Discussion of

Concentration of Control Rights in Leveraged Loan Syndicates

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CFIC, April 6, 2018

Key Takeaway

- We (practitioners and academics) have observed a rise in **covenant-lite** term loans over recent year.
- Covenant-lite loans, although have some benefits (increased loan liquidity, reduced costs of renegotiations with a diverse syndicate), they might prevent lenders from **effectively monitoring the borrower**.
- The reason is that covenants help lenders monitor borrowers.
- This paper finds that although term loans are covenant-lite, they are a part of a loan deal that includes a revolving facility with covenant.
- Therefore, banks can effectively play they role as monitors.

Methodology

- The authors use a sample of about 1,000 actual loan contracts during 2005-2014.
- They obtain more accurate information about loan tranches and financial covenants than using DealScan.
  - Can you give us some statistics on how DealScan coverage is?
- They find that by 2014, 35% of loan deals have split control rights. This was 0% in 2009. In these deals, the revolving lenders are given the unilateral right to renegotiate with the borrower.
  - Cross-default or cross-acceleration clause in term loans (needs more elaboration)
  - Do all these loans have cross-acceleration/cross-default clauses?

Comments: “Leveraged loan”

- The paper studies how “leveraged” loan market has evolved.
- Leveraged loans are defined as loans that are rate BB+ or lower or an unrated loan with an interest-rate spread larger than 150 basis points.
- More elaboration on how we make sure the contract is leveraged (more elaboration), because the contracts are reported by large public firms (SEC filings).
- Maskara and Mulineaux (2011) found that many borrowers do not even announce their loans. They find borrowers announce their loans if the announcement is a good news or the loan is material.
- SEC requires public firms to disclose information if the loan agreement is considered a “material contract.”

DealScan – Replicating the results

Step	No loans after the step
1. DealScan loan facilities from 2005 to 2014, issued by US borrowers, syndicated in USA	56,258 loans
2. Defining a loan deal as a set of loan facilities belonging to same borrower issued on the same date	56,258 loans (36,727 loan deals)
3. Dropping 1digit SIC = 6 or 9	31,915
4. All facilities in a deal need to be secured	12,141
5. Exclude deals that have a loan type other than term or revolver	11,139
6. Exclude only revolver loans	6,880
7. Restrict to loan deals with a leveraged term loan	1,742
Public firms? Deals including institutional loans	

Performance Pricing Provisions

- In DealScan, financial covenants and net worth covenants are defined at Deal level not facility level.
- However, performance pricing covenants are defined at the facility level.
- Among deals that have both revolver and term loan I found that consistent with author's finding, revolvers are more likely to have performance pricing provisions

Unobservable factors/selection

- 2-stage Heckman correction?

- Institutional = f(observables, instruments) (discrete choice regression)
- Split = f(Institutional, observables)

- Or use 2SLS but we need instruments

Maturity mismatch

- As the authors mentioned Institutional term loans have a longer maturity than revolvers (1.5-2 years).

- How does the split rights and the monitoring of lenders in the revolvers help, when the revolver is matured but the term loan is still alive?

Minor comments

- Old question: Why does monitoring matter? (should we even talk about it?)
  - There are benefits for minority shareholders and bondholders (but why should the lender care), but if a lender is willing to transfer loan to institutional investors, why should they care about monitoring (split right or other ways).
- If the definition of “financial covenant” is not accurate in DealScan why must the definition of “leveraged loan” or “institutional loan” be accurate in DealScan?