A supporting role

JOHN GROUT, THE ACT'S DIRECTOR OF POLICY AND TECHNICAL, PARTICIPATED IN A RECENT INDUSTRY CONFERENCE ON SYNDICATED LOANS WHERE THE DISCUSSIONS RAISED SOME CRITICAL TOPICS FOR TREASURERS TO CONSIDER. **PETER MATZA** HAS BEEN LOOKING OVER THE ISSUES.

In the recovery from the depths of the financial crisis, banks have broadly worked out who they want to support and who they don't want to support – the "good" customers and the "poor" ones. Where they want to do business, they believe they must support relationships with loans – to drive sharing of ancillary business. However, many borrowers are cutting the size of renewals and holding their syndicates down on price, so not only are banks that want higher pricing left out but those that stay yield to lower prices. There is increasing concentration of banks within Europe, with the top 10 providing half of all new facilities.

MOVE TO CLUB DEALS A possible outcome of this will be pure club deals – same ticket, same exposure, but with different pricing tied to different levels of ancillary business. At the conference a number of banks suggested there was a lot of self-arranging going on but the general consensus was that it was just a way for borrowers to be seen to be managing their banks. The implication is that two or three years out, banks that don't get – or for Basel III (B3) type reasons can't take on – the ancillary business they are offered will drop the customer. However, many bank speakers disagreed with this analysis, as did a number of corporate treasurers in the audience. Some participants noted that banks had already reduced the size of their balance sheets and needed to maintain remaining relationships, and so had to take what business was offered. Focusing on preferred customers simply does not generate enough business. However, the ACT has pointed out before – in relation to Basel II – that banks have become more sector-focused, which is not good news for corporates in sectors that are less attractive to the banks.

B3 means simply that bank-provided capital will be more expensive. Interestingly this will affect the banking industry as well as corporate sectors: a loan to a large bank requires 35% more capital than a loan to a large corporate! Banks want an increased cost clause for B3 in any new loans, but corporates clearly do not. The existing Loan Market Association (LMA) documentation can't be relied on for B3 as it is not possible to show how any particular B3 cost can be reliably measured or relates to a particular loan – and were it possible, banks would, commercially, not want to disclose that information. Banks therefore need to price positively for B3 in new facilities, and not use cost clausing.

BASEL III MEANS SIMPLY THAT BANK-PROVIDED CAPITAL WILL BE MORE EXPENSIVE.

LOW TRANSACTION LEVELS Primary transactions have been very few in the leveraged loan sector, which has left a lot of banks with many employees looking to do more. Banks are supporting refinancing and event-driven transactions (M&A, etc.) but there are too few such transactions. Both trends are driving down pricing. The growth, so far as there is any, is in European mid-cap business sectors as they recover, providing good drawn bank loan and bond market business.

The question for many corporates is to what extent the bond market will pick up the slack from reduced bank lending (presumably leaving the equity markets to the brave). At present there is a total absence of AA companies in the loan market. Companies from across the investment-grade space can get seven-year bond finance with no covenants at 7% – an attractive proposition for many. A word of caution, though: sovereign and bank refinancing in bond markets will be very high through 2013, so companies should think about going to bond markets soon.

At the conference none of the companies believed banks' claims on ancillary business. Those that did ancillary business with banks that did not lend to them could see little difference between the prices of those banks (which should have been lower) and those of lending banks (which should have been higher). Accordingly, corporates were not persuaded they would pay more for loans on a promise that banks would charge less for ancillary business. Managing ancillary business is becoming a higher priority and how much of the optional kind could be sustained in the new regulation and accounting regime was questioned.

Where appropriate, companies seem intent on reducing their leverage and diversifying away from dependence on bank lending by increased use of bond markets. Some of the leverage reduction was to be by equity issue and disposal of assets (although that would suggest other corporates will make use of cash balances/new capital for acquisition). Joint ventures and the odd subsidiary in a difficult location apart, banks would be shifted to stand-by lines, despite their relative unattractiveness. Some corporates with sub-investment grade ratings might also target a move up the credit curve if they thought sub-investment grade would become untenable with any chance of sustainability and long-term planning.

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