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The EU loan syndication impact assessment is out: more competition scrutiny ahead?

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Setting the scene

The long anticipated European Commission (DG COMP) report on *"EU loan syndication and its impact on competition in credit markets"* (see here) has finally been published. The study primarily focuses on the syndicated loan market segments, which relate to Leveraged Buy-Outs ("LBOs"), project finance, and infrastructure finance. The study's objective is to identify potential competition risks and provide a clear picture of the relevant markets in question. In particular, it focuses on syndicated lending in France, Germany, the Netherlands, Poland, Spain and the United Kingdom.

This report was foreshadowed in a 2017 "management plan". DG COMP launched a call for tenders on April 2017 with the aim of obtaining *"a systematic analysis of the loan syndication market, focusing on six EU Member States, and its possible implications for competition policy"*.

The Final Report was completed by the end of 2018 and published on April 5th, 2019.

The Report's findings

The report analyzes each step of loan syndication and identifies a number of potential competition issues. Some deserve to be treated with special care since they could qualify as restrictions "by object" according to the study.

At the preliminary stage, the process of loan syndication necessitates that lending banks share information, either at the pre-mandate stage (in the context of a consortium bid)[1] or at the post-mandate stage, when banks forming the lead banking group interact with each other to come up with a single loan agreement.[2] The study identifies a potential risk that the exchanges may go beyond what is strictly necessary, and therefore may give rise to a potentially anticompetitive exchange of information, especially in infrastructure projects.

During the general syndication phase, the power of Mandated Lead Arrangers ("MLAs") to influence the selection process of participant lenders may reinforce tacit reciprocity, or enable them to use reciprocal arrangements to influence the loan terms.[3]

More broadly, the study points to potential risks for the other loan participants (through unfair terms), and for the borrower/sponsor (facing a higher price). According to the study, particular attention should be paid when, for example, lenders have "in-house" advisers, because there could be a sub-optimal loan outcome for the

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1 European Commission, *EU loan syndication and its impact on competition in credit markets*, Final Report, p. 162.

2 *Ibid.*, p. 169

3 *Ibid.*, p. 177

borrower when the adviser is appointed directly, without a competitive process.[4] For each competition concern mentioned above, the study identifies some potential safeguards.

Particular focus on ancillary services

It is a common occurrence in syndicated lending for the borrower and lenders to negotiate ancillary services pertinent to the loan.[5] According to the study, the allocation of ancillary services, which do not directly relate to syndicated loans, across banks - alongside the pricing of such services – might give rise to moderate concerns, if the number of providers of these services is limited.[6]

Hedging services for interest rates or foreign exchange risks directly related to the syndicated loan have a strong impact on the borrower's creditworthiness. When these risks are evaluated as high, especially in the context of project finance loans, the lenders might require hedging against them.[7] Therefore, the processes followed by the market participants need to be carefully considered to avoid potential anti-competitive conduct. The Report underscores that the key parameters in the assessment of the competitive dynamics of hedging services are: (i) the timing of the negotiation of the services, (ii) the banks to whom the services are allocated, and (iii) the process under which the services are allocated, namely either allocated directly by the borrower or via competitive bids from banks.[8]

As evidenced in the Spanish Markets and Competition Commission's ("CNMC") decision of February 2018, the ancillary services associated with syndicated lending facilities may be central in the regulator's scrutiny. The CNMC fined four of Spain's major banks €91 million for allegedly fixing the price of interest rate derivatives attached to syndicated loans.[9] While the rationale behind the banks coordinating in order to provide syndicated lending was not questioned by the CNMC, the banks were still found to be colluding to set the price of interest rate derivatives above market price. The CNMC emphasized that the collusion generated the appearance that rates were set in line with market terms while, in reality, they were agreed by the banks before making the final offer to the client.

In short, ancillary services related to syndicated lending have been flagged by the Report as potential competition law infringement triggers. Banks must pay close attention to the business environment and the specific conduct they engage in when hedging contracts with borrowers, as future competition scrutiny may be on the cards.

Conclusions

The Report provides an overview of potential anti-competitive outcomes, along with some safeguards. It highlights the need for banks to take measures to prevent anti-competitive outcomes in the loan syndication process.[10] According to the Report, the banks' duty of care to their clients, the avoidance of unwarranted information exchange, the promotion of unbundled price competition, as well as tailored trainings and competition law guidance for banks, all contribute to reaching that goal.

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4 *Ibid.*, p. 191

5 *Ibid.*, p. 185, figure 43

6 *Ibid.*, p. 12. Perhaps more importantly, when only a sub-set of lenders has the capacity to offer hedging services directly related to the loan, competition risks become higher, e.g. tacit collusion may be a concern. See *ibid.,* p. 145.

7 *Ibid.*, p. 49

8 *Ibid.*, p. 65

9 For a description of the decision see, CNMC, Summary Note S/DC/0579/16 Financial Derivatives, available here.

10 *Ibid.*, p. 14

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