Lead Left Interview – Bram Smith and Lee Shaiman (Part 2)

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In February, LSTA EVP Meredith Coffey sat down with the outgoing LSTA Executive Director Bram Smith and the incoming LSTA Executive Director Lee Shaiman to discuss the last 10 years … and what is on deck for the next 10. ***Second of two parts – View part one.***

Meredith Coffey: Bram, today the institutional loan market totals more than $960 billion, nearly doubling since the crisis. What have been the growing pains?

Bram Smith: It's generally been all to the good. But being a nearly $1 trillion asset class brings downside as well. For instance, we now will be more scrutinized by regulators. And there will be more articles about the loan market – some good, some not so good. This is just the reality that we have to accept.

MC: Lee, speaking with your (ex) buyside hat on, how do you see regulation affecting the loan asset class?

Lee Shaiman: Two regulations that have had a major impact are Leveraged Lending Guidance and risk retention. While people think the Guidance might have capped leverage, I would suggest it muddied the waters. The definitions of EBITDA and leverage have become murkier as companies attempt to prove compliance with the Guidance. Perhaps an unintended consequence is the further disintermediation of the banks and the institutional loan market by less regulated alternative lenders.

Risk retention has made managers focus on how to fund their business rather than how to manage the risks inherent to their portfolio. I figure raising risk retention capital roughly "costs" the salaries of two analysts. That is not my definition of progress, particularly for an asset class where careful analysis and mistake avoidance are key to successful portfolio management. I'd also posit that it doesn't make the financial system safer.

MC: Let's move forward and discuss the next 10 years. Lee, what are the key regulatory issues on deck for the LSTA in the coming 10 years?

LS: As George R.R. Martin famously wrote, "Winter is Coming". The loan market has a limited window to refine some areas of regulatory over-reach such as risk retention and the Guidance. However, the current political environment won't last, nor will the appetite to refine regulation into something that works for both markets and Washington. So we have to act now.

Longer term, the LSTA – and the entire loan market – needs to work with regulators on LIBOR transition. We are committed to helping make the transition as orderly, fair and balanced as possible for all market participants. This includes lenders, borrowers and arrangers. Indeed, this may be a case study in how the LSTA meets its mission statement.

MC: On that note, what is the LSTA mission statement and how will we meet it?

LS: Our mission is to promote a fair, orderly, efficient and growing corporate loan market and provide leadership in advancing and balancing the interests of all market participants. We want to continue to do what we do well: Standardization, documentation, best practices, standards, advocacy and promotion of the asset class.

Specific items we are considering are i) working on socially responsible investing (including green loans), ii) working with a wider range of interested parties, including borrowers and ultimate investors (such as pension funds and mom and pop investors)**,** iii) engaging with all sources of financing (including direct lenders) and iv) helping to make regulation work well for the markets and Washington.

MC: That's a big list. When we are having this same conversation in 10 years, what will you be most proud of?

LS: Ask me then.

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