SQUIRE PATTON BOGGS

Loan Syndication and Competition Law in the EU and UK

EMEA – February 2021

Introduction

EU syndicated loans are likely to continue to play a significant role to try to solve the liquidity crisis emerging from the 2020 global pandemic. As economic activity slowed and uncertainty rocketed during the COVID-19 outbreak, non-financial firms dashed to debt markets – namely, bond and syndicated loan markets – to secure funds for covering operational expenses, and possibly buttress their cash buffers. However, banks should be aware of the potential competition law risks inherent to syndicated loans and know how to mitigate them. This client alert provides a reminder on the findings of the most recent European Commission's report on the EU syndicated lending sector, "EU loan syndication and its impact on competition in credit markets" ("the EC Report"). The Report responds to increasing antitrust scrutiny of the syndicated lending sector by assessing whether there are potential competition concerns with regard to syndicated loans in leveraged buyouts (LBOs), project finance (PF) and infrastructure projects (INFRA). Geographically, the Report focuses on France, Germany, the Netherlands, Poland, Spain and the UK.

What Is Loan Syndication?

Loan syndication is where multiple lenders join together to provide one loan. This often occurs where the amount the borrower needs would represent too big a risk for one single bank to take.

What Are the Competition Law Issues?

Cooperation between competitors is inherently risky from an EU/UK competition the risk level depends on the type of cooperation and market context and it can often be mitigated with the appropriate safeguards. For banks involved in loan syndication, the three distinct stages of the process offer different levels of competition law risk.

- Before the syndication group has been formed – This is the stage with the most potential risk. Banks should compete individually and avoid sharing competitively sensitive information, unless subject to appropriate safeguards (e.g. within "clean teams" and subject to non-disclosure agreements).
- After the group has been formed – Banks are permitted to cooperate and exchange information; however, this must be within the scope of the borrower's instructions.
- After the mandate has been signed – Competition law issues may arise, for example, in relation to potential events of default.
- There is no official guidance on the application of competition law to syndicated loans. However, in 2014, the Loan Market Association (the LMA) published a notice on this, which made it clear that banks involved in loan arrangements need to exercise caution when competing with each other on a prospective multi-bank deal.

The LMA notice made it clear that banks should take account of:

- General market soundings
- Their conduct during the bidding phase
- Exchanging competitively sensitive information
- Interaction regarding the "flexing" of terms
- Their conduct regarding refinancing/distressed arrangements

Guidance from the LMA included:

- Seek, and keep a careful record of, the prior consent of the borrower to any proposed contact with competitors, whether in contemplation or following the appointment of the lead arranger or underwriter, as well as the formation of the banking group.
- Only act within the terms of the consent given.

The EC Report

Since the LMA notice, the EC Report has provided some additional insights on the potential EU competition law issues arising in loan syndication.

The EC Report notes that a syndicated loan facility is an important source of large-scale lending where several lenders come together to share credit risk in order to provide loans to a borrower in a single loan facility agreement. At the time of the EC Report, syndicated loans are a significant source of capital in Europe, with €720 billion raised across all of the EU.

However, the EC Report also notes that cooperation between lender competitors is inherently risky from an EU competition law angle and so must be mitigated with the appropriate safeguards at each stage of the loan.

Competitive Bidding Process for Appointing Individual Banks to the Lead Banking Group

The boundary between generic and specific market sounding needs careful definition to ensure compliance. Although the risk is low, generic market soundings by Mandated Lead Arrangers (MLAs) could potentially facilitate collusion if information is communicated back to the "sounding" bank's origination team. This risk may be exacerbated where there is no functional separation between the syndication and origination desks. Furthermore, if there is a single MLA, there remains the possibility that information sharing may occur such that the negotiations of the syndicate could be coordinated and the price and terms of the loan move against the borrower.

