Heads of syndication panel: fitting the pieces together

The Heads of Syndication provided an in-depth insight into the current shape of the syndicated loan market and offered a look at the challenges the next 12 months might bring.

The panel was chaired by **Mathias Noack**, Co-Head of Debt Capital Markets, Loans & Bonds at MUFG. Mathias was joined by **Charlotte Conlan**, Head of Loan Syndicate, EMEA and Deputy Head of Leveraged Finance Capital Markets at BNP Paribas; **Reinhard Haas**, Managing Director, Global Head of Syndicated and Leveraged Finance; **David Pepper**, Head of EMEA Loan Capital Markets at Bank of America Merrill Lynch (unfortunately could not attend); **Paul Gibbs**, Co-Head of EMEA Loans at Citi and **Laurent Deroy**, Head of Debt Optimisation and Distribution UK, at Crédit Agricole CIB.

Syndicated loans in context

Market volumes in Europe, the Middle East and Africa have reduced by 40 per cent compared to the previous year. The number of deals also decreased by 25 per cent year-to-date in the same period. Despite this, liquidity and investor demand remain high.

A number of economic and political challenges have contributed to falling market volumes and deal count, with market conditions being worse than expected, despite the audience at the 2018 LMA Conference predicting the market would remain unchanged. The challenges driving this trend include trade war tensions between China and the US, resulting in lowered investment and market growth globally; the discontinuation of LIBOR, affecting business planning in the near term; and uncertainty regarding Brexit, with the threat of a no-deal still looming, and no definitive deal on the table.

Despite these challenges, the syndicated loan product remains flexible and liquid, with the reduction in deal count being a result of macroeconomic changes. The collateralized loan obligation (**CLO**) market has continued to grow. Looking forward, the market will remain very much relationship driven, with an increased focus on environmental, social and governance (**ESG**) factors.

The credit cycle has historically spanned 63 months on average, with the current credit cycle now at around 125 months. This could suggest that a downturn is on the horizon. However, confidence remains high, with market participants strong in the belief that the loan market can accommodate a downturn, especially given the abundance of liquidity. The additional rounds of quantitative easing proposed by the European Central Bank could act as a buffer to a forthcoming downturn.

Investment Grade / Crossover Market

Overall volumes are down, only investment grade is holding its volume. Robust volumes in US markets, combined with a high level of transactions, could suggest that Brexit is a key reason for the fall in EMEA volumes. The disparity between US and European merger and acquisition (**M&A**) volumes is expected is narrow.

Often in large syndications, banks are unable to rely on the same pool of ancillary businesses, leading to the rejection of more deals at the outset.

ESG

The rise of ESG is driven by both banks and borrowers, becoming a growing focus in deals. Green and sustainable loans have emerged after the long-standing presence of the green bond. Only large and increasingly medium-sized companies are conducting such deals, as most smaller institutions do not yet have the resources, these companies are seeing interest from both their debt and equity investors.

Due to the infancy of the green and sustainable loan market, institutions should avoid conducting these deals for pricing reasons, ESG must become part of institutions' DNA. When this has happened, ESG criteria can then become a method of the general risk appraisal. Some rating agencies have started to include ESG criteria into their calculations.

Private Debt Instrument

Private debt instruments are an alternative liquidity pool that has emerged over the last few years. Private debt instruments provide an alternative to bonds. They allow a more flexible approach to tranching.

The Schuldscheindarlehen market is starting to eat into the bank market. Its availability for cross over credit names has impacted on European markets, presenting itself as the cheapest method of financing, enabling retail banks to access a different type of borrower. Private debt is no longer solely undertaken by true investment grade companies, meaning a higher level of caution is required.

Leveraged Market

The leveraged market had a quiet start to the year, with arranging banks taking on less underwriting risk. Demand started to bounce back in February / March. CLO volumes and deals are higher than in 2018. This robustness can be largely attributed to the cheap nature of the leveraged product. The market is focusing more on credit, good credit and a bad document is preferred to bad credit and a good document.

A significant increase in peer-to-peer lending due to lower valuations and stronger private capital, as a result funds are increasing their investments into the private market. Although, often these deals are not completed.

There is high liquidity in the CLO market but not enough paper to fill CLOs, weighing on profitability, and on management fees. The larger US market is complemented by other investments, causing a higher market volatility, and so money is far less "sticky" in US markets. There is also less competition among bookrunners, whereas in Europe the higher competition puts pressure on margins and the structure of the market. Although, the increased emergence of price-to-clear has resulted in more of these deals being pushed through.

The leveraged market is still preferred to the high yield market, due to its higher flexibility and cheaper nature. Fixes rate deals are still the preference. This pricing advantage is starting to reduce, so we may expect to see higher bond issuance at the expense of leveraged loans.

Developing Markets

Lower levels of activity than expected in the developing markets has resulted from a deferment in capital expenditure, largely driven by weaknesses in cross-border markets and general uncertainty. Lack of supply is showing the weakness in market structure.

Conclusion

A few key areas are expected to experience growth towards the end of this year and into 2020. Green finance is expected to become ever more relevant to the market as a whole. Infrastructure finance is becoming more poignant in the market, with its footprint ever growing.

There are various threats that will continue to inhibit the market, Brexit and the uncertainty around it will certainly still be a factor, whether we leave on 31 October or not; the trade war between the US and China continues to hinder larger M&A deals, however, if resolved jumbo deals could be on the horizon; and the ECB's quantitative easing policy and its effect on countries such as Portugal, Italy and Greece.