

30<sup>th</sup> March 2016

To: European Securities Markets Authority

Attention: Verena Ross

Dear Ms Ross,

**Securities Financing Transactions Regulation (SFTR) – application to syndicated lending**

I am writing to you to raise concerns of the Loan Market Association (LMA) with respect to the potential application of the reporting requirements of the SFTR to the European syndicated loan market.

In particular, it appears that the definition of "margin lending" in the SFTR could mean that the reporting requirements of the SFTR apply to a wide range of syndicated lending transactions with corporate borrowers, including loans relating to the financing or refinancing of infrastructure and asset transactions, mergers and acquisitions (M&A) and corporate reorganisations, even though these transactions have little in common with the kinds of bilateral margin loans that were intended to be reported under the SFTR. We urge ESMA – in conjunction with the European Commission - to provide guidance interpreting the SFTR in a way that makes clear that the reporting requirements do not apply to these kinds of transactions. In any event, including syndicated loans of the kind discussed above within the SFTR reporting framework would present a number of challenges which would need to be addressed in the regulatory technical standards (RTS) under the SFTR.

I have copied this letter to Commissioner Jonathan Hill at DG FISMA.

**The Loan Market Association**

The LMA has as its key objective improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa (EMEA). By establishing sound, widely accepted market practice, the LMA seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.

As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

Since the establishment of the LMA in 1996, our membership has grown steadily and now stands at over 600 organisations covering 55 nationalities, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

## **The SFTR – margin lending**

The SFTR was published in the Official Journal at the end of December 2015. One of its principal objectives is to improve transparency to regulators of "securities financing transactions (SFTs)" by requiring the counterparties to SFTs to report SFTs to a trade repository.

During the course of the legislative process, the definition of SFTs was expanded to include "margin lending", defined as:

"a transaction in which a counterparty extends credit in connection with the purchase, carrying or trading of securities, but not including other loans that are secured by collateral in the form of securities."

This extension of the definition of SFTs was not the subject of public consultation or impact assessment.

It is clear that the definition was intended to cover traditional bilateral margin lending transactions in relation to securities, where a bank, investment firm or other lender extends credit to an investor to acquire or fund the holding of trading positions in securities and where the credit is secured on the securities financed, with provisions for margin calls where the value of the securities falls below some pre-agreed threshold in relation to the value of the securities (this purpose is confirmed by the defined term in the French and Spanish language versions of the SFTR: "opération de prêt avec appel de marge" and "operación de préstamo con reposición de la garantía").

This would be in line with the objectives stated by the Financial Stability Board (FSB) in "Transforming Shadow Banking into Resilient Market-based Finance - Standards and processes for global securities financing data collection and aggregation" (November 2015) which also proposed the extension of reporting requirements to margin lending transactions:

"Margin lending entails the provision of collateralised loans by a financial institution (usually a bank or a broker) to clients who are seeking leverage of their trading positions by borrowing money. The securities serving as collateral are held in margin accounts and are often re-hypothecated by financial institutions to fund the loans provided and eventually may reduce the cost of funding to the clients. In most jurisdictions, margin lending is included in the "prime brokerage" services provided to the client, based on a margin agreement between the financial institution and the client. For the purpose of the collection and aggregation of SFT data at the global level, the FSB would only focus on margin lending provided to non-retail clients as it may pose risks to financial stability similar to those of repos and securities lending."  
(page 15)

However, there is a risk that the SFTR definition of "margin lending" could cover a much broader range of transactions, including syndicated lending transactions to companies in connection with a wide range of transactions where all or part of the proceeds of the loan is used to acquire shares in companies (or to refinance previous loans made for those purposes). These transactions may involve financings of shares in unlisted companies in the context of privately-negotiated transactions, e.g. infrastructure or asset finance transactions, financings for the purchase of a group of subsidiaries or an intra-group reorganisation of activities. They may also involve financings of shares in listed companies in the context of public M&A (e.g.

"take private" transactions where the financing is for the purchase of all of the publicly traded shares with a view to de-listing the company). In some cases, the borrower will provide collateral including the securities financed but even where the loan is collateralised in this way it would be exceptional for the loan to include loan-to-value triggers for margin calls of the kind used in traditional margin lending or for the lenders to have the right to re-use the shares which are provided as collateral. In some cases, these transactions will involve a single lender but larger transactions at least will be syndicated so that many institutions (including banks, funds and other institutional participants) participate as lenders.

These transactions are an important part of the European syndicated loan market, where last year deal volumes totalled Euro1trio.

