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Competition Law and Syndicated Loans – A Framework

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Introduction

In April 2019 the European Commission published a long-awaited Study by Europe Economics and Euclid Law that looked at the legal and economic issues in Loan Syndication. A full copy of the Study can be found at http://ec.europa.eu/competition/publications/reports/kd0419330enn.pdf

Whereas the Study looked at competition and regulatory issues across the sector, this article expands on the underlying competition law framework that was developed for the study. The views expressed in this article are therefore attributable only to the authors and not to the European Commission.

Multi-bank lending, including the provision of syndicated loans, by its nature involves a group of banks (and other lenders) who are otherwise actual or potential competitors coming together on commonly agreed terms for the purposes of providing joint funding to a borrower for a particular transaction. Syndicated lending necessarily involves co-operation between the lenders and agreement between the lenders and the borrower on elements such as, the required amount of capacity, a single price for the loan, a unified term sheet and the allocation of the proportion of the loan between the various lenders.

Multi-bank lending, including syndicated lending is provided in circumstances where a single bank would not be willing or would not be able to lend the required funds alone. From the lenders' side it allows the lenders to spread risk and to potentially participate in a wider range of transactions in areas where they might not venture alone. From the borrowers' side it facilitates access to more substantial funding from a wider group of lenders in an efficient manner.

This article first examines the overall context and potentially relevant issues and considerations for syndicated lending generally and then examines the issues that may arise at each stage of the process. It should be noted that the stages in any syndicated loan arrangement may vary and are not always so clearly delineated. Accordingly, the potential issues outlined below at each stage may occur at different stages with corresponding adjustments to the context which would need to be factored in to the analysis.

Framework for Legal Analysis – Potential Issues at Different Phases of a Syndication

The Bidding Process

The competitive process for the selection of a Mandated Lead Arranger (MLA)[2] and other roles (i.e. the initial bank group) will typically start with a borrower issuing a Request for Quote (RFQ). A borrower will generally request that banks submit individual responses to the RFQ but may in certain circumstances expressly request that a number of banks come together to form a consortium for the purposes of submitting a bid. In the case of a consortium bid, a borrower will typically set a limit in the RFQ on the number of banks that can be involved in any one joint bid or otherwise set parameters for the co-operation between the jointly bidding parties to ensure that there is a competitive bidding process.

At this stage, a bank, if it is submitting an individual bid, in order to develop its proposal (including as to factors such as price, underwriting/hold levels and syndication strategy) it will need to form its own view as to the likely attractiveness (and at what price) of the transaction to other lenders, who it will ultimately need to join with as either underwriters or at the wider syndication. By contrast, in a consortium bid the banks will discuss and agree such terms between them prior to responding to the bid.

Independent bids and information exchange

Information exchange (even if unilateral) between actual or potential competitors may result in a concerted practice which restricts competition where it facilitates alignment of their competitive behaviour. In a multi-bank lending situation (as compared to a situation where competing bidders would provide the relevant service entirely independently and where there is unlikely to be a legitimate reason for exchanging any information pre-bid), there may be a legitimate reason for a bank to gain an understanding of other lenders appetite for the transaction – e.g. whether / how much and at what price level the other potential lender would be interested in participating. However, it is also at this pre-bid stage that any exchange of information has the greatest risk of impacting the competitive outcome of the bidding process by potentially removing uncertainty between competitors, especially if the exchange is between entities that are potential competing for an MLA/ other lead bank role.

Whether such an exchange will have a restrictive effect on competition and/or whether it can be considered indispensable under Article 101(3) requires a case by case assessment but various factors, such as the availability of relevant information either publicly or through the lenders own prior experience on previous recent transactions in the same or similar segments, the number of potential lenders /appetite for lending to the segment, are likely to be relevant to the analysis.

This will also depend on an analysis of precisely what information is strictly required in this situation, for example, will a general indication of interest in a segment within a range be sufficient as compared to a highly specific indication of exact interest at a price? Furthermore, could the necessary insights be provided by potential investors who, whilst they may participate in the wider syndication, will not be competing for a role as an MLA or underwriting?

Where such information exchange takes place with the express consent of the borrower, whilst not ultimately being determinative as to the anti-competitive effect, is good *prima facie* evidence that the exchange is not anti-competitive by object and may further indicate that the exchange was considered and accepted by everyone as necessary in the circumstances.

The information exchange scenario outlined above is to be contrasted with information exchange pre-bid which may amount to a concerted practice and which is not potentially justified by circumstances such as those indicated. An example would include, a bank sharing information (including on a unilateral basis) on whether and on what terms it intends to bid, especially where such action is taken without the consent and without the knowledge of the borrower. Such information exchange will likely be considered as having the object of restricting competition.

