15 December 2023

Via e-mail to LL-CLOconsultation@iosco.org

The Board of the International Organization
of Securities Commissions
C/ Oquendo 12
28006 Madrid
SPAIN

Re: Public Comment on Leveraged Loans and CLOs – Good Practices for Consideration (IOSCO, September 2023)

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to comment on the International Organization of Securities Commissions' ("**IOSCO**") consultation report Leveraged Loans and CLOs – Good Practices for Consideration (September 2023) (the "**Report**"). We appreciate the efforts of IOSCO to engage with, and provide guidance to, market participants across the global leveraged loan asset class – from borrowers and their owners, to underwriters and arrangers who commit to and syndicate leveraged loans, to the credit funds and collateralized loan obligations ("**CLOs**") that buy leverage loans in the primary and secondary markets.

MFA represents over 170 alternative asset management firms, including hedge funds, credit and crossover funds that invest across a diverse group of investment strategies. We have a vital interest in ensuring that global leveraged loan markets remain robust, liquid, and transparent and that leveraged loan markets globally benefit from lessons learned from the past 15 years of development of the asset class in the United States. These markets are important because they allow lending institutions to provide the necessary capital to fuel economies. We appreciate the thought and effort that went into the Report. However, we are strongly concerned with the Report Measures. Markets are not static. We are concerned that the Measures will increase the cost of capital and availability of loans to businesses, including small and mid-size companies. This will harm their ability to expand or operate, and negatively impact jobs and innovation and the real economy.

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[1] Managed Funds Association ("**MFA**"), based in Washington, D.C., New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

Executive Summary

MFA appreciates the thought and effort that went into the Report. We believe, however, that the Measures are unnecessary and, in many instances, would be harmful to the availability of loans to real businesses. MFA provides the following commentary on the **Measures** and Questions set forth in the Report. We've divided the IOSCO **Measures** and Questions into the following 3 general categories –

1. One-size fits all "solutions" may have unintended market consequences. To be clear, the Report does identify many important credit risk items that arranging financial institutions and leveraged loan buyers should carefully consider when evaluating deals. However, MFA believes that untailored rules may interfere with the liquidity of the leveraged loan market.

2. Market dynamics have been generally sufficient to alleviate substantial concern. The scope of information provided to potential loan buyers as well as key flexibility provisions and covenant terms within leveraged loan documentation have largely been a function of the relative bargaining power between borrowers and loan buyers. For the past 15 years, with the expansion of the CLO market and a large increase in the investable capital allocated towards the leveraged loan market, as well as the search for incremental yield in a low-interest rate environment, borrowers (and their private equity ("**PE**") sponsor owners) have had the upper hand. Documents have become looser and more flexible. However, with relatively few – albeit high profile – exceptions, credit structures within the asset class have performed as expected. Where egregious flexibility has led to perceived "bad" outcomes, market-based solutions have been included in documentation to preserve the expectations of loan buyers.

3. Existing regulatory frameworks provide adequate investor protection and additional, overlapping regulatory frameworks may cause inefficiencies. The imposition of interlocking and overlapping regulatory requirements on well-functioning financial markets often leads to unintended and negative consequences. In general, MFA believes where a regulator already has primary responsibility over a category of participants in a market, adding further layers of regulatory complexity will not be beneficial to investors or the efficient functioning of the leveraged loan markets.

The leveraged loan market is functioning well, and the terms are driven by basic supply and demand principles and negotiations between sophisticated parties. If certain terms, documentation, and information are viewed as critical, investors will demand them. Market participants have sufficient bargaining and negotiating power to fend for themselves. A broad-based regulatory "fix" of the leveraged loan market is not needed – the market simply is not broken.

Background

Our response is guided by three general principles: First, with tremendous growth in the U.S. leverage loan market over the past two decades, market practices have evolved to a point where there is consistency across underwriting, marketing and documentation processes. The market has thrived, with minimal regulatory intervention, by self-organizing around widely accepted principles and documentation, particularly Loan Syndications and Trading Association forms. Best practices have developed around loan syndication, deal documentation and loan trading. Underwriting banks that arrange leveraged loans provide investors with marketing materials that highlight important borrower information, including current financial information such as earnings before interest, taxes, depreciation, and amortization ("**EBITDA**") and EBITDA-based credit statistics, and a detailed financial model of the borrower. Potential lenders are provided with detailed termsheets that summarize the underlying loan documentation and material deal terms. Loan documentation typically includes incurrence-based negative covenants and no financial maintenance covenants as the leveraged loan documentation has evolved to more closely mirror traditional high yield bond covenant packages. Secondary trading markets are relatively liquid. In general, the leveraged loan market has become more transparent and more liquid and both MFA and its members find the market to be relatively straightforward to navigate.

