

MEMORANDUM

To: File No. S7-16-15

From: Jill S. Henderson
Counsel to Commissioner Kara Stein
U.S. Securities and Exchange Commission

Date: April 28, 2016

Re: Meeting with representatives from the Loan Syndications and Trading Association

On April 27, 2016, Jill Henderson and David Bartels met with R. Bram Smith, Meredith Coffey, and Elliot Ganz of The Loan Syndications and Trading Association, and Scott Baskind of Invesco. Topics discussed included the Commission's proposal on liquidity risk management programs.

Attachment: LSTA, U.S. Syndicated Loans and Loan Mutual Funds

U.S. Syndicated Loans and Loan Mutual Funds

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Meeting Topics

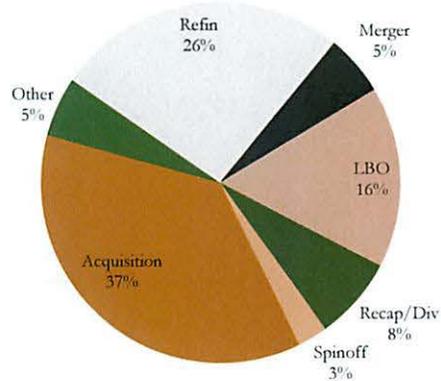
- Loan Market Background
 - Loan market borrowers, trends and investors
 - How characteristics impact secondary prices, liquidity
- Loan Settlement
 - Settlement times
 - Industry efforts and standardization
- Appendix:
 - Loan Market Characteristics
 - August 2011 Case Study

The Non-Investment Grade Loan Market: Who the Borrowers Are, What They Use Loans For

Who Uses Non-investment Grade Loans?
(Among Others)



What 2015 Non-investment Grade Loans Were Used For

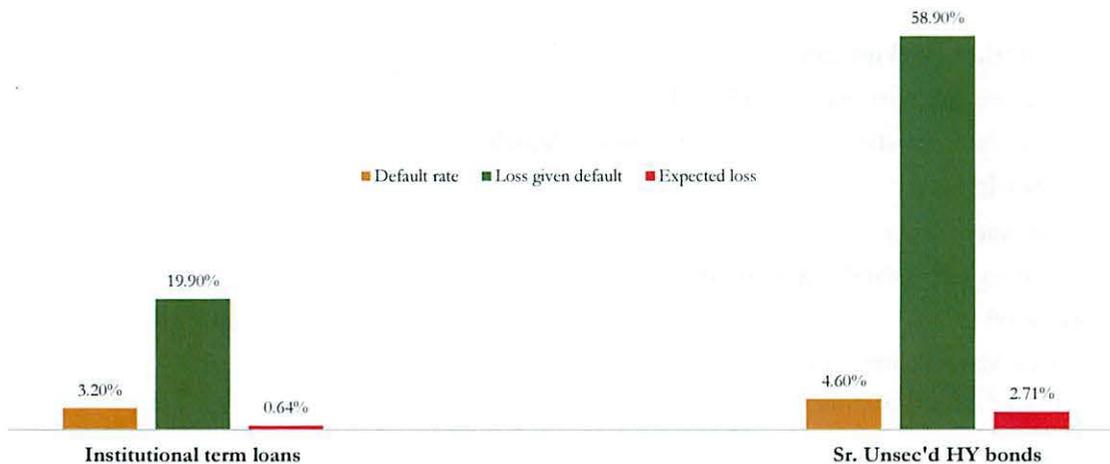


- Non-investment grade lending, which funds many well-known US companies, totaled \$421 billion in 2015
- Non-investment grade loans are used by companies for many different purposes



