

Public consultation

Draft guidance of the European Central Bank on leveraged transactions

Template for comments

Contact details (will not be published)

Institution/Company

Mediobanca

Contact person

Mr Ms

First name

[REDACTED]

Surname

[REDACTED]

Email address

[REDACTED]

Telephone number

[REDACTED]

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Draft guidance of the European Central Bank on leveraged transactions.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 Mediobanca

Country Italy

Comments

Guide	Issue	Guidance (Include number)	Comment	Concise statement of why your comment should be taken on board
<input checked="" type="checkbox"/>	Definition of Total Debt: the definition should include a criterium of Total Net Debt (Gross current and non current Financial Debt less Cash and Cash Equivalents and Short Term Securities)	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment	Excluding liquid sources would penalize several companies that held in their balance sheets a safety cushion to be used to repay existing debt. In addition in case of bullet financing, the Group can't take show any deleverage in gross debt.
<input checked="" type="checkbox"/>	Definition of Total Debt: the figures to be used are the ones reported in the Financial Statements as	Draft Guidance on Leveraged	Amendment	As for market standard leverage ratio is based only on the drawn amount (i.e. as for covenant computation); furthermore

	drawn portion	Transactions Paragraph 3		precise information on undrawn Revolving Credit Facilities or Uncommitted Lines are often difficult to obtain.
<input checked="" type="checkbox"/>	Definition of Total Debt: the figures to be used are the ones reported in the Financial Statements as drawn portion	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment	The inclusion of undrawn lines would penalize the Group especially in the case of: back up facility (never used in the life of the loan but structurally needed to maintain the rating), acquisition line (the Ebitda of the potential target is unknown).
<input checked="" type="checkbox"/>	Definition of EBITDA: the reference EBITDA used for the credit approval process should be used	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment	The use of adjusted EBITDA is justified by a consistent due diligence package. It should also be mentioned that a due diligence package is most of times available in LBOs that are already included in the defintion of Leveraged transactions
<input checked="" type="checkbox"/>	Level of Leverage: it should be modified and amended to Total Net Debt to EBITDA of at least 4.5 times	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment	The use of a threshold of 4x on a gross basis would penalize some clusters of safer industries like Infrastructure, Utilities, Healthcare, Telecom
<input checked="" type="checkbox"/>	Inclusion of leverage ratio for the definition only upon the occurrence of a specific event like dividend recap/capital distribution or ring-fenced corporate acquisitions.	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment	We think that this perimeter should be limited only to those transactions that are considered more risky like capital distribution and ring-fenced corporate acquisitions because they usually significantly increase the leverage
<input checked="" type="checkbox"/>	Perimeter of the computation of the Leverage ratio: the leverage should be computed exluding potential PIK/Subordinated Debt/Shareholder Loan/Vendor Loan outside of the restricted	Draft Guidance on Leveraged Transactions Paragraph 3	Clarification	This need comes from: i) these instruments are deeply subordinated and can be repaid only after bank loans; ii) the lack of information in some cases; iii) these structures are common in LBOs (already part of the definition)

<p>covenant group and that are not part of the intercreditor agreement.</p>				
☒	Clarification on the definition of Financial Sponsor	Draft Guidance on Leveraged Transactions Paragraph 3	Clarification	What do you mean with Financial Sponsors? Are Infrastructure Funds, Insurance, Pension Funds or Financial Holding companies included in this category? We think we should exclude this kind of investors because they have a long/very-long investment period
☒	Presence of majority ownership of Private Equities in listed companies after the completion of an IPO financing	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment	We think this category of counterparties should not be considered as Leveraged transactions because the Private Equity funds are in exit strategy and financial policy has been usually set at a more appropriate level
☒	Exclusion of Infrastructure from the definition: for this industry other ratios are usually considered apart from leverage (i.e. Net Debt/Regulated Asset Based)	Draft Guidance on Leveraged Transactions Paragraph 3	Deletion	Infrastructure industry can generally afford higher levels of leverage (as considered for AQR) and take-outs are usually put in place by Pension Funds, Infrastructure Funds or Insurances with a long/very-long investment horizon
☒	Exclusion of Regulated Utilities, Infrastructure Telecom and Healthcare from the computation of leverage ratio: these industries can usually afford a higher leverage due to the stability of the sector and presence of non-replicable tangible assets	Draft Guidance on Leveraged Transactions Paragraph 3	Deletion	Companies belonging to industries like Regulated Utilities, Healthcare and Infrastructure Telecoms report a significant portion of tangible assets (i.e. networks, real estate) within an expected stable/regulated frameworks, thus can afford higher leverage
☒	Inclusion of a threshold in terms of internal rating (equal or above BB-)	Draft Guidance on Leveraged	Amendment	We consider the inclusion of an internal rating threshold as reasonable mainly because it already includes more complete

