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IMPACT OF BREXIT ON SYNDICATE LENDING

Authored By – Srividya P

Abstract

The borrowing requirements of corporates, individuals, commercial banks, hedge fund investors and so on, can be out of the scope and lending capacity of a single lender. This leads to the concept of syndication whereby one borrower under a single credit facility can borrow money from a syndicate of lenders, sharing the credit risk. This paper provides an insight of loan syndication and its significance in the global market. It also sheds light on the advantages and disadvantages of syndicate lending. Loan syndication is an important source of finance in European economy. This paper analyses the loan syndication in the global credit market and the regulatory framework applicable on such lending. It also studies the impact of BREXIT on syndicated lending based on statistical data and provides an analysis of temporary changes made in the policy regulations in the transition period.

Keywords: Syndicate finance, BREXIT, European Finance, European Union, Britain, UK.

Introduction

Syndicate loans are large global markets for credit. Syndicate loans are significant as majority of the multinationals and conglomerates take loans through syndication and as much as 5 trillion USD are conducted by banks as a syndication.¹ Syndication involves the sale of a relatively large commercial loan in “parcels” to a group of institutional buyers.² A syndicate loan is a credit facility whereby money is pooled by a group of lenders, collectively called as the syndicate, to lend the money pooled to a borrower.

Every lender in the syndicate contributes at least one part of the loan, sharing the credit risk and potential capital loss. They are single credit facility arrangement having various types of

¹ Jang Ping Thia, ‘Bank Lending – What Has Changed Post Crisis?’ (2019) 43 Journal of Economics and Finance 256.

² Steven A Dennis and Donald J Mullineaux, ‘Syndicated Loans’ [1999] SSRN Electronic Journal <<http://www.ssrn.com/abstract=152689>> accessed 24 October 2022.

loans each with different repayment modes negotiated and agreed upon by the lenders and borrowers. Loan syndication happens when one borrower requires a large sum of money and a single lender is unable to cater to the same or when such loan is beyond the scope of such lender's risk exposure³.

Syndicate finance is an important source of finance to the European Economy⁴. Debt is critical source of finance in the European Economy with about \$800 billion (about €720 billion) raised in 2017⁵. Syndicate lending is an alternative debt financing mode that aims to eliminate factors such as information asymmetry, matching problems and moral hazard.⁶

Syndicate finance is different from traditional banking associated with bilateral relations between the bank and the customer. In loan syndication lenders achieve greater diversification in their loan portfolios.⁷ There are essential parties to loan syndication: the borrower, the mandated lead arranger or agent, the participant lenders and the trustees. Upon the application made by the borrower the arranger (typically a bank) finds potential sources of syndication, from the participant lenders, for obtaining the loan quoted by the borrower. The borrower and arranger negotiate the terms and conditions of the loan granted in syndicate. The trustees are persons who hold the security given by the borrower on behalf of all the lenders. Trustees have a fiduciary relationship with the syndicate. While there are many advantages to syndicate lending such as loan diversification, sharing of credit risks, there are various disadvantages of syndicated loans. For instance, lead arrangers are more likely to hedge their credit risk exposures than other syndicate members,⁸ there are no competition law provisions with respect to syndicated loans protecting the interest of the borrowers.

³ 'Syndicated Loan' (*Corporate Finance Institute*)

<<https://corporatefinanceinstitute.com/resources/knowledge/finance/syndicated-loan/>> accessed 25 October 2022.

⁴ Johan Ysewyn, 'The European Commission Publishes Report on EU Loan Syndication and Its Impact on Competition in Credit Markets' (*Covington Competition*, 29 April 2019)

<<https://www.covcompetition.com/2019/04/the-european-commission-publishes-report-on-eu-loan-syndication-and-its-impact-on-competition-in-credit-markets/>> accessed 25 October 2022.

⁵ European Commission. Directorate General for Competition., Europe Economics., and EUCLID., *EU Loan Syndication and Its Impact on Competition in Credit Markets: Final Report*. (Publications Office 2019)

<<https://data.europa.eu/doi/10.2763/738938>> accessed 24 October 2022.