Responding to an RFQ as a consortium

Where a group of banks come together to submit a joint bid in response to an RFQ at the request of a borrower then, provided that the bank group operates within the instructions of the borrower then it is likely that any information exchange between the banks for the purposes of putting together that proposal and the ultimate agreement that the banks reach as to the terms of that bid, will either fall outside Article 101(1) altogether or satisfy the conditions of Article 101(3). Such information exchange would certainly not appear to have the purpose or objective of restricting competition and, taking into account the overall context of the arrangement, would not be anti-competitive by object. Arguably, it should therefore fall outside Article 101(1) altogether. For the purposes of bidding for the particular loan the lenders must co-operate (in order to meet the borrower's request) rather than competing independently and to the extent that the information that is exchanged and the agreement that is reached are inherent to that joint bid then it is directly related and necessary to the joint bidding.

To the extent that discussions or agreements go beyond what is required for the purposes of submitting the joint bid then, depending on their nature, such discussions may breach Article 101(1) and indeed may be anti-competitive by object.

A borrower will have typically appointed (perhaps informally) a lead bank to bring the consortium together. The lead bank will need to understand each potential participating bank's potential interest (e.g. willingness to underwrite/hold) and at what price. The banks will need to communicate this between each other and ultimately agree. If a bank(s) has a certain price requirement in order to participate at a certain level, which is higher than others, then either (i) the other banks may be willing to accept an increased participation, (ii) there may be other banks (not involved in an alternative bid) who could be invited to participate; or (iii) if the particular bank(s) is needed for the purposes of the joint bid and then the price will have to be set at the highest price acceptable within the group. As such, discussions or agreements between the banks that might undermine or distort this process such as agreements not to invite other banks to participate or not to increase their participation (where acting independently they could and would have done so) are likely to have an anti-competitive effect and could in fact be anti-competitive by object.

Initial Bank Group Formation through to Mandate

As described above, the borrower creates competitive tension by inviting various banks to independently bid in response to its RFQ. At the next stage of the transaction the borrower will evaluate the respective responses to the RFQs and select the preferred banks based on their bids. The borrower will seek to put together an initial bank group, including the appointment of the MLA, other lead banks and underwriting banks. This initial bank group will be formally mandated to secure a certain amount of financing (partly or fully underwritten) at a certain price (including fees/margin).

At this stage of the process banks may decline to participate (and others may then be invited to participate) based on the borrowers' invitation – for example if the borrower invites banks to participate at the best price offered by one or more of the banks some banks may not be willing to participate at that price. Whether the borrower will be able to achieve that price will depend on whether enough banks are willing to provide the level of financing that the borrower requires. The price may need to increase if particular bank(s) required cannot commit to certain hold levels other than at a particular price. This dynamic is an essential element of the formation of the single loan price which is inherent in the multi-bank loan process

However, that does not mean that all activities that banks could engage in as the terms of the mandate are determined fall outside Article 101(1) or will satisfy the conditions of Article 101(3). Agreements or practices of the banks which might undermine the process that the borrower has put in place to achieve competitive tension (either through inviting individual tenders or requesting several consortium bids) could restrict or distort competition and be in breach of Article 101(1).

Until the initial bank group is established and the mandate is granted, the banks are still competing independently for a role/participation in the provision of the loan. Information exchange between the banks about the terms of their respective RFQs post bid but pre-mandate could thus still undermine the competitive bidding process and accordingly are likely to fall within Article 101(1) and outside Article 101(3). Such information exchange may be considered a restriction of competition by object – if done without the consent or knowledge of the borrower.

Similarly, discussions or agreements directly between the banks at this stage (under an individual RFQ response scenario) concerning their respective willingness to participate or adjust the amount they are willing to lend could potentially lead to agreements or concerted practices to fix prices or restrict supply to the borrower. If a bank or banks are not willing to commit at a certain price but others are willing to increase their hold levels or other banks are willing to participate and can potentially be invited to join, then agreements or practices that undermine this would likely be agreements that have the object of restricting competition.

Post Mandate to Loan Agreement

At this stage the borrower has instructed the MLA together with other participants in the initial bank group to agree a single term sheet /loan agreement for providing the financing. That may be either fully or partially underwritten and may include back-to-back syndication of the loan (or the syndication may occur later).

Lenders need to come together to agree all the terms of the loan and they are doing so with the express mandate of the borrower. At this stage banks could still drop out and other banks could be invited to join.

Banks are clearly mandated by the borrower to agree the loan at a single unified price on unified terms for a specified amount. Accordingly, joint meetings and discussions between the banks for the purposes of agreeing those terms are an essential element of the loan syndication process and provided that the banks are operating within the terms of the mandate granted by the borrower and their actions are designed to achieve that aim then the loan agreement itself and the discussion and exchanges of information between them which are related to achieving that aim will likely fall outside Article 101(1) or alternatively benefit from an exemption under Article 101(3).

