



Public consultation

Draft guidance of the European Central Bank on leveraged transactions

Template for comments

Contact details (will not be published)

Institution/Company

Bayerische Landesbank

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Please tick here if you do not wish your personal data to be published.

Please make sure that each comment only deals with a single issue.

In each comment, please indicate:

- the relevant article/chapter/paragraph, where appropriate
- whether your comment is a proposed amendment, clarification or deletion.

If you require more space for your comments, please copy page 2.

Public consultation

Draft guidance of the European Central Bank on leveraged transactions.

Template for comments

Name of Institution/Company Bayerische Landesbank

Country Germany

Comments

Guide	Issue	Guidance (Include number)	Comment	Concise statement of why your comment should be taken on board
<input type="checkbox"/>	Implementation relative to a banks assets, earnings and capital	No. 2	Clarification	What level of e.g. the risk weighted assets to capital ratio would allow a less rigorous implementation of the guidance? Will each bank receive feedback from the ECB whether it qualifies for a less rigorous implementation?
<input type="checkbox"/>	Definition of a leveraged transaction	No. 3	Amendment	The current definition stands in contrast to the US LL Guidance with a more narrow definition, based on a leverage in excess of 4 <u>and</u> the use of proceeds for buyouts, acquisitions, or capital

distributions (both criteria must be met). The unequal treatment creates a competitive disadvantage for ECB supervised banks and an excessive administrative burden.

Leverage as sole criterion would also discriminate industry sectors that by nature have higher leverages owed to their less risky business model or government regulations (e.g. Utilities).

We suggest that the leverage level alone should not result in a transaction being considered as a leveraged transaction. It needs to be linked to a specific financing purpose or other appropriate condition like an PE ownership background that has to be fulfilled in addition to the leverage criteria (“and” instead of “or” wording).

Calculation of leverage No. 3 Amendment

Adjustments/normalizations to EBITDA when calculating the leverage is market standard and a widely accepted practice by practitioners and scholars. Prohibiting adjustments does not seem appropriate and stands in contrast to the US LL Guidance. While we admit that in some cases adjustments might be rather customer-friendly, there are other examples with very clear one-off expenses (e.g. high transaction expenses following a buy-out) or one off income (e.g. proceeds from the sale of assets). Risk Management should analyse individually whether adjustments are justified or not.

Total Debt should be defined as drawn debt and not include other committed facilities or even uncommitted incremental facilities. Corporates, especially investment grade companies, typically have access to high (committed und uncommitted)

				<p>credit lines. This provides them financial flexibility which is generally assessed positively by banks and rating agencies, therefore it seems unreasonable to sanction them. Shareholder Loans and Vendor Loans have an equity character and should therefore be excluded. This is also market standard and common practise.</p> <p>Further more there are various ambiguities in determining the appropriate reference leverage, e.g. treatment of ring fenced structures within a group.</p>
<input type="checkbox"/>	Definition of a leveraged transaction - exemptions	No. 3	Amendment	<p>We recommend to include ECA loans, or any other loan that is guaranteed by an entity with a sound financial standing, into the list of exempted leveraged transactions. Those transactions carry a fundamentally different credit risk than a normal leveraged loan.</p> <p>Additionally we recommend to increase the materiality threshold from 5 Mio. EUR to at least 10 Mio. EUR. This amount is better aligned with the size of our organisation.</p> <p>A further exemption that we recommend is to exclude loans like revolving credit facilities (RCF) to clients that have a private equity ownership background but whose purchase price (EV) was financed with 100% equity. The RCF alone does not constitute long term financing.</p>
<input type="checkbox"/>	Extension/Renewal or Refinancing of a loan	No. 3	Amendment	<p>We recommend that the extension of a loan (e.g. via a +1 extension option) should not trigger an assessment of whether the financing is designated as a "leveraged transaction". The</p>