Why Investors Like Institutional Term Loans

Losses Low on Secured Loans, Higher on High Yield Bonds

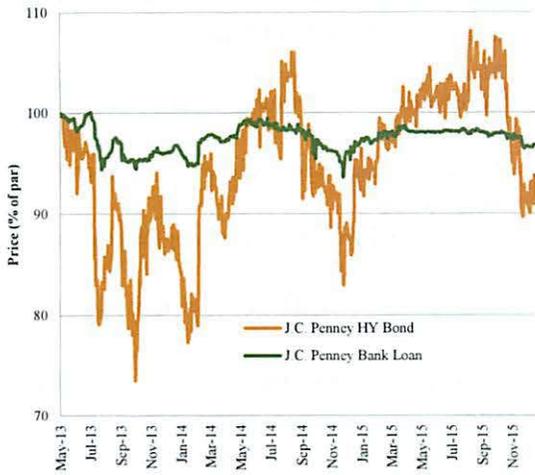


- Loans are senior and secured, thus have a low loss rate
- Loan repayment rates are high, averaging 2.7% per month since 2001
- Loans are floating rated (based over LIBOR), so interest rate risk is minimal

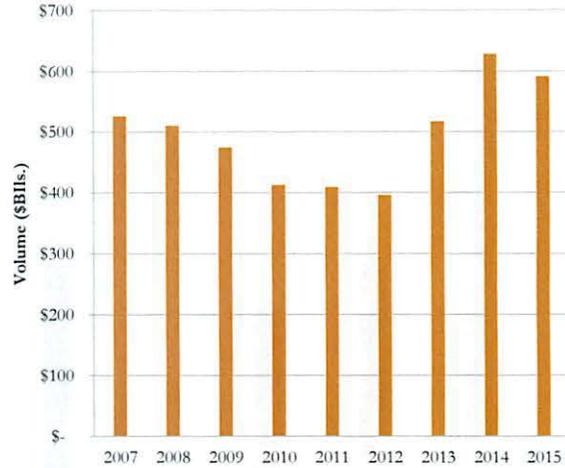


Loan Characteristics Generally Lead to More Stable Secondary Prices

JC Penney's Loan and HY Bond Prices in Secondary Market



Annual US Loan Trading Volume



- Because loans are senior and secured, they trade down less if credit quality deteriorates
- Because loans are floating rate, they have limited interest rate risk and the price does not move substantially due to changes in interest rates
- US loan trading exceeded more than \$500 billion in each of past three years

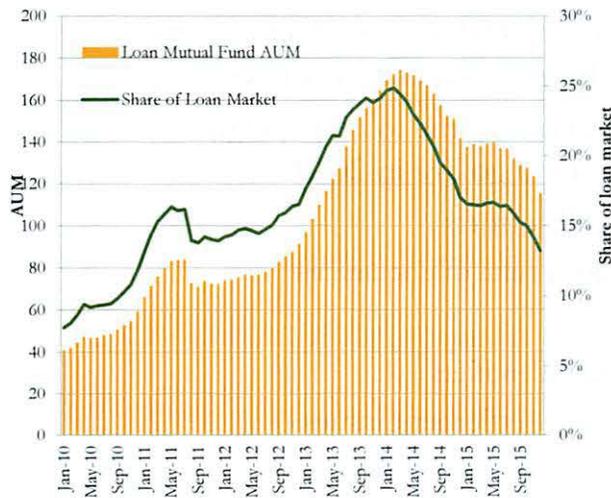
Source: Bloomberg, LSTA

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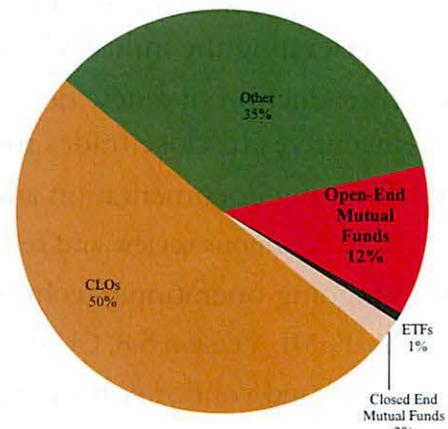


