading teams, so a good practice recommendation to manage conflicts of interest appropriately should be in line with existing practices.

Leveraged loan documentation will typically include provisions to restrict voting rights for lenders which are affiliated with shareholders in a given borrower, subject to carve-outs for independent debt funds which are separately managed. The LMA's recommended form of facilities agreement for leveraged and acquisition finance transactions includes disenfranchisement provisions in relation to "Sponsor Affiliates".

Measure 10 – Managing conflicts of interest in management of CLOs

Question 25: Have the considerations above captured the key considerations regarding potential conflicts of interest which may arise between the CLO manager and the CLO investors?

Question 26: Do you agree with the proposed good practices? What other good practices have been or could be put in place to help manage such conflicts of interest?

While we agree that CLO managers should identify and manage potential conflicts of interests, we would note that for European CLOs this is typically already the case and that, as noted above, this is a market with a sophisticated investor base and the investors are well-placed to understand the potential for conflicts of interest and to ask appropriate questions in due diligence questionnaires, as well as to stipulate requirements applicable to the terms in the offering process. We would also note the UK and the EU have extensive regulatory requirements, including risk retention requirements, for regulated asset managers which include provisions for managing conflicts.

As regards the proposed good practices:

- Policies/restrictions governing the purchase of distressed assets, cross-sales and trading/valuation of CCC/Caa rated loans are all clearly set out in the relevant offering document for the CLO and form part of the investment criteria applicable to the CLO and to be complied with by the CLO manager.

- Furthermore, where applicable the carrying value and/or designation of each asset type (e.g., discounted obligations, defaulted obligations) for the purposes of the CLO form part of the terms and criteria set out in the offering document, allowing investors to stipulate any changes to such values as part of the offering process. This is also extensively reviewed and modelled by applicable rating agencies.

- Conflicts of interests that may exist as regards the CLO manager are disclosed in a specified section of the offering document clearly labelled for investors which typically

also includes detail on the cross-trade policy of the CLO manager. Again these are also subject to the overarching regulatory framework applicable to asset managers.

- On an ongoing basis we note that the trustee reports provided to investors in CLOs already disclose on a monthly basis detailed trading and valuation information on the portfolio typically including:
    - the identity of assets sold in the preceding month (and the reason for sale);
    - the carrying value of the portfolio with respect to assets not carried at par;
    - the asset type falling within the predetermined constructs (defaulted obligations, CCC assets, etc.);
    - an approximate market valuation of the assets by the CLO manager (as determined in accordance with disclosed and detailed market valuation procedures); and
    - commentary by the CLO manager on the portfolio (in some cases optional).

Regarding the commentary on disclosure on management of the CLO's exposure to CCC assets, we do not see such detailed analysis as helpful to investors given that there is (i) disclosure on each CCC asset and the carrying value thereof and (ii) restrictions on reinvestment where CCC assets form more than 7.5% of the portfolio.

There already therefore exists in CLO documentation extensive disclosure, both prior to investment and on an ongoing basis, around conflicts of interest and valuation of assets. There is also sufficient opportunity for investors to (and investors do) request additional specific reporting information prior to investment. As such we do not think any further good practices are required to be put in place and see the proposed good practices as already being broadly in place in the UK/ European CLO market.

Measure 11 – Disclosure in CLOs

Question 27: Have the above factors captured the necessary information that are important considerations to investors for their CLO investment decision and evaluation of CLO managers' performance?

Question 28: What additional good practices in disclosure can be put in place to help investors better understand and evaluate their CLO investments?

As noted above there is detailed reporting provided to CLO investors, and such investors are given the opportunity to (and do) comment and request information as part of the offering process. In addition to the information listed above, and that required under the EU and UK Securitisation Regulation reporting, monthly trustee reports typically already provide detailed information on the status of the liabilities of the CLO including:

- statements as to the coverage ratio levels (and satisfaction of the coverage tests) applicable to each class of notes issued by the CLO; and

- statements as to the satisfaction and levels of (i) the collateral quality tests and (ii) the portfolio profile tests (including the CCC exposure as a percentage of the portfolio) and details of the result of the calculations required to be made in order to make such determination (including the applicable numbers, levels and/or percentages resulting from such calculations).

The opportunity for sophisticated investors to participate in the makeup of the investment restrictions/designations and the ongoing reporting thereon, as well as receipt of the detailed information set out in this response and the response to Questions 25 and 26 above results in investors being in receipt of useful and detailed information on both the underlying portfolio and the performance of the liabilities of the CLO. As a result investors in European CLOs are already in a good position to understand, evaluate and input in their CLO investments.

Measure 12 – Disclosure on underlying loans

Question 29: Have the above practices captured the necessary information that are important considerations for investors to evaluate the on-going financial performance of LL borrowers?

Question 30: What additional good practices in disclosure can be put in place to help investors better understand the financial position and status of LL borrowers?

The LMA has no further particular comments on the proposed good practices. However, we would welcome confirmation from IOSCO that none of the good practices would involve breach of any confidentiality commitments that lenders may have given. For example, in the event that CLO SPVs are asked to provide the loan agreements with the underlying borrowers, this would be excessive look through for an aggregated vehicle and would violate the terms of confidentiality.

Members would also welcome good practices in relation to the timing for disclosure of financial information on borrowers (at least in relation to management accounts and high-level

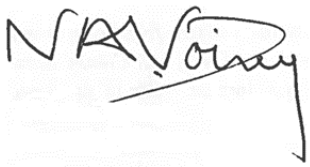
data), and also in connection with disclosure of any non-financial information prepared by borrowers (e.g., in accordance with regulatory obligations to publish ESG related information).

The LMA also encourages greater awareness and use of the LMA/ ELFA's "Best Practice Guide for Term Sheet Completeness" as this would address many of the issues that have been raised in IOSCO's paper (such as those in relation to the transparency and completeness of disclosure).

We look forward to continuing to collaborate with IOSCO as it progresses this initiative and we would be pleased to discuss any aspect of the above with you in more detail.

If we can be of any further assistance, please do not hesitate to contact me by email at Nicholas.Voisey@lma.eu.com.

Yours faithfully,



Nicholas Voisey
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