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Europe Economics Publishes Competition Report on EU Loan Syndication

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Europe Economics has published its final report on “EU loan syndication and its impact on competition in credit markets” ("Report"). The full Report can be accessed **here**.

The Report examines the practices and structure of origination and syndication departments within banks, across several jurisdictions in Europe, and highlighted practices in the origination and syndication process which may cause concern from a competition perspective. Although this Report does not produce any recommendations with respect to legal and/or regulatory changes, the observations will nevertheless serve a highly influential role in assisting competition authorities and regulators with respect to ongoing competition law/regulatory developments.

The study focuses primarily on a sample of six Member States -- namely, France, Germany, the Netherlands, Poland, Spain and the United Kingdom -- and on specific segments of the syndicated loan market: those connected with Leveraged Buy-Outs ("LBOs"), project finance and infrastructure finance. However, parallels could be drawn with respect to other syndicated loan markets (for example, real estate finance or corporate finance) as the structure of the loan desks and syndication teams are similar and therefore comparable.

The Report discusses extensively the entire bidding and syndication process, and how the common practices taken by lenders may lead to certain behaviours and therefore presents risks resulting in adverse competition outcomes. Set out below is a summary of the areas which have been identified in the Report as key risk areas. Please refer to the Report for full discussion.

1. ***Competitive bidding process for appointing individual banks to the lead banking group***

It has been found that in a bidding process, there is evidence of generic market soundings by mandated lead arrangers ("MLAs") with investors prior to submitting bids, and specific transaction details may be communicated to the origination desks (although this isn’t supposed to happen given the separation). If there is no significant separation between the origination and syndication desks, then the risk is even higher. The Report suggests that there is a risk that the practice of soundings (whether generic or specific) could be abused by MLAs, which lead to lenders colluding and therefore achieving some degree of collective bargaining power against borrowers. The Report also points out that although information-sharing is governed by non-disclosure agreements ("NDAs"), this in reality doesn’t adequately address the risk due to the fact that NDAs are difficult to enforce. Therefore, the Report suggests that consent should be acquired from the borrower as to who should be contacted.

2. ***The allocation of ancillary services across banks, and the pricing of such services***

The Report found that, in most cases, ancillary services are offered either as part of the initial discussion in loan terms or as part of a competitive process after the loan is in place. It was found that, in both cases, the borrower was able to choose between lenders’ offers and therefore competitive pressure is maintained. However, there is a small minority where MLAs make it a condition of the loan to provide ancillary services, and this is considered to heighten the risk of reducing competitive pressure in favour of the borrower/sponsor. It was noted that this practice was only found in Spain, and not present in other markets.

In addition, any loan requirement to include “first right of refusal” or “right to match” have been banned in the UK by the Financial Conduct Authority, and this was viewed as a positive development in the Report.

3. ***Refinancing in conditions of default***

Due to the nature of the process in restructuring the facility in a default scenario, which involves members of the syndicate to act collaboratively, the Report has made some observations as to behaviours and training which these

teams should undertake to avoid any anti-competitive behaviour. It is important to note that the Report has not found any evidence of any abuse of power stemming from the conduct by the lenders, but it does point out a few factors which would enhance/decrease the level of risk in these scenarios:

1. the presence of outside banks – the presence of new financing would be a limit on the bargaining power of the existing group of banks, although the Report also acknowledges that sometimes negotiating with the existing syndicate may be the only option;
2. competition policy training – this is generally undertaken by bank restructuring teams to ensure staff are aware of the risks and also to avoid certain behaviours.

The Report also found that there is some evidence of tying ancillary services with the restructuring negotiations and, therefore, this area deserves future monitoring.

Safeguards

The Report recommends a few safeguards which can be taken by both banks and borrowers. These include:

1. Where the borrower sources debt advice and the adviser is the same lender who wishes to act as MLA, it is recommended that there should be adequate training and policies for the relevant staff about managing conflicts of interest, and also the duty of care (as an adviser) to the borrower and the need to provide neutral advice.
2. Prior to aligning loan pricing terms to the highest common denominator, MLAs should ensure that they have looked at all available alternative options before doing so (e.g., inviting other lenders who were not involved in the process to participate). This is especially relevant for situations where the loan is being re-structured, as there is a tendency for the same group of banks to provide the loan terms without reaching to outside lenders. The borrower can also engage in bilateral negotiations with the banks to enhance competition in the process.
3. Banks should be aware of safeguards that can be put in place when exchanging information between origination desks to syndication desks and have protocols around how (and the content) the information should be released/dealt with to minimise risks of anticompetitive alignment of prices.
4. “Right of first refusal” and “right to match” with respect to ancillary services are seen to impair the competition of these services and their prices, and so it has been advised that syndicates limit the cross-sale of these services and keep them outside of the syndication process.