⁶ *ibid.*

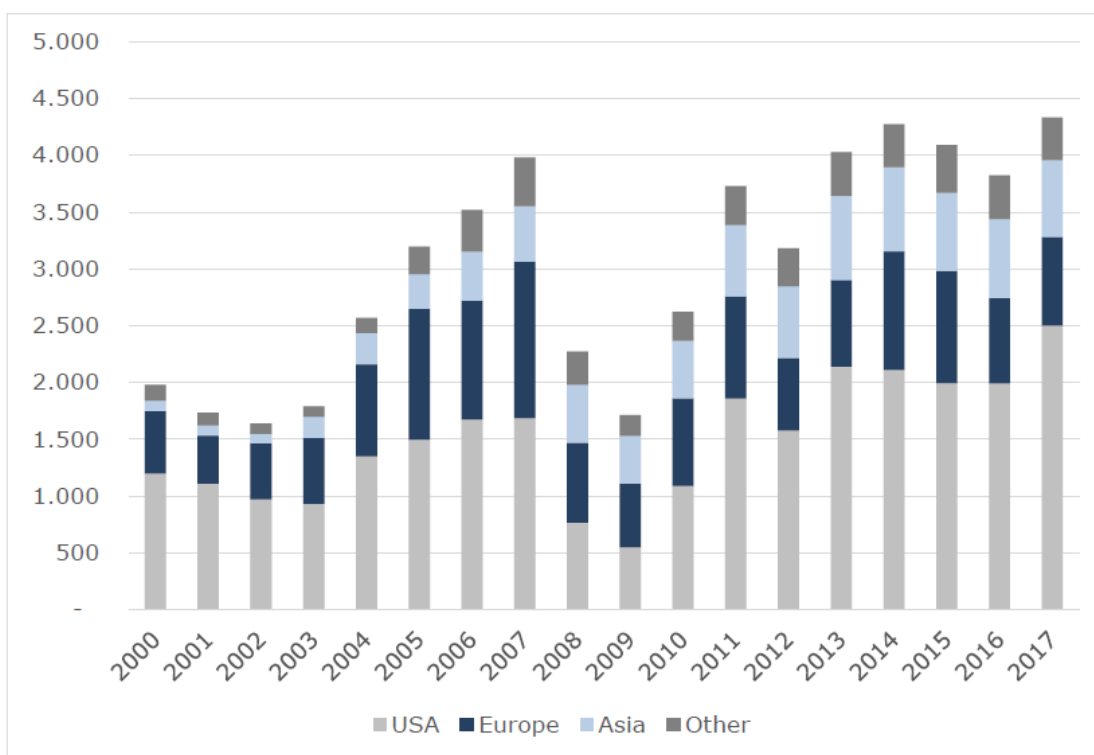
⁷ 'Syndicated Lending' 5.

⁸ Iñaki Aldasoro and Andreas Barth, 'Syndicated Loans and CDS Positioning' [2017] SSRN Electronic Journal <<https://www.ssrn.com/abstract=3723405>> accessed 25 October 2022.

Syndicate lending and Global Credit Market

Syndicated loans are favourable as they enable institutional investors and banks to pool their resources to support initiatives that would otherwise be deemed too risky to undertake by a single institution. The global syndicate market has received a boost after the 2008 Global Financial Crisis, the introduction of Euro and is strongly influenced by credit bubbling building.⁹ As of 2017, the syndicate credit market is major source of debt financing with borrowings raising over almost 4 trillion US dollars. The figure 1 depicts the Annual syndicated lending of USA, Europe and Asia. Figure 2 shows the average amount of transaction value of deals that are syndicated.

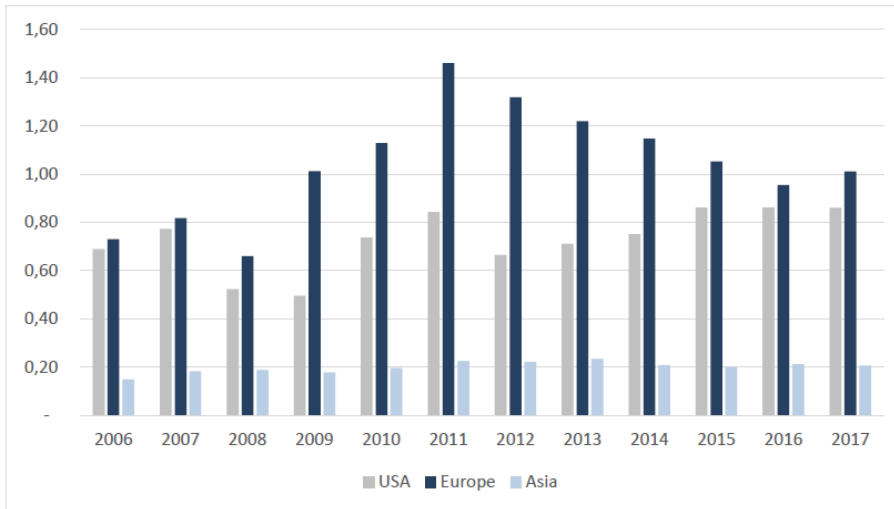
Figure 1: Annual syndicated lending (US\$ billion)



