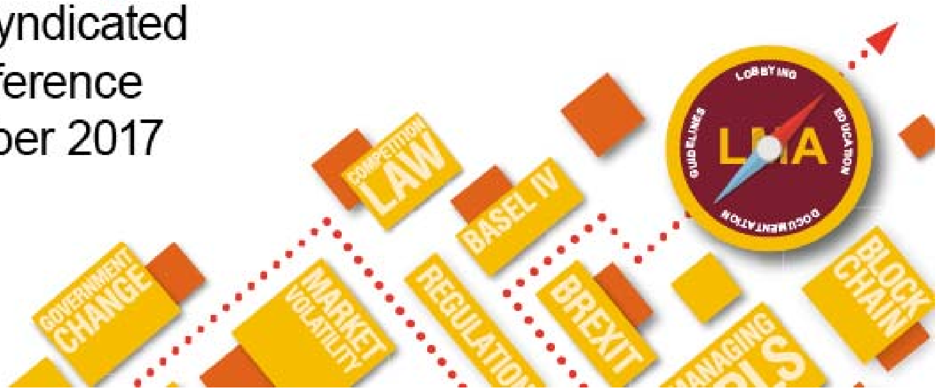
Navigating Change

LMA 10th Syndicated Loans Conference

19 September 2017



Liquidity and efficiency: sailing into the wind

QE2 Conference Centre, Broad Sanctuary, London SW1P 3EE, UK

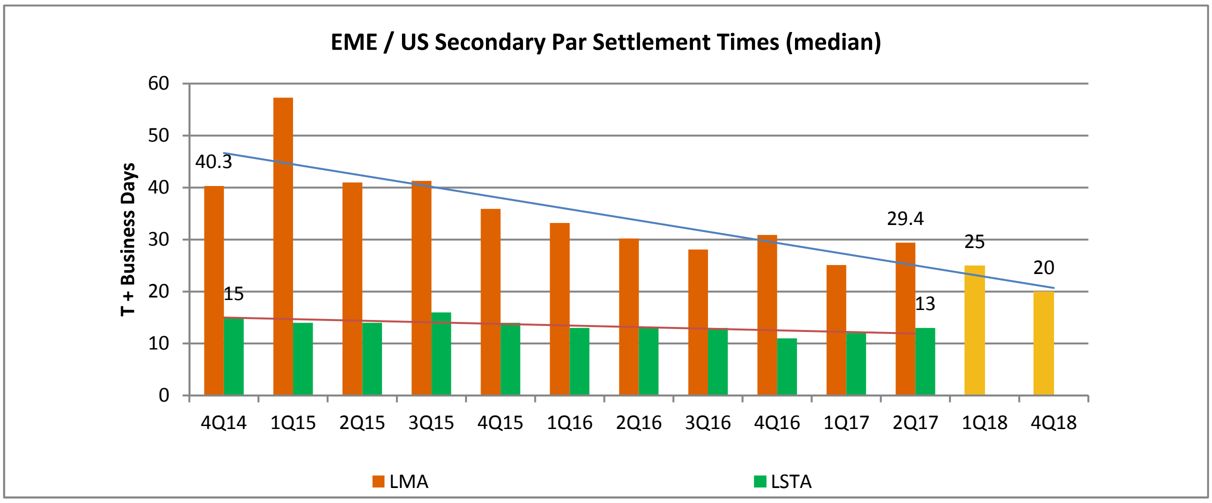
Panel Speakers:	Chair: Doug Laurie, Director – Barclays Yasmine Bassili, Managing Director - Goldman Sachs Charles Bennett, Head of Loan Sales – Credit Suisse Ian Borman, Partner - Winston & Strawn Steven Connolly, Vice President, Wholesale Lending Services, Middle Office - JPMorgan James Slessenger, European Managing Director and Senior European Covenant Analyst – Xtract Europe

On 19 September 2017, a panel of experts came together to discuss the opportunities awaiting the European syndicated loan market should it pull together to improve efficiency measures, chiefly evidenced by settlement statistics.