Investor Base and Historical Loan Mutual Fund Assets Under Management

Loan Mutual Fund AUM and Market Share



Loan Market Share by Investor Type



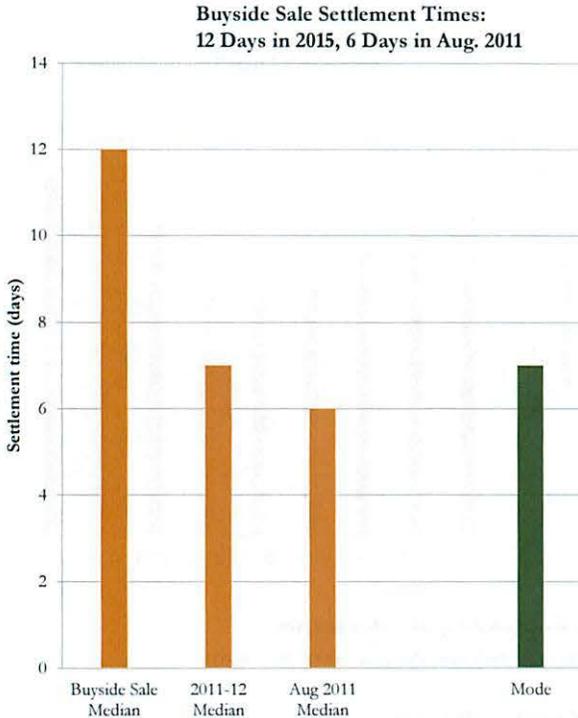
- Loan mutual funds have experienced substantial inflows in 2012-2014, and substantial outflows in 2008, August 2011, 2014-2015
- Currently, open end loan mutual funds hold roughly 12% of outstanding loans

Source: ThomsonReuters LPC Collateral

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Loan Settlement: Median Times to Settle



- Why use median buy-side sale times when measuring redemption liquidity?
 - Median is the more accurate statistic when the distribution of observations is skewed, e.g., not a bell curve.
 - Buy-side purchases are not relevant to redemption liquidity
 - Sell-side purchases or sales are not relevant to redemption liquidity
 - Hence, median buy-side sale settlement days is the appropriate statistic
- How do managers manage settlement times today?
 - Cash and T+3 securities holdings
 - Lines of credit that only bridge the time of true sale (with risk transfer) and settlement

Source: LSTA Trade & Settlement Study, LSTA Mutual Fund Survey

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Recent Loan Settlement Efforts

- Formation in 2014 of an LSTA board-level liquidity committee charged with accelerating the industry's efforts to address settlement challenges
- Introduction of a new delayed compensation regime to better align incentives to close trades more quickly; set to go live in 2Q16
- Ongoing documentation and trade practice efforts
 - Continuous review and refinement of LSTA suite of documents
- Ongoing operations/technology efforts
 - FpML Version 5.8, CUSIPs, Markit Entity Identifiers
- Increased vendor commitment to focus on settlement issues

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Appendix



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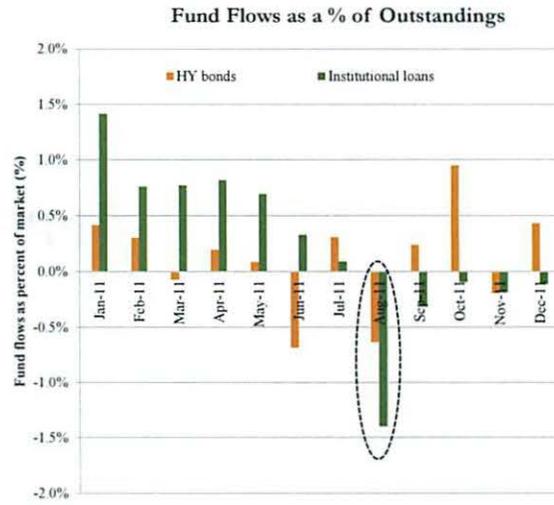
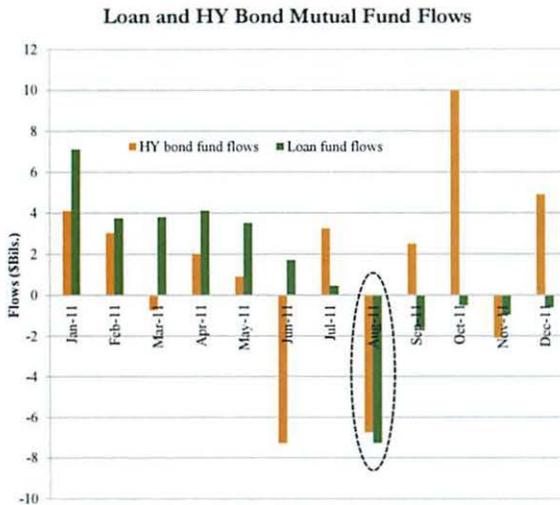
Non-Investment Grade Loan Characteristics