Note: Other includes Russia, Middle East and Africa, and the Americas outside of the USA.
Source: Thomson Reuters Loan Connector.

Figure 2: Average deal value of syndicated lending transactions (US\$ bn)

⁹ European Commission. Directorate General for Competition., Europe Economics., and EUCLID. (n 5).



Source: Thomson Reuters Loan Connector.

The following Table 1, shows the total percentage of syndicated loan in Leveraged Buy Out (LBO), Infrastructure (INFRA) and Project Finance (PF).

Table 1: Total amount borrowed by Member State and loan purpose (2010-2017, €m)

	LBO	Project Finance	Infrastructure	Total (%)	Total (€m)
DE	23%	5%	12%	17%	83,886
ES	10%	12%	23%	15%	73,876
FR	18%	32%	14%	19%	92,958
NL	14%	8%	9%	11%	57,031
PL	3%	0%	2%	2%	9,899
UK	32%	42%	40%	36%	181,379
Total (%)	100%	100%	100%	100%	
Total (€m)	256,499	67,254	175,277		499,030

Source: Europe Economics (using Thomson Reuters Loan Connector).

Note: Loan Connector does not report amounts borrowed for 17 out of the 4,020 tranches.

A decline in the market was experienced particularly strongly in Spain post-Euro crisis, but is also evident in the Netherlands and Poland. The largest markets – i.e. borrowers located in Germany, France and the UK - exhibit much more consistent deal flow than the others.¹⁰

Table 2: Total number of deals by Member State and loan type (2010-2017)

¹⁰ *ibid.*

	LBO	Project Finance	Infrastructure	Total
DE	150	23	68	241
ES	77	70	228	375
FR	188	50	199	437
NL	76	17	36	129
PL	10	1	22	33
UK	247	78	181	506
Total	748	239	734	1,721

Source: Europe Economics (using Thomson Reuters Loan Connector).

The above Table 2 depicts the number of deals that were entered into by different states through syndicate lending. Any given loan syndication can involve multiple ‘tranches’. This means that the syndication of a revolving credit facility (one tranche) could differ in process and in syndicate members to a Term Loan (another tranche) on the same deal. The total of 1,721 deals in turn corresponds to over 4,000 tranches¹¹.

Regulation Of Syndicate Lending

Number of regulatory framework have been introduced to regulate syndicate loans. Capital Requirements Regulations and Directive IV (CRR and CRD IV), Solvency II, the AIMF Directive and MiFID 2 are major frameworks that regulate syndicate lending. The CRD IV and CRR implement regulations dealing with liquidity, capital and leverage. These are mandatory to follow and are stringent. With respect to capital these regulations set bar for increased quality and quantity of capital reserve, increased financial stability by replacement of non banks by banks and consumer protection. The CRD IV increased the regulatory costs and posing higher capital requirements for syndicate fund raising. This was implemented to eliminate the risky borrowers in the credit market.

With regard to leveraging, the introduction of leverage ratio decreased the capacity of banks to provide for loans in general. In order to comply with the leverage ratio requirement, banks may consider taking the junior role in the syndicate loan system and finance only a small part of the loan to keep their capital requirements low. The prohibition of netting might also increase the cost of borrowing, as without the benefit of netting, borrowers might appear less creditworthy. Coming to the liquidity part, The liquidity coverage ratio (LCR) requirements are introduced on bank lenders in respect of committed undrawn facilities, since these will be required to be

¹¹ *ibid.*

backed with liquid assets. Loans or loan participations are not eligible for inclusion within the liquid asset pool, regardless of the underlying borrower¹².

