LMA & LSTA Loan Operations Seminar Summary (8 March 2018)

On 8 March 2018, the LMA and LSTA held an afternoon seminar focusing on loan operations, which featured sessions on the LMA and LSTA initiatives tackling delayed settlement, the uptake of identifiers, global challenges to operations and the use of blockchain in syndicated lending.

Session 1: Tackling delays in primary syndication – timeline and delayed settlement compensation

The LMA and LSTA have both been working hard to tackle settlement delays in primary syndication within their respective remits. The LMA has introduced a new form of Recommended Timeline for Settlement of Primary Syndication and Delayed Settlement Compensation (DSC). This was driven by high levels of demand from investor, as well as from arrangers, for standardisation in this area. One of the key issues to address was the lack of understanding regarding when legal risk actually transferred between the parties. There were also questions to answer regarding the KYC process and the issuance of transfer certificates.

The LMA's 'Recommended Timeline' was produced by an experienced working party and introduces: (i) recommended timings for the various stages of syndicated (with 'standard' and 'fast track' timelines); and (ii) provides a framework for the payment of delayed settlement compensation, where relevant. The timelines are based on what the working party felt would be reasonable and achievable in the circumstances, as well as being designed with the intention of promoting good practice. In either case the timeline will flow from the date of allocation (AD), with the standard timeline running up to 27 business days and the fast track timeline up to 14 days. The latter assumes that the vast majority of KYC requirements have been complied with prior to allocation.

In relation to delayed settlement compensation, the differences between primary and secondary market trading are reflected in the mechanism through which DSC is paid. The underwriter will pay any margin and recurring fees from AD+27/14, but only if: (i) the underwriter is a sole or fronting underwriter; (ii) the amounts have been received from the obligor; (iii) the investor has signed the transfer certificate when requested; and (iv) the investor funds its allocation on the agreed date.

The market response to the LMA's initiative has been positive, with both investors and arrangers stating that it is a move in the right direction.

In relation to the LSTA's efforts to implement a form of primary delayed settlement compensation, a framework is being built which looks at the option to use the primary allocation date, funding date, or trade entry date as trigger points for the settlement timeline. The availability of compensation will be subject to the buyer complying with certain requirements running from the times specified above. In addition to this, delayed compensation for primary transactions will continue to include exclusions for, amongst other things, 'CLO Blackout Periods', purchase price calculation errors, material errors in assignment agreements and force majeure events. The LSTA's work in this area is still ongoing.

Session 2: Global uptake of identifiers?

The discussion of identifiers was framed against the background of AnaCredit, an ECB granular data collection project. Credit data, taken on a loan-by-loan and trade-by-trade basis, will be required from all reporting agents in the reporting member states. This data will then be collated with other micro data bases containing information such as contract types and counterparties.

Stage one of Anacredit implementation starts 30 September 2018 and is mandatory for resident credit institutions in reporting member states. This stage is voluntary for foreign branches in reporting members states, but is foreseen to become mandatory at a later stage. It is hoped that the introduction of new data alongside existing national credit registers will help (i) ensure more comparability among banks and reports; (ii) improve the statistical information basis for the Euro system; and (iii) support monetary and prudential policies with reliable statistical data.

Institutions caught by Anacredit will need to provide a host of identifiers, being a key part of the AnaCredit data model. Of particular relevance to the loan market is the requirement to include a syndicated credit identifier. Whilst not defined, it has been questioned whether this may assist in the uptake of ISINs across Europe.

Session 3: Global Challenges to Operations

Institutions are experiencing delays to funding and staggered funding in primary syndication. This has become a prevalent problem with knock-on effects to settlement and the LMA's European Loan Operations Committee has set an aim to investigate this issue and seek possible resolutions.

Looking to secondary settlement statistics, for Q4 2017, the LSTA published a median settlement time of T+12, with the LMA's median at T+33.3. Delays in the European market are comprised from a variety of variables, but the most notable issue over the past 6 months involves (some) institutions unwillingness to settle secondary trades until primary syndication is fully closed. Given the delays to primary funding, this is having a substantial knock on effect for the secondary market, with sell-side institutions being encumbered by larger amounts of risk in primary, for which they are not receiving compensation. The has led to parties adapting the LMA's secondary T&Cs so that delayed compensation commences from the later of T+10 or the date on which the intitial Predecessor-in-Title purchased the Traded Portion from the Agent. This is not just a European phenomenon but impacts the US market on a smaller scale, and is primarily seen where agent banks stagger funding due to the size of the primary deal.