Post Mandate to Loan Agreement

Loan terms should be agreed bilaterally between the borrower/sponsor and individual lenders and joint discussions between lenders post-mandate should be limited to agreeing the loan documentation and syndication strategy, meaning the scope for lenders to discuss loan terms together in order to move against the borrower at the post-mandate stage is low. However, there have been cases where the borrower/sponsor does bring lenders together at an earlier stage to discuss loan terms, e.g. in a club deal. In that case, there is a risk that lenders may engage in discussions outside of the borrowers' mandate. This risk would be heightened should the borrower/sponsor be less sophisticated than the norm. Furthermore, there is a definite, albeit low, risk that multiple interactions between lenders on transactions over time enable lenders to observe each other's behaviours and strategies, and, thus, possibly coordinate on future loan transactions – however, the EC Report found no evidence of this happening in practice.

The Allocation of Ancillary Services Across Banks and the Pricing of Such Services

For a small minority of borrower/sponsors, the Mandated Lead Arrangers make the provision of ancillary services by them a condition of the loan. While competition law precedent (e.g. Spain's CNMC) has not concluded that this is unlawful, this does create a risk that a borrower/sponsor will achieve a sub-optimal economic outcome. In the PF/INFRA segment, it is more common for ancillary services directly related to the loan to be allocated by the borrower/sponsor to lending banks at the initial stage of agreeing overall loan terms. The fact that the banks know who is to be providing the services provides them with scope to discuss and collude on pricing.

The Use of Debt Advisors Who Are Also Involved in the Syndicated Loan

There is limited evidence that some lending banks do bundle the advisory role with a lending role at the request of the borrower/sponsor. This creates a risk that the borrower/sponsor may not receive the most preferable loan as the advising bank could attempt to influence the borrower/sponsor towards a strategy or debt structure that suits its lending arm. However, the study also showed that where an advisory role is provided by a lending bank, this is functionally separate from the lending role, and, therefore, adherence to internal protocol should mitigate the risk of suboptimal outcomes to borrowers.

Coordination by Lenders on the Sale of the Loan on the Secondary Market

The study found no evidence of coordinated activity to manipulate prices in the secondary market and the features of the secondary loan market (such as buyer sophistication) should limit any attempt by sellers to manipulate the price of the debt.

Refinancing in Conditions of Default

As members of the syndicate collaborate on discussions and negotiations of potential restructuring in the event of a default, there is an enhanced risk that banks could act in a coordinated manner. It is, thus, important that bank restructuring teams undertake competition policy training. Results of the study show that refinancing discussions tend to involve lenders from outside the original syndicate. This arguably places a limit upon any bargaining power that the existing group of lending banks may have. Furthermore, non-syndicate members are often involved in discussions concerning ancillary services. This reduces the risk of the original syndicate tying ancillary services to the refinancing. However, the study found a minority of negotiations did take place only with the syndicate members – this area requires future monitoring.

Consequences of Breaching EU/UK Competition Law

The consequences of breaching EU/UK competition law can be serious and may include:

- Lengthy investigations, in addition to the costs associated with diversion of management time from the ordinary course of business
- Fines of up to 10% of global group turnover
- In the UK, personal consequences for the individuals involved, including: (i) disqualification from acting as a director; and (ii) criminal sanctions, which could include fines or imprisonment
- Legal costs, as well as reputational damage caused by negative publicity

Conclusion and Next Steps

While the Report identifies certain market features that may enhance competition law risk, it does not identify specific infringements. However, it does highlight critical safeguards to ensure competitive outcomes in the loan syndication process. These include (i) adequate training and policies for the relevant staff at the potential MLAs to preserve the bank's duty of care to clients; (ii) protocols to ensure deal-relevant information obtained by the syndication function from other potential participants is not transferred to the same bank's origination function; and (iii) limiting the cross-sale of ancillary services in order to avoid the risk of impairing competitive conditions in neighbouring markets.

The EC Report has identified areas where the European Commission may conduct further inquiries in the future, either on its own or following a complaint. At the same time, national competition agencies could also launch individual investigations if they suspect any specific conduct in their respective jurisdictions. For example, the UK's Financial Conduct Authority (FCA) has regained full jurisdiction to apply antitrust law in the UK financial sector following the UK's exit from the EU and loan syndication remains a hot topic of competition law compliance, especially following the 2020 pandemic.

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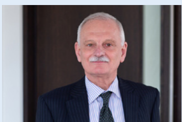

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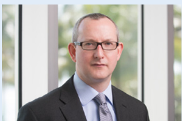

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