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Syndicated Loans and EU Competition Law

Flashlight or Spotlight? The EU's Latest (Final) Report Continues to Look Closely at the Syndicated Credit Market

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Lenders involved in syndicated loans may encounter additional scrutiny from competition regulators in light of the final publication of a study prepared on behalf of the European Commission by Europe Economics and Euclid Law.

Loan syndication typically involves banks and other lenders agreeing to jointly finance a loan, usually in a scenario where it is considered that one bank cannot (i.e., due to the size of the loan) or will not (i.e., due to credit risk) finance the loan on its own.

Background

In 2017, the EU formally commissioned a study into "*EU Loan Syndication and its impact on competition in the credit markets*". The report (the Report) was completed in 2018, and earlier this month (5 April 2019) it was formally finally published.

The Report looks closely at the functioning of the syndicated loans market across two principle areas of cross-border finance activity, namely, the markets for 1) leveraged buy-out loans (LBO); and 2) project finance and infrastructure loans (PF/IL). Its findings, without suggesting any fundamental or systemic cause for concern, do shed light on a number of potentially anti-competitive practices in the current market where improved compliance is sought. Importantly, the Report also goes on to identify a series of "safeguards" to better regulate the market and its participants. The study focused on six EU Member States—France, Germany, Spain, Poland, the Netherlands and the United Kingdom.

In recent years, there have been a number of national competition investigations within certain EU Member States, and the UK is no exception. For example, in 2016, the UK's Financial Conduct Authority (FCA) considered syndicated loan markets as part of a wider market study into investment and corporate banking where a number of key conclusions were drawn. The Report builds on some of the key findings from the FCA study.

Analysis and Safeguards

The 324-page Report covers a "*stage-by-stage analysis of competition issues*" in connection with each stage of the loan syndication process, and confirms that "*the nature of the competition risk varies depending on the stage of the syndication process*". The Report flagged that, amongst other things, the following "risks" could lead to potential antitrust breaches:

Market soundings at the pre-bid stage—these can lead to collusive outcomes as an individual bank's risk appetite can be communicated back to the arranging bank at the bid stage. Hence, the recommendation is that, in order to avoid inappropriate information flows, all communication should be kept bilateral between the banks and the main bank arranger and sponsor/borrower until commercial funding terms have been crystallised (i.e., to ensure that there is a degree of separation between the syndication and origination teams at banks—"*the greater the degree of separation the better*"). Also, banks should not rely purely on terms contained within non-disclosure agreements (which require banks to keep confidential the funding proposal) to mitigate against competition risk. A further safeguard provides clear parameters for information exchange involving the sponsor/borrower (i.e., where the borrower identifies which information is strictly necessary for the purposes of banks being able to form a view of the loan and make a potential bid).

Co-ordination against the borrower at the post-mandate stage—whilst it is clear that antitrust risk reduces once a specific loan mandate has been agreed, there are, however, circumstances where repeat interactions amongst lenders on transactions may lead to inadvertent information sharing "*in that lenders might observe each other's behaviours or strategies and use this knowledge to align their bids in future transactions*".

Co-ordination and bundling of ancillary services—the Report touches on the provision of related "ancillary" services provided by syndicate banks at the time a loan is structured, such as hedging or transaction banking/cash management services. The inability of a sponsor/borrower to shop around for such services could lead to antitrust risk, particular if the banks in the syndicate collude as to how to provide these services between themselves. While the concept of "bundling" or tying such products was not necessarily viewed as a heightened competition law issue in and of itself (in line with recent investigations by Spanish regulatory authorities), the Report notes that such bundled arrangements could lead to a below-par outcome for the sponsor/borrower. In the UK, the FCA has banned the use of "right of first refusal" and "right of first match" clauses, except for bridging loans.

Loan default scenario—the Report specifically highlights a scenario where the sponsor/borrower is in financial difficulty or where the loan is trading in default (i.e., following an event of default). Due to the sponsor/borrower's loss of bargaining power, there is an enhanced risk of banks colluding amongst themselves regarding the terms of a potential restructuring to the detriment of the sponsor/borrower. That said, the Report notes that there are already significant safeguards in place to protect sponsors/borrowers. For example, the fact that any restructuring discussions will always involve the sponsor/borrower to agree to new economic and structural terms, and also that within banks often restructuring teams are completely separate from origination and syndication teams.

Conclusions

Katten takes the view that the Report is yet a further indication that the competition authorities are taking an ever closer interest in the overall syndication process across key financial markets, particularly when it comes to market conventions around how commercially sensitive information is shared amongst banks and participants both pre- and post-syndication. Reassuringly, the Report shows no clear evidence of there being any "highly-concentrated" markets for loans where market participants are in obvious breach.

It is acknowledged that different antitrust risks are inherent for each of the different stages of the credit syndication process. The broad conclusions that Katten draws from the Report include:

1. greater tailored training and awareness (including on competition law) should be made available to all functions within banks as well as market participants;

2. better controls within banks (origination and syndicated desks) for information exchange and sharing should be adopted and appropriately and robustly segregated where necessary; and

3. greater involvement of sponsors/borrowers in the syndication process.

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