There has been an "avalanche of change" in respect of transfer provisions in European loan documentation, which impacts the efficiency in which the secondary market can function. This includes the increasingly common requirement for borrower consent to any transfer, with no "reasonability" restrictions, and the increasing use of white and black lists. White lists are common in most deals, together with the borrower's unilateral right to remove institutions from the white list. There is concern around increased use of amendable blacklists, which are not falling away in an event of default. The impact of these transfer provisions is a decrease in liquidity for asset managers. Furthermore, settlement delays are experienced whilst parties seek to acquire borrower's consent to any transfer.

Delays to settlement have also been seen where institutions are looking to negotiate trade confirmations. moving it away from the terms agreed orally over the phone. A trade confirmation is a reflection of the deal made at the trade over the phone or on email, it should not be subject to negotiation in its own right. Buyer and seller should agree all the terms when setting the deal. The market has seen terms such as voting rights and borrower consent try to make it onto the confirmation. This is a behavioural issue and can only be solved by educating sales teams of the correct procedure.

New technology has aided the settlement process significantly. The use of vendor platforms have been transformative in regards to the efficiency of settling a trade. E-signatures have meant that operations teams can handle large volumes of trades. There is still a far way to go in the effort to use technology to our advantage in the syndicated banking market. Banks are intently focused on innovation, seen through the advances in DLT, FPML messaging and artificial intelligence.

KYC is still viewed as the largest operational challenge within the market. Questions can be asked here whether the market should be working together on KYC to remove replications. There have been examples of buyside institutions providing KYC packs of the creation of a new fund, a trend that if it were to grow would support a faster settlement process. A practice to promote is agents seeking out open trades and starting KYC early where applicable. The JMLSG board are in the process of reviewing their guidance, including the chapter of syndicated lending (chapter 17:

Syndicated Lending). This is currently in the market for consultation and could provide the market's greatest opportunity yet to reduce the KYC barrier.

The LSTA Delayed Compensation regime has led to improvements in settlement times in the US market. The regime allows for a mapping of where the delays lie, revealing new bottlenecks in the settlement timeline. The regime is not perfect yet and requires more transparency, but it has made a tangible difference to US loan operations.

The global move to risk-free rates (RFRs) poses one of the largest challenges yet to loan operations. The practical implications of this regulatory move are huge. Operations teams will have to consider how they will reconcile different currencies with the base rate, new system fees, where the new rate will be obtained and the mechanics of this change. The future move to RFRs has required parties to incorporate contingency language into loan documentation. Actions that institutions can take now is to articulate what changes will need to be made to prepare for the replacement of LIBOR, and consider whether these will be phased in, or happen in one swift action.

Session 4: Is syndication a good use for blockchain?

Blockchain is more than a glorified data base, it is an advanced data exchange mechanism. Blockchain, being one type of distributed ledger technology (DLT) allows information held in credit agreements to be sent through the network to communicate with agent banks. Any alterations in this thread of communication is then visible on the blockchain, a highly useful function for agents on deals with hundreds of lenders. Using blockchain, standardised smart contracts can catch errors before these are sent to the lender or borrower, streamlining the deal-making process.

Looking more broadly at DLT, one of the best use cases for syndicated loan market is the creation of a "single source of truth." If all parties access the same thread of data, obstacles will be removed and settlement times will decrease. For the sellside this means a release of capital and for the buyside a reduction in the costs of joining a syndicated deal. An area that could really benefit from a single supply of information is KYC. Currently multiple banks spend resources and time running the same KYC checks on the same institutions. By unifying this process, compliance teams would experience immediate benefits.

DLT will not remove all jurisdictional and documentation problems – smart contracts will still have to comply with jurisdictional laws. Furthermore, smart contracts may not lend well for the coding of non-operational clauses. DLT invites questions on whether lawyers will have to have a basic understanding of coding in the future, and whether this should start to play a part in junior lawyer's training. Smart contracts pose a large change to the current legal framework and market participants do recognise that it will take time for these changes to be accepted. However, the vast scope for cost and efficiency benefits means that there will be increasing pressure for institutions to invest in DLT initiatives.

Banks are already noticing that operational tasks could become more efficient using DLT, as it provides access to information which is easy recognisable and more reliable. Collaboration and communication are simple to track and follow. Furthermore, DLT initiatives like these have a low cost of entry, low infrastructure requirements and short implementation times. DLT intiaitives are likely to rolled out to the US market in the first instance, due to high levels of liquidity and single currency, then move into the European market through the global banks.