

LMA Syndicated  
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### Heads of Syndication: responsible lending in a growing market

The Heads of Syndication panel discussion provided delegates with an in-depth insight into the current shape of the syndicated loan market and offered a look forward to the challenges that 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 at BNP Paribas; **Reinhard Haas**, Head Debt Capital Markets Loans at Commerzbank; **David Pepper**, Head of EMEA Loan Capital Markets at Bank of America Merrill Lynch; **Tim Spray**, Head of EMEA Syndicate at HSBC and **Keith Taylor**, Head of Loan Syndicate EMEAPAC at Barclays.

### Syndicated loans in context – open for business

Market volumes in Europe, the Middle East and Africa have stayed relatively stable in 2018, with a slight decline of four per cent when compared to the previous year. The actual number of deals recorded has also decreased 20 per cent year-to-date in the same period. These figures are not surprising, however, given the multitude of potentially threatening macroeconomic events looming on the horizon. That said, the market has reacted by remaining stable, healthy, proactive and, some might argue, "irrationally resilient".

Despite the number of economic and political challenges the syndicated loan market currently faces, it has remained extremely competitive, and continues to be a borrower's market, with pricing, structures and documentation reflective of this ongoing trend. Such challenges include the slowing of outward investment from China, and ongoing trade tensions between the US and China, both of which have the potential to dampen market growth (especially in developing markets) and cause ripples within the wider economy. Meanwhile, uncertainty over Brexit negotiations continues, whilst the discontinuation of LIBOR is likely to affect business planning in the near term. In addition, whilst the ECB expects another year of interest rate stability, quantitative easing will continue to unwind. Although the tapering off of QE presents certain opportunities, it is also likely to result in less liquidity for maturing assets, and therefore an up-tick in refinancing activity. In terms of market outlook more generally, in the next 12-18 months, M&A activity is expected to continue to increase, as has already been the case during 2018 (at least in Western Europe). Infrastructure also remains an important area of finance and is an increasingly sophisticated market, despite limited opportunities for underwriting. Finally, certain opportunities will also present themselves in the developing markets, but for specific countries and transactions.

In terms of broader opportunities, assuming the market can continue to remain resilient and thrive in the current environment, initiatives such as green lending and the use of technology could be key to increasing loan volumes. Keeping abreast with technological growth will also be necessary to increase general market efficiency. Potential

threats meanwhile, include regulatory disparity between the EU and the US, as well as the need to maintain disciplined lending practices in an ever more competitive environment.

### **No room for complacency**

Whilst there is general consensus that the loan product is more stable than other asset types, this does not mean that market participants should become complacent, for the following reasons:

1. In general, the loan market follows a late economic and credit cycle. This naturally introduces an element of greater risk to transactions. However, to date, GDP growth has remained reasonably steady, which has proven beneficial for the product.
2. As 'no deal' headlines remain prevalent because of the state of play of current Brexit negotiations, the market will face increased disruption as a result. UK corporates with exclusively domestic headquarters will be the most challenged when it comes to maintaining relationships with the EU post-Brexit. However, according to the FTSE 100, a large proportion of the financial services industry operates on an "international" basis, which should enable it to stay somewhat immune to Brexit.
3. There are additional concerns emanating from emerging markets. Specifically, Argentina, Turkey and South Africa have been hard hit by the ongoing trade wars and interest rate hikes in the US. The consequences of such events have been local stock and currency market volatility. Russia and the Middle East also remain plagued by sanctions, which will continue to increase uncertainty and reduce liquidity in these regions.

### **The investment grade market**

Western European corporates will be impacted as a result of Brexit, meaning that borrowers will likely migrate to those banks that have the breadth and capacity to meet their business needs. This may be challenging for borrowers at the lower end of the investment grade spectrum, whilst highly rated companies are unlikely to experience any issues.

The market has seen a general expansion in M&A activity. The main drivers of this are corporate consolidation, as well as diversification of earnings and geographical locations of businesses. M&A asset prices remain high and are generally considered the bright spot of the primary market. In the US, for example, the first \$100 billion deal was recently executed. Although a deal of this scale would be rare in EMEA, it gives a good indication of market health and capacity. Furthermore, given the contraction of quantitative easing, M&A growth is expected to overtake growth in refinancing going forward.

Overall, despite ongoing uncertainty, the fundamental benefits of the loan product will remain, with the relationship element continuing to be the most important driver for borrowers. This relationship aspect will help to fuel the loan market's resilience, as well as its reputation for being a flexible product that can be adapted to meet a borrower's needs.

### **Leveraged Loan Market**

The leveraged market has seen various acquisition-driven opportunities and a large number of underwritten transactions. In the late spring of 2017, several transactions were withdrawn and were subsequently re-priced. The loan market overcame this to a large extent, and demand for leveraged loans continued. However, in the summer of 2017, there was an over-supply of transactions, which resulted in greater choice for buyers and the ability to cherry pick the best transactions. As a result, a small number of leveraged deals fell through. That said, the leveraged market remains largely healthy and hugely diversified with CLOs investing in ever greater volumes, and other types of investor consistently ready to buy in both primary and secondary, despite volatility in other markets. As a result, 2018 was a good year for the leveraged market and clearly any difficulties experienced differed from the struggles seen in 2008. This may be attributed to the fact that the demand/supply imbalance did not cause a fundamental breakdown within the system, nor were there any huge losses stemming from it. The market has also become more efficient and transparent, thanks to recent work undertaken by the LMA.

Overall, the loan remains a product of choice in the leveraged space. However, one notable distinction is between the EU and US markets which continues to be significant, with the latter setting trends for the former, and large-scale deals being more frequent. Nonetheless, both markets operate well and there is an expectation that this will continue.

### **The secondary market and the role of technology**

The secondary market is increasingly active, as investors adopt a much more dynamic portfolio management style. Greater secondary market activity would be welcome, but this is hampered by transferability provisions within documentation. There is a clear demand within the secondary market for loan assets, as the European investor base continues to grow and diversify. Despite this, the market has become more restrictive in terms of transferability, and lengthy settlement times are also affecting overall secondary market liquidity.

While certain secondary and operational processes can be assisted and benefit from the implementation of new technological advances, a key issue relates to the investment cost associated with such a transition. Where new IT systems are required to improve work processes, it is often seen as burdensome from a cost perspective.

### **Emerging markets**

In Russia, which is faced with multiple challenges stemming from sanctions, deals continue by virtue of bilateral lending. Despite ongoing geo-political challenges, the Middle East continues to thrive as a result of which the market has expanded considerably. The situation in South Africa is also improving, and despite the troubles towards the end of 2017, some promising transactions completed. The updates from Turkey, meanwhile, continue to raise concerns. While some banks have withdrawn from the market within the past two to three years and from developing markets more generally, there are still groups of banks ready to lend and develop their business platforms within the developing markets, and new opportunities continue to arise.

### **Conclusion**

The loan market as a whole is expected to experience slow and steady growth, with an increasing shift towards green finance, as investors seek new opportunities within this developing area. Additionally, robust activity is anticipated within certain developing market countries, where there remains great potential for growth, with solid fundamentals to facilitate this.

Some of the key threats have been identified as the failure to properly exploit technological advances, whereas economic trade wars could have a knock-on effect on the loan market as well as the economy more generally. The uncertainty stemming from a potential 'no-deal' Brexit scenario also poses numerous challenges, as investment and financing may be substantially affected in a worst-case no-deal scenario. However, complacency is thought to constitute the greatest challenge of all, and loan market practitioners are urged to ensure that this doesn't become a feature of the market in the coming months.