Solvency II is specifically an EU directive which establishes new risk based capital requirements. As per solvency II regulations debt structures that are relevant to the syndicated loans such as the long maturity debt, structured finance products, and real estate are imposed with high capital charges compared to other forms of debt, in order to reduce the use of syndicated loans.

Alternative Investment Fund Managers Directive (AIFMD) is mainly introduced to regulate AIFMs, hedge funds, private equity funds, investment companies, retail investment funds and real estate funds. This directive emphasised on greater diligence requirements and reduce the size of the market. Under the directive the fund managers are expected to act in favour of the AIF so as to prevent the AIF from attracting penalty in the form of “undue costs”.

The MiFID 2 regulations directly does not affect the syndicate loan market. The structured loan finances fall within the scope of MiFID 2 which are subject to greater transparency in the transactions and with regime that is tailored for the best execution of loans.

Impact of BREXIT on Syndicate Lending

The UK syndicate lending market is one of the largest syndicate loan markets in the world. The UK credit market constitutes around 10% of UK's GDP, 12% of tax receipts and 3% of trade surplus GDP¹³. Rising political and macroeconomic uncertainties continue to dampen firms' motivation to borrow across the continent, but the drop in the volume of loans of UK is due to the UK's decision to exit the European Union¹⁴. In 2016, the UK voted to leave European Union – BREXIT vote, though the polls forecasted ‘remain’ situation, it had an immediate effect on the macroeconomic consequences on the UK economy¹⁵. The global syndicated loan market document a drop of loan issuances in the UK syndicated loan market by about 24% after the Brexit vote¹⁶. To check the impact of Brexit on the syndicated loan market, data related to the

¹² *ibid.*

¹³ Tobias Berg and others, “Brexit” and the Contraction of Syndicated Lending’ 27.

¹⁴ ‘LPC - UK Syndicated Lending Slumps amid Brexit Uncertainty’ *Reuters* (28 October 2016) <<https://www.reuters.com/article/uk-loans-brexit-idUKKCN12S1ZY>> accessed 26 October 2022.

¹⁵ Deyan Radev and Georgi Penev, ‘Brexit and the Fintech Revolution in Europe: Lessons from the Bulgarian Digital Finance Cluster’ [2022] SSRN Electronic Journal <<https://www.ssrn.com/abstract=4177337>> accessed 24 October 2022.

¹⁶ *ibid.*

syndicated loan market has been analysed in relation to other countries in the global syndicated loan market. The following Table 3 contains data of global syndicate market from 2000-2015, the UK stands in the third place with respect to loan issuance. Compared to the US, we can see that UK has highest exposure to foreign borrowers, foreign lenders and currencies, needless to say it being a part of the EU is the biggest reason for such exposure.

Table 3:

Syndicated Loan Market around the world, 2000-2015

Data: Dealscan/SDC, 49 countries worldwide

Country of Syndication	Total Loan Volume in 2015 US\$ billions	Number of Observations	Percentage of Total Loan Volume	Cum. Percentage of Total Loan Volume	Av. Loan Amount in 2015 US\$ millions	% of Foreign Borrowers	% of Foreign Lenders	% of Foreign Currencies
1 USA	24,416	86,278	48.92	48.92	283.01	5.72	24.24	1.15
2 Japan	3,604	28,378	7.22	56.14	127.09	4.19	6.24	7.53
3 United Kingdom	3,107	8,147	6.23	62.37	383.75	17.38	56.35	35.47
4 Canada	1,965	6,489	3.94	66.31	302.9	4.56	16.12	31.71
5 France	1,878	5,332	3.76	70.07	354.94	6.42	47.83	7.15
6 Germany	1,721	5,209	3.45	73.52	332.57	7.24	55.42	9.99
7 Australia	1,209	5,023	2.42	75.94	242.06	12.22	38.6	20.42
8 Spain	1,046	3,694	2.1	78.04	283.9	9.65	48.98	10.4
9 China	874	3,189	1.75	79.79	274.75	12.42	14.31	21.29
10 Netherlands	777	2,060	1.56	81.35	378.41	22.91	74.64	27
11 Hong Kong	708	2,641	1.42	82.76	268.54	29.98	93.39	47.19
12 India	657	3,033	1.32	84.08	217.11	10.83	28.59	40.02
13 Italy	654	2,274	1.31	85.39	287.95	17.32	59.37	3.95
14 Taiwan	508	5,486	1.02	86.41	93.1	12.58	11.36	27.01
15 Switzerland	511	729	1.02	87.44	703.43	18.6	85.55	82.35
16 Russia	469	1,388	0.94	88.38	338.67	15.38	87.53	95.88
17 Singapore	370	1,609	0.74	89.12	231.04	34.39	65.91	50.07
18 Sweden	374	889	0.75	89.87	425.1	7.09	74.05	64.87
19 Korea (South)	347	2,493	0.7	90.56	140.47	11.99	32.58	48.77
20 Norway	318	1,073	0.64	91.2	296.95	29.69	61.55	74.65
Rest of World	4,392	16,010	8.8	100	275.44	15.01	86.62	
Total	49,908	191,424	100					