				majority of extension options are already credit approved at loan origination and they do not constitute an unforeseen event. We therefore don't consider such an event as significant enough to trigger a potential change in designation as long as the underlying credit risk has not changed substantially.
<input type="checkbox"/>	Independent risk function	No. 4	Amendment	We recommend that the syndication risk should be evaluated by an independent function with the highest expertise like the syndication team rather than an independent risk function. In our opinion the risk office lacks closeness to the market to evaluate syndication success.
<input type="checkbox"/>	Referral to the highest level of credit committee or similar decision-making level	No. 5	Amendment	We recommend to implement size-related competence levels that depend on the volume and credit rating of the transaction. A credit rating already incorporates the leverage and other structural considerations like covenant light structures. Additional factors are therefore not necessary. Based on those two criteria a referral to the highest competence holder like the board of directors should be an exception for banks that have established a credit committee composed of various department heads (Bereichsleiter). We therefore recommend to delete the wording "highest level".
<input type="checkbox"/>	Set of sub-limits	No. 5	Amendment	The implementation up of a granular set of underwriting sub-limits in addition to a group wide limit is too extensive for institutions that do not heavily engage in underwriting practices. We recommend to amend "if appropriate" or an equivalent wording into the guideline.

<input type="checkbox"/>	Monitor and report on an ongoing basis	No. 5	Amendment	We recommend to change the wording from ongoing to quarterly and to exclude club and best effort deals from the monitoring and reporting requirement. Those deals do not carry any underwriting risk.
<input type="checkbox"/>	Investor Base diversification	No. 5	Amendment	We recommend that this provision should only apply to institutions that are heavily engaged in underwriting and syndication practices.
<input type="checkbox"/>	90 day rule	No. 5	Amendment	We recommend to increase the time after which a syndication should be classified as failed from 90 to 180 days. We commonly observe syndication periods in excess of 90 days in highly complex public to private transactions and syndications to smaller credit institutions (e.g. Sparkassen). Therefore, an automatic classification as failed after 90 days seems inadequate.
<input type="checkbox"/>	Stress testing framework	No. 5 and 6	Clarification	Please elaborate in more detail what kind of tests should be performed.
<input type="checkbox"/>	Material modification of a loan agreement	No. 6	Clarification	Please clarify and give examples of a material modification of an existing loan agreement
<input type="checkbox"/>	Repayment of at least 50% within 5-7	No. 6	Clarification	Current Leveraged Buy-Outs contain either a small (<50%) or even no repayment tranche, however, legal maturity does not exceed 7 years. Mitigants for the low amortisation are the

	years			agreement of a cash sweep and/or strong repayment capacity proven in stress scenarios (including accumulated cash). Please confirm whether you are satisfied with this approach.
<input type="checkbox"/>	Enterprise Valuation	No. 6	Deletion	We recommend to delete the use of EV in various parts of the guidance. First of all, the “correct” EV of a company is highly debatable and benchmark multiples are not readily available; hence, the concept is susceptible to manipulation and even counterproductive with respect to making risks among credit institutions transparent and comparable. Second, a high purchase price does not automatically result in excessive risk taking via the banks if the funding consists of a high share of equity capital. Third, the use of cash flow models is far more relevant in evaluating the capacity of the borrower to pay back its debt.
<input type="checkbox"/>	Liquidity coverage requirement	No. 6	Deletion	We recommend to delete any referral to the liquidity coverage requirements (bullet point 4 on page 7). This concept is already sufficiently addressed in other regulation and therefore irrelevant in this context.
<input type="checkbox"/>	Impairment triggers	No. 6	Amendment	The scope of application of the triggers is far too broad. We recommend to include an additional condition to the impairment triggers, that is, a client has to be in financial difficulties. Only then an impairment test should be performed. This is in compliance with the definition of forbearance used in the “EBA FINAL draft Implementing Technical Standards” (Section 18, No. 163ff, page 15ff).

For example, the breach of a covenant alone does not allow a judgement about the financial health of a company, especially in the LBO market, where step down covenants are common. Also, the refinancing of a bullet facility is a standard transaction and a substantial increase in leverage (as the case may be, e.g. doubling from 1.0x to 2.0x) is not automatically a cause for concern.

Impairment triggers No. 6 Amendment

We recommend to change the wording from “initially projected as part of the stress-case scenario” to “latest applicable stress case”.

Companies may have changed materially, e.g. through additional acquisitions or sale of subsidiaries, which makes the initial stress case scenario an unsuitable benchmark.

Default trigger No. 6 Deletion

We recommend to delete the default trigger EV < total debt. Multiples are not readily available and highly debatable. The presumption of a default irrespective of additional default criteria such as payment default, overdue payments, insolvency seems not appropriate. We therefore propose – if anything - to classify the indicator “EV multiple < Total Debt multiple” as an additional impairment trigger

Regular monitoring No. 8 Clarification

Please specify if regular refers to months, quarters or years.
