

# RENEWED REGULATORY ATTENTION ON COMPETITION IN FINANCIAL SERVICES AND SYNDICATED LENDING

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Legal Briefings - By **Annalisa Heger**

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Competition and anti-competitive behaviour in financial services is a continuing focus of the Australian Competition and Consumer Commission (**ACCC**) and competition regulators worldwide.

The European Commission, on 5 April 2019, published a long-awaited thematic review on loan syndication and its impact on competition in credit markets in the EU (the **Report**). The Report considers potential competition concerns at each stage of a syndicated loan from pre-mandate to secondary market trading. The Report notes that while market features and safeguards tend to limit the risk of competition law breaches, certain practices could give rise to concerns of collusive behaviour amongst syndicate members and the exertion of bargaining power contrary to the interests of borrowers and sponsors. The Report therefore makes a number of recommendations for safeguarding competition in syndicated lending and potential future developments.

The financial services sector has seen significant enforcement action by competition authorities in recent years, and we expect the Report's findings to also be of interest to the ACCC. The ACCC is an aggressive enforcer with a stated enforcement priority of targeting anticompetitive behaviour the financial services sector. The Report's findings may prompt the ACCC to focus on syndicated lending by undertaking thematic reviews or initiating antitrust investigations into specific firms or conduct. The ACCC has sharpened its capabilities in this area with its financial services unit (**FSU**), a permanent specialist enforcement team dedicated to conducting regular inquiries and advocacy into financial services competition issues. The FSU has a budget for a rolling program of inquiries and market studies over the next four years and to date launched inquiries into residential mortgage pricing and foreign currency conversion services. These thematic reviews can often lead to follow-on enforcement action, as evidenced by the recent commencement of criminal cartel proceedings against a foreign currency conversion provider.

Financial institutions active in this sector may wish to review their compliance policies and arrangements in respect of syndicated lending in light of the Report's findings and recommendations.

## BACKGROUND AND SCOPE

In 2017, the European Commission highlighted concerns that syndicated lending “*exhibits close cooperation between market participants in opaque or in-transparent settings... which are particularly vulnerable to anticompetitive conduct*”, and referred to the possibility of engaging in a study on potential competition law issues in this area.

The European Commission then engaged external consultants to prepare the Report. The Report is based on a study of syndicated lending for leveraged buyouts (**LBOs**) and project finance (**PF**) including infrastructure finance (**INFRA**), in France, Germany, the Netherlands, Poland, Spain and the United Kingdom. The intention of the Report is not to establish specific cases of competition law infringements, but to rather assess whether market features and processes in each segment are more or less conducive to potential competition law problems. The Report is wide-ranging and proposes not only safeguards to address key risks to competition but also non-competition-related measures to increase efficiency, for example, the adoption of technologies such as smart contracting and blockchain.

## RISKS

The Report identifies the following main risks to competition, observed throughout the lifecycle of a syndicated loan transaction:

- **Market soundings:** A risk of collusion may arise from mandated lead arrangers (**MLAs**) crossing the boundary between generic and deal-specific market soundings, and also from communication to origination desks of information about specific lenders' appetite (even if obtained in the context of generic soundings). In addition, soundings between MLAs (whether specific or generic) may facilitate collusive action and increase the collective bargaining power of lenders. The Report identifies interactions in the PF/INFRA segment giving rise to a higher degree of risk than the LBO segment as PF/INFRA markets tend to be more heterogeneous than LBO ones, requiring more specialist knowledge of certain types of risks and therefore potentially more concentrated markets.
- **Non-Disclosure Agreements:** The Report highlights the lack of reliable ways to enforce restrictions in NDAs on information sharing in practice.
- **Single MLA (who may also act as advisor):** The Report notes that information sharing among lenders through a sole MLA may lead to coordination on price or terms to the detriment of the borrower. Where the sole MLA is difficult to replace, for example, because it also has a role as an advisor to the borrower or sponsor, this risk is exacerbated.

- **Post-mandate collusion by lenders discussing the loan terms:** The Report observes that the risk of this is low on the whole since the borrower/sponsor generally agrees the loan terms bilaterally with each lender following the mandate. However, two specific risks are noted:
  - negotiations resulting in agreement on the highest common denominator (whether in respect of price or other terms) and the practice in some PF/INFRA deals, especially club loans, to bring lenders together at an earlier stage to discuss terms, and
  - the risk of collusion may be higher where the borrower is relatively unsophisticated.
- **Tying of ancillary services to MLA services:** The Report notes the general practice of agreeing the provision of ancillary services directly related to the loan during the initial agreement of overall terms, over which the borrower/sponsor has control. However, it notes three issues:
  - MLAs sometimes make the provision of ancillary services a condition of the loan. The Report identifies this as an "*area of at least moderate concern*" which raises the risk of sub-optimal economic outcomes.
  - Lenders' knowledge of who is providing the loan-related ancillary services (following allocation to lenders at the initial stage of agreeing terms) provides scope for those lenders to discuss and collude on pricing.
  - Ancillary services not directly related to the loan can be negotiated as part of the loan negotiation. In this respect, the Report notes that outside the UK (where such clauses are banned for UK regulated firms, irrespective of the location of the borrower), both "right of first refusal" and "right to match" clauses are still used, which may result in a sub-optimal outcome for borrowers/sponsors.
- **Advisors belonging to the syndicate:** The Report observes that the practice of using advisors who are part of the syndicate is widespread (particularly in the PF/INFRA segment), but that adherence to protocols around keeping this role functionally separate