Data shows that there has been a significant drop in the number of loans issuance after the brexit vote. A sharp 20% drop can be seen in the UK after 2016 compared to all the other global syndicate markets. The following Figure 3 depicts the sharp decline in the number of loans issued in the syndicate loan market of UK.

UK versus Rest of World: Drop by ~20%

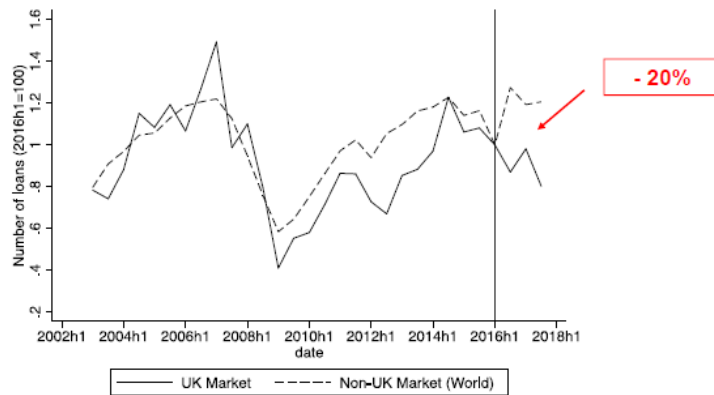
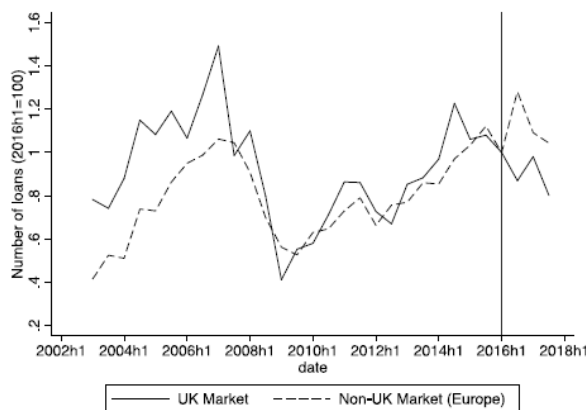


Figure 3:

It can be analysed from Figure 4 that the syndicate loan market of Europe as a whole, excluding UK, hasn't been affected much after the Brexit while as mentioned earlier a significant drop can be witnessed in the UK syndicate loan market.¹⁷

Figure 4:

UK versus Europe-ex-UK



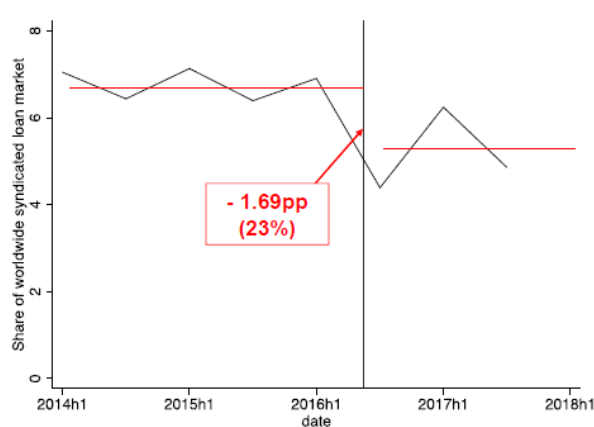
A significant drop in the UK market share after the Brexit referendum, from an average of 6.94% to 5.10% can be observed. This drop by 1.84 percentage points is economically highly significant and amounts to 27% of the pre-referendum market share of the UK market.¹⁸ It is analysed that the drop in the loan issuance is because of the drop of the demand of UK firms and the drop in the use of Pound Sterling as currency. UK volume is significantly down, this is

¹⁷ Tobias Berg and others, "Brexit" and the Contraction of Syndicated Lending' 27.