Second, loan documentation continues to evolve based on basic economic principles of supply and demand, as well as the changing expectations of parties and, while not perfect, has generally served the loan industry well. Unlike in the London market, where loans typically follow the Loan Market Association "form" credit agreement, in the U.S. leveraged loan market, credit documentation tends to be PE sponsor- (or borrower-) specific. PE firms, in general, have form credit agreements that they use across their portfolio companies – and these forms have tended to become looser over time. EBITDA definitions are long and arguably too permissive with add-backs, but they are understandable. Financial covenants are few and far between. Supply and demand principles drive substantive differences in loan documentation – deals that have high demand will benefit from looser covenants. Deals that struggle to clear will have the opposite. This is not a "bad" result, as high demand often results from the borrower being a better-quality credit. Despite these documentation limitations and challenges, true "surprises" are rare. When unexpected events do happen (*i.e.*, the Chewy, JCrew, Serta, etc. transactions)[2],

[2] "Chewy," "JCrew" and "Serta" refer to a handful of liability management and other corporate reorganization transactions consummated by PE-backed borrowers. In "Chewy," the borrower (PetSmart) distributed a portion of the stock of its Chewy subsidiary to an affiliate, resulting in the release of the Chewy subsidiary from the guarantee and collateral provisions of the loan documentation. So, while the "Chewy" subsidiary remained wholly owned by the PE sponsor, it was not a wholly owned subsidiary of the borrower and therefore no longer provided direct credit support for the loans. In "JCrew," the borrower took advantage of a loan documentation irregularity to contribute valuable intellectual property rights to an 'unrestricted subsidiary' that did not provide credit support to its secured lenders, and then borrowed additional 'priming' debt at the intellectual property-owning subsidiary. In Serta, the borrower conducted an 'uptier' transaction that was a combination of (1) subordination of debt of existing secured lenders and

market solutions develop quickly, and investors look for inclusion of these "fixes" at the termsheet stage of syndication.

Third, the universe of borrowers able to access the leveraged loan market has evolved from mostly industrial, asset-heavy businesses with significant histories of stable cash flows to include asset-light, high growth companies that will need substantial increases in revenue and EBITDA to "grow" into their capital structures. Across this spectrum of borrowers, "one size fits all" solutions across the leveraged loan asset class are unlikely to be effective and are likely to have unintended, negative consequences. MFA cannot support broad-based, poorly tailored regulatory approaches that threaten the liquidity of the leveraged loan markets.

Comments

A. One-size fits all "solutions" may have unintended market consequences

The Report's **Measure 1** (Debt repayment capacity test)[3] suggests implementation of a market requirement that would limit a borrower's debt capacity (considering funded loans as well as unfunded commitments) based on its ability to repay 100% of senior debt or 50% of total debt over the life of the loan. **Measure 1** also suggests that debt repayment capacity based on the borrower's financial projections should be disclosed in the termsheets. MFA does not believe additional market regulation on this point is required and that a "bright line" amortization requirement would not be reflective of the wide differences in the credit profiles of borrowers across the asset class. The percentage of needed amortization for a specific borrower is a function of enterprise value, growth trajectory, industry, consistency of earnings and cashflows, etc. – and sophisticated market participants may have differences of opinion on how much debt repayment is "sufficient." The amortization requirement suggested in **Measure 1** is consistent with the US Interagency Guidance issued by the Federal Reserve and the OCC in 2013, which also imposed a bright-line test on regulated financial institutions participating in the underwriting or arrangement of transactions in which the borrower's total leverage exceeded 6.0x last twelve months ("**LTM**") EBITDA. Importantly, by 2018, compliance with the US Interagency Guidance was no longer

(2) an exchange or repurchase of all or a portion of the existing debt of the majority holders who approved the subordination transactions. In response to these transactions, buy-side participants have insisted upon the inclusion of "blocker" provisions in leveraged loan documentation and a review for these blocker provisions has become common practice.

