EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Public consultation

Draft guidance of the European Central Bank on leveraged transactions

Template for comments

Contact details (will not be published)

Institution/Company

Spanish Banking Association

Contact person

Mr X Ms ☐

First name

[redacted]

Surname

[redacted]

Email address

[redacted]

Telephone number

[redacted]

X 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Draft guidance of the European Central Bank on leveraged transactions.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	Spanish Banking Association
Country	Spain

Comments

Guide	Issue	Guidance (Include number)	Comment	Concise statement of why your comment should be taken on board
☐	Leveraged Transactions (threshold)		Amendment	With regard to the European Central Bank's consultation on its draft guidance on leveraged transactions, published last November 23rd, 2016, The Spanish Banking Association (AEB) welcomes initiatives to bring discipline and best practices to the leveraged finance market segment and does appreciate the opportunity to provide arguments on the different issues included in the draft guidance. The AEB, a member of the European Banking Federation (EBF), has participated in the preparation of EBF's

response to this consultation and fully shares its main messages. Notwithstanding that, AEB has prepared its own response in order to underscore those issues of particular relevance for Spanish banks.

AEB supports the main messages from the EBF´s response:

Firstly, we would like to stress our fully support to the EBF´s vision about the very low threshold (€5m) that the guidance includes. As a consequence of that, a significant number of SMEs exposures, which are not financed by leveraged finance markets but are clients of retail and commercial banking, will be affected by the guidance. According to that idea, we support the EBF´s idea that the commitment threshold should be materially increased, for example to €25m.

Furthermore, and owed to the aforementioned low threshold, the guidance captures a large number of SMEs and many of these companies may be unable to provide the requested information and data and will therefore find it more difficult to raise bank financing. We are concerned that this may prove an obstacle to growth and jobs in the EU as SMEs are a crucial pillar in the European economy.

For that reason, we might consider appropriate, not only increasing the threshold, but also reducing the scope of the guidance to such transactions when they meet a "purpose test", i.e. when they have the objective of financing buyouts, acquisitions or capital distributions.

At the same time and in order to apply adequate proportionality, any definition of leveraged lending should be individual to the specific institution but based on minimum criteria. This allows banks to broaden the definition if required in view of the individual bank's strategic direction and exposure to leveraged lending.

Secondly, we agree on the idea that while leverage is a key consideration, it should not be the only indicator in determining whether a transaction should be within the scope of the guidance. Credit quality matters too and we consider that any guidance should only apply to non-investment grade borrowers (BBB- equivalent or lower). Finally, we consider that borrowers, known as fallen angels under US Guidance, that have exhibited a significant deterioration in financial performance after loan inception and have subsequently become highly leveraged (unless the credit is modified, extended, or refinanced) should be excluded. In this context, it will be important that the ECB clarifies that the guidance will only apply retrospectively.

Summing up the previous paragraphs, a transaction could be considered as leveraged lending, and therefore under the scope of the guidance, when all the following conditions are fulfilled at deal inception:

1. The specific purpose of the financing is one of the following:

a) Company purchase, through the acquisition of shares or the purchase of industrial assets or business unit, and/or

b) Capital distribution, such as dividends distributions, share buy-backs, repayment of subordinated debt, etc.

2. The borrower of the transaction has an internal rating below BBB-;

3. The borrower is not an SME;

	4. The borrower's "Total Financial Debt /EBITDA" leverage ratio is greater than 5 times and/or the borrower's "Net Total Financial Debt / EBITDA" leverage ratio is greater than 4 times; 5. All transactions will be subject to a commitment materiality threshold of €25m. **Particularities of the Spanish Banks** During the last decades, some Spanish Banks have developed part of their activities in jurisdictions located outside the European Union where, in some cases, they already have to meet with local requirements similar the one which the ECB is proposing to implement with this new guidance. Firstly, we are concerned that the draft ECB guidance establishes a definition of leveraged transactions based on specific thresholds (e.g. transactions above EUR 5 million, Total Debt to EBITDA ratio of 4.0 times, etc.). In our opinion, that definition is closer to a regulatory framework (i.e. with the objective of allowing or disallowing certain transactions) rather than a guide to supervisory expectations. In this sense, we are concerned that the draft text goes beyond being a guide and will instead result, for those credit institutions with subsidiaries in non-Eurozone area, in a double regulatory and reporting framework. Moreover, we also wish to stress that detailed specifications in the ECB guidance will not be helpful if they contradict regulations or guidelines in other jurisdictions that have different approaches.

		With all this in mind, **we consider that those aspects of this guide in conflict with local jurisdictions should not be applied to a subsidiaries located outside of the SSM area.**
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