¹⁸ Radev and Penev (n 15).

a Brexit effect. There has been no new M&A activity in the UK corporate space to replace deals that have run off¹⁹. Though the domestic market of UK faced a decline it can also be observed that the international market is not much affected by brexit.

Figure 4: Share of UK market as a percentage of worldwide syndicated loan market drops 1.69pp after Brexit vote



The drop in borrowing is also a reflection of UK's preparedness before the referendum.²⁰

Impact of Brexit on Regulatory Framework

The UK post brexit will be treated as a third country by the EU.²¹ Lending activities are as such not regulated in the UK, EU based entities could grant loans to UK firms without any authorisation, whereas there are jurisdictional authorisations applicable in EU. These authorisations are not required if the lender is an EU credit institution regulated by CRD IV. Until the brexit, UK banks relied on the EU passport to grant loans to EU based businesses. The EU clarified that the third countries will not be granted equivalence in their regulatory framework. As of 2020 EU is reluctant to give UK "equivalence" irrespective of UK implementing the financial framework of EU and has only granted UK temporary and limited equivalence for settling Irish securities. On the other hand UK decided to on-shore EU equivalence decisions into its own framework and set out similar guidance on its own new

¹⁹ 'LPC - UK Syndicated Lending Slumps amid Brexit Uncertainty' (n 14).

²⁰ *ibid.*

²¹ 'The Equivalence Decisions Framework of the EU and UK – Brexit and Beyond'

<<https://www.dentons.com/en/insights/articles/2020/december/28/the-equivalence-decisions-framework-of-the-eu-and-uk-brexit-and-beyond>> accessed 27 October 2022.

framework for UK equivalence determinations.²²

With regard to loan documentation, the laws of England and jurisdiction of the English courts will be applicable. As per Article 55 of the EU Bank Resolution and Recovery Directive (2014/59 EU) (BRRD)²³, the European Economic Area (EEA) institutions are to be governed by third country laws with regard to bail in clauses. The contracting entities must identify the institutions obligations under the BRRD II directive. As UK is deemed a third country post brexit, the EEA financial contracts are all brought under the scope and ambit of English Laws. The end of the transition period will have a much more limited impact on UK financial institutions' bail-in clause obligations.²⁴ As of 2022, the obligation to include bail in clauses would apply to EEA law contracts under which a UK financial institution will incur an unsecured debt obligation. Pre brexit the EU specific regulations were applicable to UK EU loan agreements, pursuant of the EU withdrawal Act, the UK law is amended to incorporate EU law and in many cases the retained EU law has been amended to apply UKs domestic regulations.

Conclusion

The UK being one of the largest syndicate lending market internationally received a huge blow after the 2016 brexit vote. The Brexit vote was the outcome of the global financial crises where in the fall of one economy led to the cascading of other economies in the EU. The regulatory framework post brexit is still in the negotiating process between the EU and UK policy makers, and is quite dynamic until the transition process ends. The drop in the number of loan issuances by UK is a major sign of UK's preparedness towards disassociating itself from the EU. Borrowing activity of UK based firms gradually slowed down 12 months prior to UK's referendum to leave the European Union. While M&A activities drive the loan markets, the EU credit market is severely affected by UKs brexit vote.²⁵ The impact of brexit on syndicate lending markets can only be truly and in the correct sense be analysed only after the end of transition period .

²² *ibid.*

²³ 'Brexit: Key Issues for Lending and Loan Documentation'

<<https://www.dentons.com/en/insights/articles/2021/january/1/brexit-key-issues-for-lending-and-loan-documentation>> accessed 27 October 2022.

²⁴ *ibid.*

²⁵ 'Where next for the Syndicated Loan Market?' (*Ocorian*) <<https://www.ocorian.com/article/where-next-syndicated-loan-market>> accessed 27 October 2022.