[3] Leveraged loans offered to the market in both new originations, debt refinancings and debt restructurings should be underpinned by sound business and financial risk assumptions. Borrowers should be able to demonstrate sufficient debt repayment capacity. An adequate debt repayment capacity is considered the ability to repay 100% of senior debt or 50% of total debt over the medium term. For example, some regulatory agencies and other market practitioners measure the debt repayment capacity test over a 5-to-7-year period. Where this is not evident, a credible explanation should be provided. It is also considered good practice to disclose debt repayment capacity in term sheets and supporting documentation at the time of debt offering and refinancing. A robust assessment of cash flows including stress testing should inform debt repayment capacity assessments.

required, with one reason being that the 6.0x leverage ratio limit was seen as arbitrary and not necessarily reflective of the industry-based differences across leveraged loan borrowers. While transactions and capital structures that do not project sufficient cash flows to pay down debt deserve additional investor scrutiny, MFA does not believe that bright-line tests are needed or beneficial to the functioning of the leveraged loan markets. Likewise, MFA does not believe that the current marketing and origination regime for leverage loans is deficient in terms of disclosure of amortization ability and debt repayment capacity. Marketing materials typically include the borrower's financial projections – and from this financial model, potential lenders can easily calculate total cash flows available for debt service and the borrower's ability to pay down the loans.

Question 2[4] expands on **Measure 1** and asks whether disclosures of debt repayment capacity should consider the impact of incremental borrowings permitted under the covenants in the loan documentation. MFA believes this would be extremely confusing as it would require consideration of future incremental borrowings that are not in the borrower's base case financial model. This would also require assumptions about use of proceeds from incremental borrowings (*i.e.*, are the borrowings used for acquisitions, which would generate additional EBITDA and cash flow available for debt service, or for dividends, which do not) and the characteristics of the incremental debt (fees, coupon, etc.). Again, MFA acknowledges the concerns about creating "zombie" borrowers[5] that can stagger along, over-levered, for years. However, deals with "too much" leverage are almost never a result of incomplete disclosure or the market's inability to understand projected future cash flows.

Measure 3[6] (Enterprise Values) suggests a need for both a standard methodology for calculating enterprise value ("**EV**"), as well as disclosure of the lead arranger's key assumptions. While MFA agrees that a borrower's enterprise value is a key component of any credit analysis, MFA does not believe that mandating a standard EV methodology would be beneficial to leveraged loan market participants. Valuation methodologies are often more art than science, and different market participants may place greater or lesser value on any specific methodology.

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[4] Question 2 reads: Should there be a further debt repayment capacity test based on permissible incremental debt and if so, should incremental cash flow generated from the incremental debt (if applicable as some incremental debt is used to pay out a dividend) also be included?

[5] Business Insider, October 29, 2018. https://www.businessinsider.com/zombie-firms-statistics-on-low-interest-rates-and-leveraged-loans-2018-10.

[6] Measure 3 reads: The calculation of EVs which support the capitalisation structures of LBOs should be based on a well-constructed financial model. Underwriting entities are encouraged to clearly disclose the key assumptions underpinning the financial model. It is good practice that any EV model (DCF or otherwise) is reviewed and validated by a function independent of the origination unit. Where possible, the basis for EV should be under-pinned by multi-year forecasted cashflows and not based only on comparable multiples of EBITDA derived from other LBO transactions. It is good practice that DCF valuations which are heavily influenced by terminal values extrapolated from final year forecasted cashflows be credible and challenged.

Enterprise value methodology preference may vary by borrower size, industry and the availability of comparable credits and capital structures. Therefore, while MFA does agree that an EV calculation is a key component in the analysis of any leveraged loan borrower, any bright line rule requiring disclosure of a specific EV methodology is not likely to benefit the market as a whole. Likewise, Question 6[7] asks whether disclosure of the arranging banks' assumptions and model inputs would be beneficial to the market. Again, MFA does not believe that this type of requirement is likely to benefit market participants, many of whom perform their own sophisticated credit analysis. It should be noted that the arranging banks' underwriting model may include risks and other downside assumptions that are inconsistent with the borrower's base case model.

MFA believes the current U.S. leveraged loan market practice – borrowers provide potential lenders with detailed historical financial information and management projections – are appropriate. Additional market regulation proposed by Question 7[8] (termsheet disclosure of enterprise values) and Question 8[9] (requiring EVs based on multi-year cash flow forecasts) are not likely to substantially improve the overall mix of financial information available to potential lenders in any transaction. In fact, the idea from Question 7 that EV/EBITDA multiples should be disclosed on the basis of anything other than LTM pro forma Adjusted EBITDA (which is the market convention) would likely generate substantial confusion amongst potential investors. Marketing materials are typically consistent in that EBITDA is always presented on a fully-adjusted basis, consistent with the credit documentation. Mandated disclosure of multiple calculations of EBITDA or EVs are not likely to improve the mix of available information.