	Transactions Paragraph 3		assessment of the financial risk profile of a counterparty including the leverage ratio as well as a comparison with average industry
☒	Clarification on the use of the term "modification" in note 8 of p. 3	Draft Guidance on Leveraged Transactions Paragraph 3 Clarification	In case of a counterparty with an initial leverage below 4x that during the life of the financing reports a leverage above 4x and asks for a covenant reset, should we consider this as a modification and include it within Leverage transaction perimeter?
☒	Exit from the Leveraged transaction perimeter: is it correct to exclude from the Leverage transaction perimeter the counterparties that during the life of the financing reported a leverage below 4x?	Draft Guidance on Leveraged Transactions Paragraph 3 Clarification	
☒	Exclusion of margin loans/holdco loans (i.e. loan collateralized by pledge on listed shares/financial assets): we propose to eliminate this particular form of financing from the definition.	Draft Guidance on Leveraged Transactions Paragraph 3 Amendment	The Leverage ratio is not an appropriate indication for leverage for these kind of financing instruments. Usually, they are monitored on the basis of Loan-to-Value
☒	Clarification on asset-based loans: should we include margin loans/holdco loans in this category?	Draft Guidance on Leveraged Transactions Paragraph 3 Clarification	
☒	Clarification on bonds: should we include bonds	Draft Guidance Clarification	We think that a separate and appropriate limits/monitoring

	within leveraged transactions?	on Leveraged Transactions Paragraph 3	should be set for this category of instruments
<input checked="" type="checkbox"/>	Exclusion of Trading book exposures	Draft Guidance on Leveraged Transactions Paragraph 3	Amendment A trading book exposure (for example traded bonds) are monitored with regard to market prices, which are not necessarily aligned with the financing structure's internal evaluation. If strengthened due diligence on these trading exposures is requested because of their riskiness, then also riskier traded instruments such as shares should be covered by special due diligence
<input checked="" type="checkbox"/>	Clarification on the sentence: "an independent risk function should be involved in the monitoring of the underwriting and syndication risk". Shall the institution put in place a duplication of the syndication team?	Draft Guidance on Leveraged Transactions Paragraph 4-5	Clarification We think appropriate that such a duplication should be justified only in case the underwriting and syndication risks are material. On the contrary, we think that appropriate limits and monitoring should be put in place
<input checked="" type="checkbox"/>	Clarification on Stress testing framework having the purpose to monitor the impact of market disruptions on uwr and synd pipeline: content, business function in charge of it, frequency	Draft Guidance on Leveraged Transactions Paragraph 4-5	Clarification
<input checked="" type="checkbox"/>	Clarification on "deal closure time": in several transactions the deal is closed only when some Conditions Precedents (i.e. Regulatory approvals) are respected that can take a long time (i.e. sometimes more than 1 year): what is	Draft Guidance on Leveraged Transactions Paragraph 4-5	Clarification We think that the most appropriate "deal closure time" is when all the CPs are respected, the financing is in place and it could be syndicated

the deal closure time?

<input checked="" type="checkbox"/>	Clarification on the policy expected to put in place aimed at avoiding reputational risk or potential conflicts on syndicating and distributing leveraged transactions	Draft Guidance on Leveraged Transactions Paragraph 4-5	Clarification	
<input checked="" type="checkbox"/>	Clarification on the sentence "ability to repay": may you confirm the institution should assess the potentiality and not the effective repayment of the debt (i.e. as in the case of bullet loans)?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification	We think that this feature should be assessed regardless of the structure of the deal (i.e. bullet vs. amortizing). Do we need to take into consideration the bank case or the sensitivity case?.
<input checked="" type="checkbox"/>	Clarification on the sentence: "an enterprise valuation of the borrower reviewed and validated by an independent unit other than the originating unit". Which unit should be involved for such evaluation (Corporate Finance, Risk Management)?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification	Information on the evaluation of the company are regularly reported in the risk memo (i.e. acquisition price, EV multiple) especially for leveraged transactions. We deem inappropriate to create or involve an ad-hoc function that validate this assessment
<input checked="" type="checkbox"/>	Clarification on assumptions to be used for the Enterprise Value assessment. Do you have any precise requirement/guidance (i.e. multiple by industry) that the institution should use?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification	
<input checked="" type="checkbox"/>	Clarification: what would be the expected implications if any of weak/no covenants?	Draft Guidance on Leveraged Transactions	Clarification	

Paragraph 6			
☒	Clarification on weak/no covenants: in which parameters (PD/LGD) do you expect to be incorporated?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification
☒	Clarification on what are your expectations from Risk Management on the pricing of an exposure.	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification
☒	Clarification on analysis to be performed by front office to price the loan. Why Risk management should verify pricing assumptions being as of today a work to be done by front office and syndication team?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification
☒	What would be the expectations in terms of reporting to top management on this specific perimeter?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification
☒	Classification of exposure as “liquidity facility” rather than “credit facility” for LCR: do you expect different processes compared to the approach for corporate exposures?	Draft Guidance on Leveraged Transactions Paragraph 6	Clarification

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| <input checked="" type="checkbox"/> Stress testing framework for events such as surge in default rates, rating migrations or collateral discounts: do you expect different processes compared to the approach for corporate exposures? | Draft Guidance
on Leveraged
Transactions
Paragraph 6 | Clarification |
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