



## Public consultation

Draft guidance of the European Central Bank on leveraged transactions

Template for comments

Contact details (will not be published)

Institution/Company

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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Draft guidance of the European Central Bank on leveraged transactions.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      Italian Banking Association

Country      Italy

## Comments

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Guide	Issue	Guidance (Include number)	Comment	Concise statement of why your comment should be taken on board
<input type="checkbox"/>	Scope of the guidance on leveraged transactions	2	Amendment	<p>Application of the guidance is only to significant credit institutions supervised by the SSM, leading to the risk of competitive advantage for banks that are not under its oversight (e.g. UK, Swiss, Asian banks), and for non-banks active in leverage transactions, underwriting and syndication.</p> <p>The ability of these banks to operate without being subject to the guidance will present them with an immediate competitive advantage relative to the ECB supervised banks directly affected.</p>

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				<p>We would also note that US guidance applies to both US banks and foreign banks with respect to leveraged loans originated and distributed by them in the US. We believe that the ECB should ensure wider applicability of its guidance to banks in the UK, US etc. for their activities in the European leveraged finance market.</p>
<input type="checkbox"/>	Scope of the guidance on leveraged transactions	2	Amendment	<p>We suggest that the ECB, following regulatory practices adopted in USA, consider a purpose test within the definition, to ensure the focus is on the core leveraged transaction market only. However, in recognition of the wider aims of the ECB, we also suggest that the supervision on the wider corporate market, where the Total Debt / EBITDA leverage exceeds the threshold, is enhanced through increased reporting requirements only.</p>
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	<p>As in the Interagency Guidance on Leveraged Lending issued by the Board of Governors of the Federal Reserve System, OCC and FDIC in March 2013, the identification of leveraged transactions should be based on a combination of more parameters.</p> <p>We propose that the identification parameters should include: i) transaction where the borrowers' post- financing leverage significantly exceeds industry levels (see paragraphs below); ii) the internal or external rating of the borrower below BBB- (or equivalent).</p>
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	<p>The proposed levels of Total Debt to Ebitda ratio to consider a transaction as a leveraged transaction (greater than 4.0 times or greater than 6.0 times for more risky transactions, that therefore should remain exceptional) are applied in an undifferentiated way: the thresholds should be adjusted on the basis of aspects such as the borrower's industry sector or business activity. Different industries carry different levels of acceptable leverages. Hence, a one-size-fits-all ratio is not appropriate and would seriously penalize some sectors (e.g. Infrastructure, Utilities, Telecom, Healthcare, Food &amp; Beverage, Consumer Goods companies) whose business is highly leveraged - as supported by a stable cash profile or in the case of utilities by the sector regulation on prices - without necessarily resulting in higher risk. Thus properly diversified acceptable levels should be defined based on industries'</p>

				underlying characteristics. Higher thresholds should be considered for these sectors.
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	The borrower's post-financing level of leverage of 4.0 times seems to be not appropriate because it is based on the total debt. The leverage should consider the senior debt (at least 4.0 times) plus the subordinated debt (at least 2,5 times) which would imply a lower overall risk.
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	We consider that the condition laid down for the definition of leveraged transactions (the post-financing ratio Total Debt to Ebitda) risks to be implemented in a very strict way. We propose to improve the criteria for the calculation of total debt to ebitda ratio introducing a more detailed information. In particular we suggest to modify the proposed Ebitda which is unadjusted, (i.e. no positive or negative adjustments are taken into account). We suggest to consider significant non-recurring expenses, the pro forma impact of acquisition already made, the full year impact of cost savings already implemented, other exceptional items and one-offs as long as the exceptional nature can be proven. The use of this figure, which normalizes income and expenses, would reduce the inconsistency which occurs as different companies treat each type of income and expense differently and would ensure the level playing field (in US the adjusted Ebitda is taken as a reference). Moreover, balance sheets of mid-cap companies sometimes do not carry any EBITDA, hence this will have to be calculated by the bank anyway which is per definition adjusted.
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	<p>An adjustment to EBITDA is also required to create consistencies between the numerator and the denominator of the level of leverage ratio. For instance:</p> <p>-trade financing would not be flagged as a leveraged transaction, but the use of the unadjusted EBITDA proposed in the draft guidance does not internalize this exclusion:</p> <p>-if the borrower's consolidation scope includes leasing and/or financial institutions these should be excluded from the leverage calculation as these industries are exempted from the</p>

				defined approach.
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	The threshold should be considered on a net basis (i.e. including the available liquidity of the corporates like cash and cash equivalents and short term investments), otherwise a significant group of companies could be classified as leveraged companies. Moreover, cash on balance provide for available buffer against liquidity needs which should be positively taken into any risk consideration.
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	The leverage should be computed considering only the drawn amount of debt (uncommitted lines and undrawn revolving credit facilities must be excluded) as reported in the financial accounts: neither short term and unconditionally revocable lines of credit should be included.
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	The leverage should be computed considering only the perimeter used for covenant purposes (i.e. excluding payment in kind/Vendor Loan/Shareholder Loans out of covenant perimeter and intercreditor agreements).
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	Regarding the second condition, we suggest that a transaction where the borrower is owned by a financial sponsor should not be automatically classified as leveraged unless other conditions are met (e.g. rating level). Application should be limited to sponsor-driven leveraged buyouts (LBOs). Inclusion of acquisition financings could additionally be considered. The mentioned leverage level can be observed for sponsor-driven LBO's, but this is less evident for plain corporates simply exceeding a certain leverage level. An additional group to be considered in the perimeter could be acquisition financings (corporate-to-corporate) if a certain leverage level is exceeded, as these transactions depend on sufficient underwriting liquidity.