B. Market dynamics have been generally sufficient to alleviate substantial concern

MFA recognizes that regulatory oversight can play a key role in investor confidence in an asset class. At the same time, market forces and the interplay between market participants – borrowers/equity owners, underwriting/arranging financial institutions and leveraged loan buyers – have caused an evolution in the arranging, syndication, and documentation for leveraged loans. In general, MFA believes that potential buyers are provided with robust financial information and disclosures as part of the loan marketing process and that documentation typically is appropriate to address most lender concerns. Where supply/demand imbalances favour the borrowers, loan documentation becomes looser. This is a trend that was seen in the market generally from the

[7] Question 6 reads: Would a clearer disclosure of the arranging banks' calculation of the borrower's EV, including high level methodology (*i.e.*, Discounted Cash Flows / Income Method, Asset Valuation, Market Based etc.) and key underlying assumptions (*i.e.*, EBITDA adjustment and total debt) assist investors to make more informed decisions?

[8] Question 7 reads: Should EV to EBITDA multiples be highlighted in term sheets and on which basis of EBITDA *i.e.*, proforma, adjusted, historic or forward looking?

[9] Question 8 reads: Do you agree that the basis for EVs should be under-pinned by multi-year forecast cashflows and not simply based on multiples of EBITDA comparable in other acquisitions or buyouts?

aftermath of the Great Financial Crisis until the outbreak of the COVID-19 pandemic. Since the beginning of 2021, with the combination of global conflicts and rising interest rates disrupting supply, terms have gotten tighter, albeit only by a small amount.

With this in mind, Question 1[10] proposes additional disclosure requirements in marketing materials that would more clearly calculate cashflow available for debt service and then debt paydowns. MFA does not believe this is necessary and that investors have become familiar and comfortable with the format and content of leveraged loan marketing materials. Projected cash flow available for debt service is easily calculated from the borrower's base case financial projections that are virtually always provided to private side investors. Most investors use this base case model as a starting point in their credit analysis – and then add additional assumptions on revenue growth, expense management, etc. – to come up with individualized credit views. If anything, adding this sort of "approved" cash flow projections to the termsheets might be confusing (at best) and might have the unintended consequence of certain investors no longer taking the important step of sensitivity-testing borrower financial models.

Question 3[11] and **Measure 2**[12] (Dividend recaps) both address topics that, at first glance, appear to be "hot button" issues for the leveraged loan market – namely, the lack of financial covenants in leveraged loan documentation and the use of leveraged loans to fund equity dividends. While mandated inclusion of a financial maintenance covenant in loan documentation and limitations on debt-financed equity distributions would arguably be beneficial for buyers of leveraged loans, MFA does not believe that regulatory intervention into highly-negotiated deal terms is necessary or appropriate for the leveraged loan market. As the asset class has developed over the past 15 years, there is no question that leveraged loan documentation has become looser and more borrower-favourable. At the same time, the asset class has grown tremendously, the number of market participants has increased, and the market has become more liquid and transparent. Regulatory "fixes" that would impose financial covenants in leveraged loans or limit the use of loans to fund distributions would likely have a significant negative impact on loan volumes.

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[10] Question 1 reads: Would a consistent debt sustainability disclosure within the term sheet based on the borrowers' base case cash flow modelled projections assist investors during the negotiation and investor assessment phase? Should this debt repayment capacity test disclosure be based on 2 measures: both total committed and total funded debt?

[11] Question 3 reads: To what extent should debt repayment capacity be linked to a financial covenant in a loan document and how should this be constructed? Does a debt service ratio covenant need to be reintroduced into loan documentation or adapted to measure debt repayment capacity test?

[12] Measure 2 reads: Dividend recapitalisations should be considered with reference to the level of remaining equity support, degree of leverage and debt repayment capacity. The use of incremental debt to affect a dividend recapitalisation should be limited. In addition, borrowers are encouraged to clearly disclose dividend distribution policy and strategy.