from lending should mitigate the resulting risks to borrowers. The authors also note that where an advisor is appointed without a competitive process and bundles its role with lending, there is a risk that the borrower may not receive the best loan outcome (even though the bundling may be done at its own request).

- **Advisors influencing borrowers in respect of transaction structure and terms:** The Report highlights the separate risk of advisor MLAs' potential to influence borrowers to adopt a transaction structure or terms suitable to the advisor's lending arm. The Report notes this as an area of high concern where controls (such as internal protocols for managing such situations) are weak.
- **Coordination of lenders when restructuring upon default:** The Report notes, first, that in the absence of an event of default, restructuring discussions between lenders should only be held with the borrower's consent. Following an event of default, however, discussions regarding potential restructuring are held collaboratively between syndicate members, which can enhance the risk of coordination – particularly where the borrower lacks choice of lenders outside the syndicate for a restructuring.
- **Tying ancillary services to refinancing:** The authors point out that in conditions of default, lenders may have the opportunity to price ancillary services on non-competitive terms as a condition of the refinancing. As with refinancing generally, the risk is exacerbated where the negotiations are limited to existing members of the syndicate.
- **Other market failures:** The Report also discusses non-competition related inefficiencies in the markets, particularly around KYC rules and settlement processes.

## PROPOSED SAFEGUARDS AND SOLUTIONS

The Report identifies a number of safeguards to drive competitive outcomes in the loan syndication process, including:

- **Training and policies:** The Report emphasises the need for adequate training and policies for relevant staff at MLAs, in particular regarding the duty to provide neutral advice to clients and to identify and manage conflicts.
- **Ensuring that alternative options are introduced to the borrower:** The Report calls for MLAs to ensure that alternative options are put to the borrower prior to aligning loan terms (including pricing) to a highest common denominator. Such alternatives may include inviting other lenders to participate or restructuring the loan.
- **Promoting competition between lenders:** The Report calls for borrowers to ensure a competitive bidding process by approaching more potential lenders, maintaining bilateral negotiations with each of them prior to mandate and building latency into the bidding

process.

- **Effective protocols on information sharing between a lender's syndication and origination functions:** The Report recommends having enforceable protocols (which are enforced in practice) governing the manner and form in which any deal-specific information obtained from other potential syndicate members may flow from a lender's syndication function to its origination function, as a key safeguard against price collusion.
- **Promotion of unbundled price competition:** To avoid impairing competition in neighbouring markets, the Report suggests that syndicates limit the cross-sale of ancillary services with lending. Where ancillary services are not directly related to the loan, the Report suggests that the offer of such services should be kept outside the syndication process.

The Report also discusses possible solutions to the general inefficiencies around KYC and settlement procedures, for example, potential and existing uses of distributed ledger technology (particularly blockchain), including reference to the syndicated loan completed by MUFG, BBVA and BNP Paribas in 2018 using blockchain, on which HSF advised (see [here](#)).

The Report states that coordination of KYC processes among market participants could be an "*area for future regulatory attention*", and as regards settlement, the Report envisages a permission-based system where the sharing of transaction input data, as well as drawdowns and documentation for individual loans, could be automatised.

## CONCLUDING REMARKS

The Report sets out the authors' own analysis and conclusions on competition in syndicated lending but does not represent the European Commission's position on how processes and practices in this area should be analysed under competition law. However, as noted above the European Commission's prior statements in 2017 clearly evidence some suspicion regarding the scope for collusion in syndicated lending, and the conclusions in the Report may prompt it to scrutinise conduct in particular segments closely. Several competition authorities (including those in Australia, the UK, Spain and the Netherlands) have also considered aspects of syndicated lending or syndicated activity in financial services in recent years. The European Commission's thematic review may encourage the ACCC to enhance its scrutiny of syndicated lending and other forms of syndicated or consortium activity in financial services.

The reaction, if any, by competition authorities and financial regulators to the Report's recommendations regarding data sharing, automation and the use of blockchain will also be of interest to ancillary service providers (for example, hedging providers or payment agents), clearing systems and data protection authorities, as well as those involved in managing loan documentation.

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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