



PRACTICE NOTE 1 ISSUED PURSUANT TO THE GUIDELINES ON THE OFFERING OF ASSET-BACKED SECURITIES ("ABS GUIDELINES")

Date Issued : 28 January 2008

SPECIFIC REQUIREMENTS AND DISCLOSURE OF INFORMATION ON PRIMARY COLLATERALISED LOAN OBLIGATIONS TRANSACTION

Introduction

1. The purpose of Note is to set out specific regulatory and disclosure requirements to be met by a principal adviser and an originating bank in a primary collateralised loan obligations (CLOs) transaction. These additional regulatory and disclosure requirements are put in place to enhance transparency and clarity of information to investors and parties involved in a primary CLOs transaction.
2. For the purpose of this Practice Note,
 - (a) "primary CLOs transaction" refers to a securitisation transaction that involves newly originated corporate loans which are granted by a special purpose vehicle or SPV to a pool of companies as borrowers or obligors; and
 - (b) "originating bank" refers to a licensed institution which is responsible in originating and structuring corporate loans in a CLOs transaction.

Application

3. This Note is intended to govern all primary CLOs transactions, except for those which are fully guaranteed by a financial institution, resulting in the rating of the CLOs transaction fully reflecting the credit rating of the financial institution providing the guarantee. Further, the Securities Commission (SC) may impose or disapply certain provisions in this Note on a proposed secondary CLOs transaction which involves a securitisation of existing or outstanding corporate loans already granted by an originating bank.

Due considerations in selection of borrowers

4. A principal adviser and an originating bank for a CLOs transaction are required to exercise due diligence in selecting borrowers and in determining whether these borrowers are suitable to participate in a CLOs transaction. Arising from this requirement, the principal adviser and originating bank shall adopt the industry standards and best practices when originating the loans. Among others, the principal adviser and originating bank shall give due considerations on the credit standing and credit history of each borrower. In addition, the principal adviser and originating bank shall consider whether it is appropriate to impose the following terms and conditions on the borrowers after taking into account the above factors:
 - (a) Sinking fund requirements in repaying the loans;
 - (b) Negative covenants such as gearing ratio and additional indebtedness;
and
 - (c) Security coverage for the loans, if any.

Additional disclosures to investors

5. In line with paragraph 9 of the ABS Guidelines on the disclosure of relevant information to investors, the principal adviser and originating bank shall disclose in an information memorandum the lending policies involved as well as the extent of terms and conditions which are set on borrowers in accordance with paragraph 3 above. Such disclosure can be made on anonymous and aggregated basis on the borrowers.
6. The principal adviser and originating bank shall provide the following minimum information pertinent to each borrower in the information memorandum:
 - (i) Full name, address and corporate profile;
 - (ii) Shareholding profile, if the borrower is not listed on Bursa Malaysia Securities;
 - (iii) Amount borrowed;
 - (iv) Whether the borrower has defaulted or restructured its loans in the past;
and
 - (v) Published rating or shadow rating, which is also known as a credit estimate (indicative rating, if the necessary rating has not been finalised).

- To facilitate the above disclosure by the borrowers, the principal adviser and originating bank shall obtain a permission in writing from these borrowers, as provided under section 99(1)(a) of the Banking and Financial Institutions Act 1989, to disclose the said information.
7. The following information on the borrowers, based on an aggregate of all borrowers, shall also be provided by the principal adviser and originating bank in the information memorandum:
 - (i) Utilisation of proceeds, in amount (on projected or actual basis, where applicable); and
 - (ii) Sources of repayment, in percentage term.
 8. The principal adviser shall disclose in the information memorandum whether early repayment or prepayment by the borrowers is allowed and if it is allowed, the relevant terms and conditions for the early repayment or prepayment.
 9. If proceeds from the issuance of CLOs are invested in structured products, as defined in the Guidelines on the Offering of Structured Products ("Structured Products Guidelines"), the principal adviser shall disclose in the information memorandum a list of minimum information, as required in paragraph 7.01 and paragraph 7.02 of the Structured Products Guidelines, relating to the investment in the structured products.

Terms and conditions on borrowers

10. The principal adviser and originating bank shall ensure that there are adequate provisions in the loan agreements or facility agreements that require borrowers to comply with the following minimum requirements:
 - (i) Submission of financial statements including semi-annual accounts and audited annual accounts, to trustee, portfolio manager and credit rating agency on a timely basis. As a guide, the audited annual accounts and semi-annual accounts shall be submitted no later than 180 days from Financial Year End closing and 30 days from the closing of semi-annual accounts respectively;
 - (ii) Provide immediate notice to inform trustee and credit rating agency of material changes to nature of business and shareholding structure;
 - (iii) Response to any enquiry from trustee on material terms and conditions relating to the loans;
 - (iv) Attendance of meeting, if duly notified, with trustee and/or bondholders on material terms and conditions relating to their loans; and

- (v) Any other standard terms and conditions that a bank will impose on their customers for loans of similar terms and conditions.
11. The principal adviser and originating bank shall ensure that the above provisions are enforceable and shall impose various forms of penalties, which are applicable to other corporate loans, on borrowers for material breaches of terms and conditions. The penalties, including variation of lending rate and termination of loans, shall be clearly provided in the loan agreements and disclosed in an information memorandum. Such penalties shall be consistent with the special purpose vehicle's recourse to the borrowers for breaches of their contractual obligations.
 12. For the purpose of clarity, both the date of repayment by borrowers to the SPV and the maturity date of CLOs shall be clearly specified in the principal terms and conditions (PTC) submitted to the Securities Commission, loan agreements and information memorandum. To facilitate redemption of CLOs, the date of repayment by borrowers shall precede the maturity date of CLOs by taking into account the time required to transfer funds between banks and the paying agent.
 13. The borrowers shall be fully informed of the risks of their investment in subordinated bonds, if any, which are structured to provide credit enhancement to a CLOs transaction. In this regard, the borrowers shall be aware that there are certain rights which are granted to investors of senior tranches of CLOs and are not given to holders of subordinated bonds.
 14. Any subordinated bonds which are held by a defaulted borrower shall be cancelled when no remedial action is taken by the defaulted borrower to repay SPV within a reasonable period or any timeframe which is stipulated in the facility agreement.

Other requirements

15. The responsibilities of all transaction parties, including principal adviser, originating bank, solicitor, portfolio manager, trustee and technical adviser (if any), under a CLOs transaction shall be clearly outlined in the PTC and the information memorandum. In particular, the principal adviser shall ensure that the following responsibilities have been assigned to a lead transaction party and the relevant transaction parties prior to the issuance of CLOs:
 - (i) Monitor and review compliance of terms and conditions imposed on borrowers pursuant to the loan agreements;
 - (ii) Matters relating to recovery of assets upon default of borrowers; and
 - (iii) Advice to trustee and bondholders on borrowers' request for variation to any terms and conditions.

16. The principal adviser shall ensure that a sufficient amount of legal fees is provided to the relevant transaction parties in undertaking legal actions to recover assets or money from defaulting or defaulted borrower(s). To expedite this recovery process, a set of procedures and documents such as letter of demand and notice of demand, shall be put in place prior to the issuance of CLOs.

Transitional arrangements

17. For any CLOs proposal which has been approved by the SC but has not been implemented or issued as of the issue date of this Note, the principal adviser and originating bank shall, where possible, adopt the disclosure and regulatory requirements which are stated in the Note before issuing or offering the CLOs.