To more specifically address certain concepts set forth in **Measure 2** and Question 4[13], MFA does agree that remaining equity, total leverage, and free cash flow available for debt service are all relevant metrics in evaluating the use of debt to finance an equity distribution. However, the relative importance of each measure will vary based on EBITDA size, total enterprise value, business cyclicality, etc., so it would be difficult to create a single rule that would work well in all situations. Likewise, the market has accepted the independent functioning of covenants in leveraged loan documentation – for example, most debt covenants do not condition or limit the incurrence of debt based on the proposed use of proceeds. Question 5[14] addresses another topic on which there is clear market practice – while existing lenders are never required to participate when a borrower incurs incremental term debt, a debt-financed dividend does not give existing lenders the automatic right to exit a loan. **Measure 2** and Questions 3, 4 and 5 all suggest regulatory approaches and credit improvements that, on an individual deal basis, would benefit buyers of leveraged loans. Yet these changes would fundamentally change the attractiveness of the leveraged loan market as a source of capital, particularly for PE-backed borrowers. Any disruption to the status quo would likely be disruptive to the leveraged loan market in general and may reduce the availability of vital loan financing to private companies, so MFA cannot support this sort of regulation.

Measure 4[15] (EBITDA complexity and opacity) addresses an issue that has long been of concern to participants in the leveraged loan market – adjustments to EBITDA definitions, as well as the growing complexity and increasingly permissive nature of the addbacks. Core principals of **Measure 4** are unassailable – EBITDA definitions should "avoid unnecessary complexity" and adjustments "should be made on a reasonable basis." Yet the value of additional regulation and bright-line rules around financial adjustments and definitions is less clear. Caps on cost savings and synergies add-backs, as well as temporal limitations on realization periods for savings – while not in every deal, are common market practice[16]. While the Report correctly cites data that borrowers often fail to achieve management projections given to participants during the loan syndication process, it's not clear that oversight of the drafting of

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13 Question 4 reads: Should limitations be placed on the ability to effect debt-financed dividend recapitalisations *e.g.*, based on minimum equity, total leverage, debt repayment test?

14 Question 5 reads: Should dividend recapitalisations only be permitted based on an initial origination or full debt refinancing (and not be permitted using incremental facilities in which all existing loan investors may not wish to participate)?

15 Measure 4 reads: EBITDA definitions should avoid unnecessary complexity. Pro-forma EBITDA adjustments based on future synergies, earnings and asset disposals should be made on a reasonable basis and borrowers are encouraged to provide clear justifications of these adjustments to investors. Borrowers are encouraged to subject forecasted cost savings and synergies to prudent time horizons and caps. Underwriting entities are encouraged to subject all EBITDA adjustments to independent review by an appropriate second line control function as part of the underwriting process with periodic back-testing thereafter.

16 For this reason, MFA believes that market evolution and market dynamics are sufficient for the setting of appropriate caps and temporal limitations raised in Questions 10 and 11.

financial definitions will fix this problem. Moreover, **Measure 4**'s suggestion that borrowers be required to detail and justify add-backs runs contrary to a broader theme of the leveraged loan market – that leveraged loan documentation is precedent-based, and once a type or category of add-backs has been widely accepted in the leveraged loan market, it is rare for these items to receive substantial pushback from the buyside community. The suggestion in Question 9[17] that some of these concerns could be alleviated by requiring disclosure of a "less-adjusted" EBITDA figure (*i.e.*, a "more prudent" EBITDA figure that eliminates the impact of certain synergies or cost savings) sounds good as a theoretical matter. Yet MFA believes that there is greater value in consistency in documentation and marketing materials as it relates to key financial definitions. The current practice of using fully-adjusted EBITDA as the basis of all ratios and credit metrics, where the disclosed statistics align with the financial definitions in the loan documentation, provides market participants with the greatest clarity. Disclosure of multiple versions of EBITDA will only lead to confusion and is something that borrowers and arranging financial institutions attempt to avoid, on the theory that buy-side market participants are free to scrutinize and make their own internal calculations of EBITDA as part of their individualized credit analysis.

Measure 5[18] (Transparency on covenants' limitations) proposes changes that would shift the burden of understanding credit risks from buyers of leveraged loans to borrowers and the underwriting banks that arrange leveraged loans. MFA certainly agrees that termsheets should be accurate and disclose material credit / risk points and agrees wholeheartedly that termsheets be "written and presented in a clear, concise and effective manner that can be readily understood by the contracting parties." Incremental debt capacity and the ability to shift collateral assets away from the lenders are fundamental credit points that should be, and, for the most part, are, disclosed in syndication materials. However, MFA disagrees that the onus should be on

[17] Question 9 reads: What key disclosures would assist market participants to come to a more accurate view of pro-forma EBITDA and projected leverage (*e.g.*, what key assumptions should be disclosed in relation to pro-forma adjustments, should there be a disclosure of a more prudent pro-forma adjusted EBITDA with the exclusion of synergies and costs savings)?