There is also a concern that the definition could apply even more broadly to cover loan facilities granted for general corporate purposes where the borrower chooses to make use of the loan to finance or refinance the purchase of shares in subsidiaries or other transactions involving securities.

Requiring borrowers and lenders to report these kinds of transactions to trade repositories will not serve the objectives of the SFTR. These transactions do not raise the kinds of systemic risks presented by securities financing transactions. Reporting these transactions would in fact undermine the objectives of the SFTR by requiring trade repositories to aggregate data on transactions that would obscure rather than illuminate the market's use of the securities financing techniques intended to be covered by the SFTR. Moreover, reporting syndicated loans of this kind to trade repositories would present a number of practical challenges which we discuss below.

In addition, introducing arrangements to manage the reporting framework may deter new categories of lender from participating in lending transactions and will increase the cost and complexity of corporate borrowing. This would run contrary to the EU's objectives of increasing the availability of finance to corporate borrowers.

We urge ESMA - in conjunction with the European Commission - to provide guidance interpreting the definition of margin lending in the SFTR in a way that makes clear that:

- The definition of margin lending only covers grants of credit in connection with the purchase, carrying or trading of securities where the credit granted is collateralised by a collateral arrangement over the securities that are financed - the definition should not be interpreted so as to apply to unsecured lending;
- The definition only covers loans where the primary or dominant purpose of the lender is to finance the purchase, carrying or trading of securities - the definition should not be interpreted to cover cases where the borrower uses a facility granted for general corporate purposes to finance the purchase, carrying or trading of securities;
- The definition does not cover loans to finance the acquisition of securities for the purposes of acquiring or increasing dominant influence or control over the issuer (or the holdings of securities which give dominant influence or control) or where the securities in question are not traded on a trading venue; and



- The definition does not cover loans where the collateral arrangements do not include a loan-to-value trigger for margin calls or any right to re-use the securities granted as collateral.

It is important that any interpretative guidance addresses each of the above elements in order to ensure that the SFTR reporting requirements do not apply to syndicated loan transactions of the kind discussed in this letter.

### **Challenges in reporting syndicated loans**

In any event, including syndicated loans of the kind discussed above within the SFTR reporting framework would present a number of challenges. For example, it would be necessary for ESMA to address the following in its RTS under the SFTR:

- The application of the reporting obligation to transactions with multiple borrowers or lenders (including the treatment of issues such as joint and several obligors). For example, the EMIR reporting framework assumes a bilateral transaction and does not allow for multiple parties to a single transaction.
- How the reports should address collateral charged to the syndicate as a whole (or a trustee or security agent for the syndicate) if individual lenders are submitting separate reports for their share of the loans (or individual borrowers are reporting the loans made to them).
- The timing of reporting e.g. whether it is triggered by the signing of the facility agreement or drawdown under it and the treatment of partial repayments (and whether the reporting relates to the amount of the commitment or the drawn amounts). The SFTR framework is not well suited to deliver this information as it is triggered by conclusion, modification and termination of transactions.
- The application of reporting in the context of assignments and novations of participations in syndicated loans. There is significant trading in loan participations which may include transfers of drawn or undrawn commitments. Borrowers are not directly involved in the assignment or novation process and may not be in a position to make new reports in respect of each lender.
- The method of reporting of multi-tranche and multi-currency facilities.
- The reporting of transactions where the securities are private company shares which may not have an ISIN (and the feasibility of obtaining ISINs for such securities).
- The timing, frequency and method of valuation of collateral, in particular in relation to collateral which does not have a ready market. Valuing shares in unlisted companies is difficult and expensive. The existing transaction document would usually not provide for the production of a valuation of the collateral either at the outset or on an ongoing basis.
- How to report collateral requirements, if required (an FSB data point) and haircuts in relation to these transactions.

- The inclusion (or not) in the report of additional collateral provided (even though the financing does not relate to the acquisition of that collateral) e.g. shares in holding companies or other companies.
- The reporting of interest rates and other fees and charges.
- How to report funding sources, if required (an FSB data point).
- How unique trade identifiers are to be created and agreed between the parties for loan transactions.
- The retroactive application of the reporting requirements to existing loan facilities if the transaction is still outstanding at the reporting start date or if a drawdown of the facility or the assignment or novation of a participation in the transaction triggers a reporting requirement.

We would welcome an opportunity to discuss these issues with you.

Yours sincerely,



Nicholas Voisey

Managing Director