Panel Discussion

Reducing Settlement Times

In close co-operation with the LMA European Loans Operations Committee ("**Committee**"), the LMA began collating settlement statistics from major European trading banks at the back end of 2014. As evidence in the chart, there has been a 25% reduction in settlement times over the past two years.



The aspiration of the Committee is to see a reduction in settlement times to T+25 by the end of 2017, and T+20 by end of 2018, by better collective working through pain points and sharing of best practice. To that end, the Committee has created an escalation matrix, to aid transparency in delays and improve communication between players in the secondary market. In addition, it has published various guiding principles to promote behavioural change in the market.

How does the origination process impact operational efficiency?

There has been a substantial shift in leveraged loan documentation over the past three-to-four years, with European borrowers looking to import US-style terms, to add flexibility to their European transactions. However, these terms have been imported without the accompanying protections and have been teamed with the flexibility traditionally afforded to European transactions. This has led to the creation of a very flexible product, whose flexibility is increasing with every new transaction.

Given the highly competitive state of the European loan market, lenders are wary of losing transactions and are therefore hesitant to push back on too many terms, especially those perceived to be "boilerplate". Sponsors are therefore able to select lenders on their willingness to accept terms, as well as on price, leading to lenders competing on sponsor term sheets. In addition, sponsors are able to play off the loan market against the high-yield bond market.

In the past, market developments have taken place incrementally, enabling lenders to push back on sensitive points in a cohesive manner. However, the recent rapid occurrence of multiple changes has put an end to cohesive pressure, with each lender picking up individual points most relevant to their institution/portfolio.

The impact of tightening of assignment provisions

A "European phenomenon" is taking place, whereby covenants are getting looser as assignment restrictions are becoming tighter which, in turn, can add additional layers to the operational burden already inherent in established transfer processes. The market has moved away from a transparent regime, and whereas borrower consent to a transfer has traditionally been required unless to an existing lender or approved lender, or on the occurrence of an event of default, this is no longer the case. Consent rights are no longer falling away on an event of default, other than on non-payment or insolvency, and additional restrictions are being put in place. These changes are severely limiting the ability of investors to manage their own liquidity and risk portfolio.

Between 2015 and 2017 YTD, there has been an increase from 54% to 79% of provisions prohibiting assignments to "industry competitors" without consent, "industry competitors" being broadly defined. Whilst industry competitor language is not necessarily itself a problem, the broad definitions being seen in the market, often extending to capture an array of affiliates, are. These can often unwittingly capture large banking groups, preventing them from taking part in secondary market transactions.

In the same period, there has been an increase from 20% to 35% of agreements permitting consent rights for assignments made to distressed debt funds, loan to own funds and hedge funds. It is difficult to define these groups so as not to restrict legitimate trading by larger institution investor groups, resulting in a more illiquid asset class.

Balance therefore needs to be brought back into the market. Currently there is a trend for the underwriter to rely on their counsel to lead negotiations with the sponsor, who often take a sledge hammer approach to negotiations, fighting for the most aggressive terms in the "interest" of their clients. However, it could be argued that it is in the interest of all parties to create a well functioning loan market, and therefore focus needs to be brought back to creating terms which can facilitate operational efficiency and support the secondary market.

At present, the secondary market remains largely buoyant, and therefore the effect of these terms has yet to be felt. However, as the market becomes tougher, these terms will start to bite.

Summary

The complexity and variability that has been added to documentation has the potential to impact operational facility and increase settlement times.

In order to take advantage of the immense opportunities available to it, the leveraged loan market needs to deliver reliable, predictable and efficient settlement. It has already proved itself as a reliable, well performing asset class, by being open throughout the financial crisis. However, in order to get to the end investor, being the pension and insurance funds, improvements to efficiency must take place. Pension and insurance funds need to put their funds to work in T+7, and lack of timely settlement in the European syndicated loan market is damaging. By market participants focusing their efforts on reducing documentation and operational inefficiencies, and consequentially reducing settlement times, the leveraged loan market will be well placed to become one of the most preeminent lending markets in the world.