[18] Measure 5 reads: It is good practice for material covenants and associated terms contained in term sheets and loan documentation to be written and presented in a clear, concise, and effective manner that can be readily understood by the contracting parties, including under what circumstances covenants can be triggered.

Where relevant, industry participants are encouraged to consider best practice guidance for transparency when drafting key marketing materials (*e.g.*, term sheets). It is good practice for borrowers and underwriting entities to provide marketing materials that clearly disclose key terms that could materially impact a borrower's credit risk, including terms that could result in subordination, structural or otherwise, of lenders. In this regard, it is considered good practice to provide clear disclosures of the quantity of incremental debt and associated baskets that can be raised and the ability to move assets beyond the reach of the lender group.

Detailed disclosures of key risks including documentation risk, through a risk factors disclosure, could be provided in a loan document.

borrowers and/or arranging banks to explain risks or include risk-factor type disclosure, a practice that is highly unusual across financial markets (other than securities offerings where the U.S. securities laws apply). Most market participants find the current marketing materials to be accessible and reasonably fulsome to understand key credit points. A wide range of service providers provide general market commentary, as well as detailed feedback on specific transactions, for those potential buyers with less familiarity with customary leveraged loan market terms. In addition, required disclosure of subjective items like "total capacity" under a specific covenant would necessarily require judgments about how certain covenant provisions would likely be used in combination – and these disclosures would likely cause more confusion, rather than less.[19]

Measure 6[20] (Transparency and fairness during underwriting and syndication) is directed at solving two "problems" in the underwriting and syndication process that MFA does not believe pose actual risks to the leveraged loan market. It is difficult to argue with the first principal set forth in the Measure, which supports providing "sufficient and clear information" to investors, who should be provided with "sufficient time and a fair opportunity to negotiate and to make well-informed investment decisions." Yet, in discussions with MFA's members, opacity of marketing materials or abbreviated timelines for investment decisions rarely are raised as key topics of concern. Without a real "problem" to solve, MFA has concerns with supporting the need for regulatory action on this topic. Likewise, the Measure dives deep into the internal credit processes of the underwriting financial institutions – with the implication that if banks have more time to review commitment papers and long form loan documentation, they will make better credit decisions and bring better deals to market. For the most part, arranging financial institutions are advised by well-known law firms and have substantial familiarity with the key issues in loan documentation. The implication that the banks aren't aware of what's "hidden" in the documents is, in MFA's view, a flawed assumption and appears unnecessarily parochial. The second core principle of the Measure is guided towards arranging banks having

[19] This response also addresses Questions 12 and 13, where MFA does not have additional recommendations.

[20] Measure 6 reads: Underwriting entities are encouraged to:

- provide sufficient and clear information to investors early in the syndication process with the aim of achieving a fair and efficient market in which investors have sufficient time and a fair opportunity to negotiate and to make well-informed investment decisions.
- review the full loan documentation thoroughly before signing the commitment letter and engage in negotiation so that they are satisfied that the risk posed by a failed syndication is within their risk appetite.
- provide anonymised feedback on investors' documentation points to all investors in a transparent way.
- highlight to investors new flexibilities built into loan documentation as well as those which have previously faced opposition from the investor base.

responsibility to give investors a summary or roadmap on perceived problems and/or weaknesses in the loan documentation. While, in theory, this could benefit certain buyside investors, MFA cannot agree with a regulatory approach that would shift the burden of understanding key loan documentation points away from buy-side market participants and place this onus on the arranging financial institutions to summarize and, more fundamentally, explain credit risks to their buy-side clients. Such an approach – which would require highlighting key documentation points and explanations of risk and credit points in the documentation – would be highly unusual in sophisticated financial markets.

Questions 14[21] and 15[22] attempt to solve more "problems" with which MFA and its members do not have significant concerns. While MFA fully supports giving investors sufficient time to review termsheets as well as definitive documentation, hard deadlines for delivery of termsheets and long-form documentation are unnecessary, as MFA and its members are generally comfortable with current market practices in this area.