Pricing and other terms may start to move against the borrower at this stage. This is a natural consequence of the fact that a single term sheet and loan agreement needs to be agreed and thus the terms will need to converge at a common denominator to ensure that all banks can participate.

At this stage in the process, information exchange may merit a slightly different approach. At the pre-mandate stage, where the bids are still independent, information exchange between the lenders without the consent or knowledge of the buyer is more unlikely to be justified. However, where the banks have been put together and where the MLA (and banks with other lead roles) have a mandate to secure the loan, a unilateral flow of information from a participating bank to the MLA or other banks concerning its requirements for continued participation must be viewed against this changed context, provided that the communication is no more than is required in the circumstances.

Provision of related services

Lending banks may also provide other services at the same time as providing the loan. Such services may be directly related to the loan (e.g. the borrower may require and indeed may be required by the lenders to enter into hedging instruments related to the loan such as an interest rate swap or a foreign exchange hedge) or may be unrelated (e.g. banks may seek to provide payment or other business banking services which may be related to the activities which are being financed but which are not related to the provision of the loan itself).

In the absence of dominance, a bank (or banks) requiring that a borrower purchases other services from them as a condition of their lending is unlikely to raise competition law concerns. Where there are multiple lenders and one or a number of banks unilaterally make it a condition of their lending that they have a right to provide a proportion of the related services, then the fact that the banks will then need to agree with the borrower an allocation of their respective proportion of the supply of that service is a natural consequence of the banks respective unilateral requirements. However, if the banks were to discuss and/or agree between themselves prior to their bid and before communicating their bid to the borrower that they will each make the provision of certain other services a requirement of their lending then, as with discussion of any potential bid terms, where such action is without the knowledge or consent of the borrower it is likely to amount to an agreement which anti-competitive by object.

In addition to specific lenders potentially requiring that they provide a specified proportion of a related service to the borrower, lenders more generally may require, as a condition of the lending, that the borrower put in place certain related services such as hedging instruments. Such terms may contain certain restrictions as to who can provide the services (e.g. that it must be a lending bank(s) or a financial institution satisfying certain conditions). Provided that the services in question are directly related and necessary to the provision of the loan, as opposed to services that may be required by the borrower but are not connected to the loan itself, then the requirement of the lenders that the borrower purchase such services is unlikely to give rise to competition concerns. We note that whether there is an appreciable restriction on competition may depend on the number of participating banks who could provide the service. Where there are many lending banks it is unlikely that a restriction requiring that the related services be purchased from a lending bank would appreciably restrict competition. Alternatively, if the condition does appreciably restrict competition it may satisfy the conditions of Article 101(3). Any determination in respect of Article 101(1) and Article 101(3) requires an analysis of the specific context – for example consideration of the purpose of the condition, for example such conditions may be intended to protect the lenders' position in a potential event of default.

Whilst agreements between the lending banks and the borrower relating to the fact that certain banks will supply certain related services may fall outside Article 101(1) altogether or benefit from the Article 101(3) exemption other agreements or practices related to the provision of such services may not. Notably, similar considerations that apply to the setting of a single price and a single term sheet in respect of the provision of the lending as described in detail above may not apply to the provision of the related service. Whilst there may be situations where a borrower requests that providers of a related service form a joint bid and offer a single price, in contrast to the provision of the syndicated lending it is not necessarily the case that the setting of a single price by a group of banks providing the related hedging instrument is inherent to the provision of the instrument. Each situation will need to be assessed on a case by case basis, but the evidence indicates that banks can and do compete independently to provide such services on an individual basis. In such circumstances, if the banks collude secretly on the setting of the price without the knowledge and consent of the buyer, such practices will almost certainly be anti-competitive by object.

Concluding Remarks

Assessing the application of competition law to syndicated loans is both complex and challenging. The level of competition law risk associated with any syndicated loan arrangement will depend on the stage of the transaction.

As a rule of thumb, the competition law risk decreases through the stages of a transaction as the bidding process will take place at the beginning of the transaction. At this stage, each competing bank should avoid any communications relating to the origination unless specifically instructed by the borrower – in those circumstances extra care should be taken in order to ensure that the banks are acting strictly within the remit of these instructions. After the group is formed, banks can communicate and work together within the scope of the borrower's instruction. After the mandate, the competition risks are limited, however, there may still be competitive issues such as an event of default, or refinancing where banks may drop out and others may be invited to join. Again, it is important that the banks act in accordance with the mandate and the borrower's instructions.

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[2] MLAs are banks mandated by the borrower/sponsor to provide the primary arrangement and initial underwriting for the transaction (or the full provision of funds in the case of a club deal).