- Loans to non-investment grade companies, like Cablevision, Dunkin' Donuts, Equinox, JC Penney's, etc
- Typically composed of a "revolver" (held by banks) and a term loan (held by non-bank investors)
- Loans are used for a variety of purposes. According to S&P/LCD, in 2015, 37% of leveraged loans were used for acquisition, 26% for refinancing, 16% for LBOs, 8% for dividend/recap, 5% for mergers, 3% for spinoffs, and 5% for other.
- Loans are floating rate, senior and secured
 - Because they are floating rate, there is limited interest rate risk
 - Because they are senior and secured, even if they default, recovery given default is typically very high (average around 80 cents on the dollar, median higher)
 - These characteristics lead to loans being more stable in the secondary market
- Loan repayment rates are high, even in periods of market stress. The average monthly repayment rate since 2001 is 2.7% per month



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August 2011 Case Study: Loan vs. Bond Fund Flows

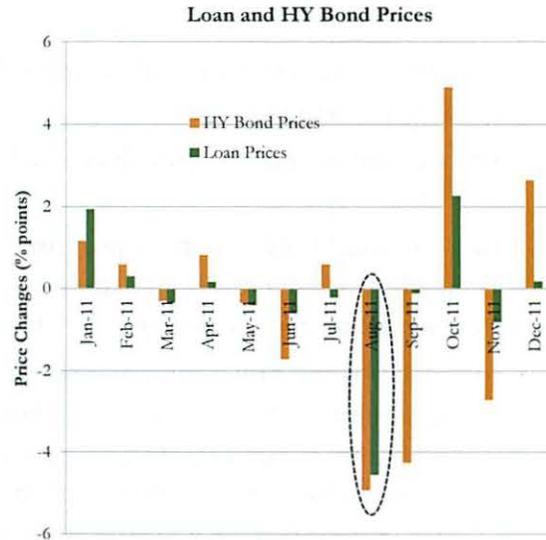
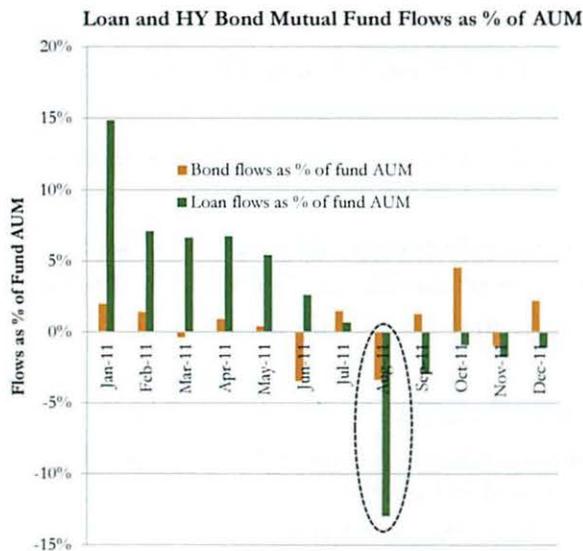


- Loan mutual funds experienced more than \$7 billion of outflows in August 2011
- HY bond mutual funds experienced more than \$6 billion of outflows in August 2011
- While similar dollar size, the flows were far more consequential for loans because the loan market was less than half the size of the HY bond market
- Flows were equivalent to 0.6% of HY bond outstandings and 1.4% of all loan outstandings

Source: ThomsonReuters LPC Collateral, BAML, S&P Capital IQ/LCD



August 2011 Case Study: Fund Flows vs. Price Changes



- In August 2011, loan mutual fund AUM (\$56B) was one-quarter of HY bond mutual fund AUM (\$203B)
- Thus, August 2011 outflows were equivalent to 13% of loan fund AUM vs. 3% of HY bond fund AUM
- Despite outflows being a far more material amount of the loan market, loan prices fell less than HY bond prices
- This reflects the resilience of loans, as well as the diversity of the loan investor base

Source: ThomsonReuters LPC Collateral, BAML, S&P Capital IQ/LCD