Measure 8[23] (Reducing restrictions on transferability of loans) is an area of particular concern amongst MFA and its members. Free transferability of loans is a key feature that has allowed the leveraged loan asset class to grow and benefit from substantial liquidity. In the U.S. markets, the use of disqualified lender ("**DQ Lender**") lists is common, and these are typically provided to the syndicate prior to transaction closing. Where problems have arisen in the context of specific transactions, it has most often been a result of documentation inconsistencies that have allowed borrowers broad flexibility to expand the DQ Lender list in a manner that severely impacted market liquidity for the applicable loan tranches. MFA is supportive of efforts by both arrangers and loan buyers to resist too much flexibility to expand the DQ Lender list beyond its initial intention – competitors of the borrower and a short list of lenders with whom the borrower or its owners have had contentious relationships in similar transactions. At the same time, the Measure suggests institutions only be added to DQ Lender lists based on "clear and documented reasons," which sounds reasonable as a theoretical exercise, but we question whether borrowers and their PE sponsor owners could ever be comfortable of detailed disclosure of the circumstances that led to the placement of a lending institution on such a list.

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21 Question 14 reads: Do you agree with the proposed good practices outlined in Measure 6 regarding circulation of a comprehensive term sheet no less than 48 hours before the bank meeting?

22 Question 15 reads: Do you agree with the proposed good practices regarding time for underwriting entities (minimum 2 weeks) and investors (minimum 5 days) to review the full loan documentation?

23 Measure 8 reads: Transferability of loans within a pool of potential investors should be as broad as possible to support a liquid secondary market. It is considered good practice that where lists of approved and disqualified lenders are used, they should only be created based on clear and documented reasons. It is expected that investors be provided with transparency early in the syndication process on transferability restrictions and how these might evolve during the life of the loan. It is expected that investors are provided with sufficient clarity on the precise definition of an event of default, which will cause limitations on transferability to no longer apply.

Measure 9[24] (Managing conflicts of interest where PE sponsors also act as lenders) takes a two-pronged approach to the often interlapping roles that PE sponsors may have in the capital structure of their portfolio company borrowers. First, MFA agrees that disclosure of potential conflicts caused by a PE sponsor's participation in different tranches of the capital structure is appropriate – but that it is also customary market practice. Second, the Measure supports current market practice towards disenfranchising PE sponsors and their affiliates who become lenders under the credit agreement – and again, MFA is supportive of current market practice in this area. However, both the Measure, as well as Question 23,[25] also seem to call for a new type of lender-protection that is rarely seen in the leveraged market. Outside of the customary "affiliate transactions" covenants, which attempt to limit value-leaking transactions between the borrower and its owners, most leveraged loan documentation does not limit the identity of the permitted counterparties for each basket and covenant exception. If a debt basket is available for the Borrower to use, the borrower is free to source that debt from any party, including one of its owners. While MFA does note the unique, and sometimes troublesome issues posed by PE sponsor participation at different levels of a borrower's capital structure, this is not a significant enough issue to MFA or its members that we would support such a radical change to loan documentation that would require a basket-by-basket and exception-by-exception analysis of the loan documentation to determine permitted counterparties for each one.

Finally, **Measure 12**[26] (Disclosure on underlying loans) addresses the provision of post-closing financial and other disclosures to members of the lending syndicate. Again, this is an area where MFA believes that current market practice is generally sufficient and the need for regulator intervention is low. Investors typically receive audited annual financial statements as well as quarterly financials with footnotes, with the provision of management discussion and analysis of financial condition and result of operations reports and/or the ability to participate in conference calls with management being common, but not universal, practice. While MFA strongly encourages and values the provision of robust and accurate disclosures to lenders, both

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[24] Measure 9 reads: Conflicts of interest which can arise from a group's investments in different parts of a borrower's capital structure, should be appropriately identified and managed. It is expected that participants in a syndication and LL investors be properly informed of the instances where a group is acquiring the debt of a borrower while also acting as the borrower's sponsor or holding other classes of debt of that borrower. In such cases, the use of a sponsor disenfranchisement clause or similar clause is encouraged.

[25] Question 23 reads: Do you agree with the proposed good practice to mitigate conflicts of interest which may arise from PE groups investing in the debt and equity of the same borrower?

[26] Measure 12 reads: LL borrowers are encouraged to provide their investors on a timely basis with their latest financial information and status, for example, the audited financial statements, periodic management financial information and financial forecast and budget in relation to its business plan. LL borrowers are also encouraged to inform their investors within a reasonable timeframe of occurrence of any events that may invalidate any assumptions originally applied in the EBITDA addbacks (including any activities that are outside the normal course of business) and potential implications and impact on the projected EBITDA.

before and after syndication, this is not a topic where MFA believes market-wide bright line rules will sufficiently benefit market participants.