<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	<p>The definition of Leveraged Transactions should be revised by preserving specific types of bank lending in support of the real economy, for instance bank lending to SMEs (e.g. firms with EUR 50 mln max turnover).</p> <p>The threshold of 5 million of consolidated exposure of the credit institution under which the loans are not considered in the definition of leveraged transactions is very low: there is the risk to involve a large part of SME loans which are not financed by leveraged finance markets but are clients of retail banking networks with negative impact for the real economy.</p> <p>We propose to increase the amount under (ii) pag. 4, to a higher amount (i.e. Euro 25 mln).</p>
<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment	<p>The ECB has proposed to approach “the highest credit committee” for leveraged transactions whose leverage level is 6x Total Debt to EBITDA or higher. In case this was the process for any loan whose amount exceeds 5m, it would risk to considerably stretch the activity of the highest credit committee. Moreover, longer times for approval might jeopardize client’s ability to do business with serious consequences for the real economy.</p> <p>In order to address the operational issue described above, we would recommend to increase the EUR 5 mln threshold above mentioned to 25 mln, Also, lower amounts are less relevant from a risk management perspective (where prioritization is based, among other criteria, on the exposure).</p>
<input type="checkbox"/>	Definition of leveraged transactions	3	Clarification	<p>The designation of a financing as a Leveraged Transaction is made at loan origination, modification, extension or refinancing. We do not understand what happen if, during the ongoing monitoring, the ratio Total Debt / EBITDA decreases below the threshold.</p> <p>We hope that the final version of the guidance, will take into account the possibility to remove from the leveraged transactions portfolio all those transactions where, in the following years, continuously, the level ratio is below the minimum threshold, unless the</p>

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second condition is complied with.

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It would be necessary to exclude from the definition also the following kind of corporates transactions:

- Project Finance loans, as long as the infrastructure is being developed/built (construction risk), the financing should not fall under the definition. Once the infrastructure is completed, a refinancing aimed to acquire the infrastructure would be considered as a leveraged finance transaction even if repayment is based on concessions granted to the operator of the infrastructure;
- the so called "Fallen angels" (i.e. those credits whose market or credit conditions post origination deteriorate to the point of bringing them within the leveraged lending definition, unless the credit is modified, extended or refinanced). The inclusion of these transactions in the definition would skew reporting and tracking of the portfolio, duplicate monitoring activities, and increase costs without any benefit to financial institutions or to the regulators;
- collateralized transactions. Similar to asset-based transactions and FED practice, collateralized transactions to the extent fully covered by valuable collateral should be exempted to take into account the lower risk profile;
- corporates that are going through an IPO financing in which the private equity sponsors are expected to become a minority in the next 18 months;
- corporates owned by Infrastructure Funds (i.e. sponsors with expected long term investment horizon) and/or by Investment Holdings (i.e. holding companies that have the main purpose to manage shareholdings with long term horizon);
- further to trade finance short term maturity transactions, also mid-term tenors should be

<input type="checkbox"/>	Definition of leveraged transactions	3	Amendment
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recognized as well. This would allow recognition of typical mid-term pre-export facilities.

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<input type="checkbox"/>	Underwriting and Syndication	5	Amendment	We consider that the time frame necessary to qualify a syndication as a “failed” or “hung” one, must be increased at least to 180 days as such time depends on the nature and complexity of the asset being syndicated and on the nature of the investors involved.
<input type="checkbox"/>	Underwriting and Syndication	5	Amendment	It is necessary to include some quantitative limits with regard to the number/amount of underwriting/syndication deals usually managed by an institution before creating a specific team within Risk Management, with <i>de facto</i> a duplication of the Syndication team within an institution.
<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings – Ongoing monitoring	6	Deletion	The criterion according to which credit institutions should be able to ensure that the leveraged borrower is able to repay at least half of the total debt granted by the credit institution is arbitrary. Therefore we suggest its deletion.
<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings	6	Deletion	We do not understand the nature of the “enterprise valuation”, on which basis it should be run and what is the use in a credit evaluation which should be run on the basis of the cash flow generation capacity of the borrower, as represented in the third bullet point on page 7. Therefore, we propose to delete it.

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– Ongoing monitoring

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<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings – Ongoing monitoring	6	Deletion	Again, we do not understand the benefit of the “detailed analysis to price the loan” (as long as distribution of the asset is not affected) within the context of the credit analysis (on page 7, last bullet point). Therefore we propose to delete it.
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<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings – Ongoing monitoring	6	Clarification	We deem that an impairment test (on page 8, second par) should be run when a combination of situations takes place, not just one of the list, and on the basis of an in-depth credit review of the borrower.
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<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-	6	Clarification	We do not understand which financial covenants are “material” and would propose to amend the first bullet point on page 8 second par. with “material breach of a financial covenant or non –remediation of a material covenant breach”.
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term leveraged  
transaction holdings  
– Ongoing  
monitoring

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<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings – Ongoing monitoring	6	Deletion	We do not deem that a refinancing at an increased level of leverage (second bullet point on page 8 second par) by itself determines the need of an impairment as the risk profile of the new refinancing might be affected and improved by other factors.
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<input type="checkbox"/>	Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings – Ongoing monitoring	6	Clarification	We do not deem that a refinancing of a borrower that was granted a bullet facility (third bullet point pag 8 second par) should by itself determine an impairment test to be run.
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<input type="checkbox"/>	Policies and procedures for new deal approval, and	6	Clarification	It should be cleared on which basis should be run the valuation of a borrower which might lead to a strong presumption of default.
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monitoring and  
managing of longer-  
term leveraged  
transaction holdings  
– Ongoing  
monitoring

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<input type="checkbox"/>	Secondary market activity on leveraged 7 transaction	Clarification	It would be better clarified if the market making activity is out of the scope of the guidance.
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