C. Existing regulatory frameworks provide adequate investor protection and additional, overlapping regulatory frameworks may cause inefficiencies

In **Measure 7**[27] (Alignment of interest between underwriting entities and investors), the Report suggests various means to encourage the financial institutions that arrange and underwrite leveraged loans to have greater alignment of interest with leveraged loan buyers. MFA recognizes that there is inherent tension in the leveraged loan market, where loans are arranged and sold by the regulated investment banks who have a distribution-based business model. U.S. investment banks are already subject to a significant set of regulations, many of which have been strengthened since the Great Financial Crisis of 2008-09 to minimize risk taking and ensure greater financial stability across markets. Implementation of significant risk-retention frameworks, where investment banks are required to retain a portion of the loans that they distribute, would fundamentally change the business model for arrangers of leveraged loans. MFA believes this type of regulation would disrupt current market practice and could have the effect of decreasing the availability of credit to the real economy, with significant implications for small and mid-sized businesses, employment, and innovation. **Measure 7** also raises the use of "designated lenders' counsel" for underwriting and arranging financial institutions as a source of market risk. However, MFA believes that, with few exceptions, the law firms that operate in this space are well known to the investment banks and that this relationship has not had a material impact on leveraged loan documentation – the deterioration of loan terms over the past decade is more a function of the market's supply/demand imbalance favoring borrowers, rather than a result of choice of counsel for the arrangers.[28]

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[27] Measure 7 reads: Underwriting entities are encouraged to demonstrate how they have aligned their interests with LL investors, through risk retention or other means. Implementation of robust risk management of leveraged lending activities can strengthen alignment of interests as well as prevent the build-up of systemic risks. Underwriting entities and LL investors are encouraged to obtain independent and impartial legal advice which represents their interests and strengthens their ability to negotiate loan terms and influence market evolution.

[28] This response also addresses Questions 17 – 20, where MFA does not have additional recommendations.

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In a similar vein, **Measure 10**[29] (Managing conflicts of interest in management of CLOs) and **Measure 11**[30] (Disclosure in CLOs) question whether additional rulemaking to encourage more fulsome disclosure on conflicts and portfolio performance would benefit the CLO market. The CLO market is broadly regulated by the securities laws and the Securities and Exchange Commission ("**SEC**"), and the recommendations posed by IOSCO are clearly within the SEC's mandate. Given the strength of the CLO market and the role of an already-watchful regulator, MFA does not believe that adding additional layers of regulation will benefit CLO investors, the leveraged loan asset class more broadly, or the real economy.[31]

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MFA believes that the leveraged loan market in the United States should be a model for other leveraged markets across the globe. While there is always room for improvement, the U.S. leveraged loan market has been, with limited exceptions, transparent, efficient, and liquid. Care should be taken with future regulatory approaches that any proposed rules or policies enhance and supplement the well-functioning market dynamics that have developed over the past 20 years.

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[29] Measure 10 reads: Potential conflicts of interest in the management of CLOs should be appropriately identified and managed. It is expected that policies governing the purchase of distressed assets, cross-sales and trading / valuation of CCC/Caa rated loans and the related policies be clearly set out in a CLO indenture to enable investors to make an informed investment decision. It is considered good practice that trustee reports regularly disclose the trading activity and valuation of assets of a CLO to enhance transparency to investors.

It is considered good practice that investors are provided with sufficient opportunity to conduct due diligence on the valuation methodology and results produced by the CLO manager and assess the strategy and rationale for management of assets when performance tests are at risk of being breached.

[30] Measure 11 reads: CLO investors should be provided with all materially relevant information on the valuation, credit quality and performance of the portfolio of a CLO, consistent with jurisdictional regulatory requirements. It is expected that such data is made available on a regular basis (*e.g.*, monthly) to CLO investors for them to make an informed judgement of their investment decisions and that potential CLO investors be provided access to such information upon request.

[31] This response also addresses Questions 25 and 26, where MFA does not have additional recommendations.

MFA would be more than happy to elaborate on the points contained in this letter, should IOSCO wish to engage in further conversation. If you have any questions regarding this letter, or if we can provide further information, please do not hesitate to contact Jeff Himstreet at jhimstreet@managedfunds.org or the undersigned at jhan@managedfunds.org.

Respectfully submitted,

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