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## Heads of Syndication: visions through volatility

The Heads of Syndication panel debate provided a summary of possible explanations for, and solutions to, the recent volatility in the syndicated loan market and the key challenges that institutions may face.

The panel was chaired by **Reinhard Haas**, Global Head of Debt Capital Markets Loans for **Commerzbank**. He was joined by **Edward Brown**, Global Head of Syndicated Finance at ING; **Charlotte Conlan**, Head of Loan & HY Syndicate for EMEA at **BNP Paribas**; **Nick Jansa**, Global Co-Head of Leveraged Debt Capital Markets at **Deutsche Bank**; **Kristian Orssten**, Head of HY & Loan Capital Markets in Sales and Trading at **J.P. Morgan**; and **Keith Taylor**, Head of Loan Syndicate for EMEA at **Barclays**.

### The shape of the loan market today

Over the past 12 months, the EMEA loan market has been impacted by macroeconomic events, such as Brexit, European growth stagnation, emerging market stalling and a slowdown in Chinese growth. It is therefore not surprising that the number of transactions is down 32% year-on-year. Whilst the slowdown in number of deals is not necessarily conducive to an upbeat market, market participants should not be overly pessimistic. There is substantial liquidity available in the market, and whilst the first half of the year saw insufficient borrower appetite for syndicated loan financing, there have recently been a significant number of large M&A transactions passing through the market. Going forward, the market requires a stronger backdrop of clients looking to do more business.

The key element for a healthy, functioning market is demand and, as a result of high liquidity, the market is in good shape for borrowers to take advantage of the change in supply environment.

### Withstanding the Brexit shock

Market predictions for the June referendum were for the UK public to vote in favour of remaining in the European Union. The markets reacted emotionally to the "leave" result, which spurred erratic behaviour. Despite this, within the syndicated loan market it has been very much "business as usual" but needless to say the medium/long term of effects of Brexit will only emerge over time as negotiations evolve. Supportive central banks and the willingness of banks and institutional investors to proactively support their clients allowed the loan market to continue to play a critical role in the economy.

Looking ahead, Brexit is not just a UK issue and is likely to have broader ramifications across EMEA, particularly when coupled with the upcoming elections in France and Germany.

### An upbeat primary market?

The first half of 2016 saw corporate and European M&A volumes down year-on-year, but the European investment grade M&A market has been more active with a number of large-cap European firms looking to expand their businesses into the US. Cash acquisition activity has also been spurred by cheap debt both in the bank markets, predominantly in the form of bridge financings, and in the takeout markets.

Despite a number of political and macroeconomic events in the past 12 months, banks' capacity for investment grade underwriting remains high and takeout markets have proven reliable for underwriters in the context of negative yield bonds. On the other hand, the leveraged market remains sensitive to market events, therefore underwriters have been more nervous, particularly with deals that combine bonds and loans.

The mid-market also lacks demand for credit, but it has benefitted from investors lending more to mid-cap firms in search of yield. An increase in Schuldschein and European Private Placements volumes has strengthened the syndicated loan market as companies of all sizes try to diversify their funding sources using a wider range of private debt instruments.

## Opportunities in developing markets

Some years after markets were hit by sanctions imposed on Russia, loan market volumes in the first half of 2016 saw a sizeable increase of around 500% versus the same period in 2015, demonstrating greater demand for funding from Russian borrowers coupled with international banks' willingness to lend. A strong local bank environment should encourage more activity in the syndicated loan market, providing there are no further geopolitical events in the region.

The pan-regional geopolitical crisis in Turkey has led to a widening spread between primary and secondary pricing because financial institution deals, which are mainly relationship driven and dominate the Turkish market, have more stable primary market credit spreads. Despite continuing financial institution deal activity, the corporate market has remained quiet.

Oil based economies in the Middle East have seen a fair amount of activity in recent months, including sovereign liquidity financings, but the region gives few signs of volume growth in the future. The public sector is an exception as it undergoes significant restructuring to increase efficiency and this may create new loan opportunities.

## Life to come in leveraged finance

More deals are expected from opportunistic borrowers, looking to re-finance, re-price or re-leverage because liquidity is abundant from both the fund and bank markets. A strong corporate M&A market is needed to provide loan market growth in 2017 and private equity will continue to compete alongside in order to find new opportunities.

European CLO issuance, which consistently supports the leveraged market, is highly attractive to investors during periods of low interest rates because of low levels of default, high yields and exposure to floating rate assets however it continues to experience low activity. Proposals for risk retention requirements to increase from 5% to 20% are a concern for CLO issuance and it would be damaging if excessive risk retention was to prevent this proven model from working effectively in the future.

The new structural concept of unitranche is also an attractive way for borrowers to finance capital structures and is another creative solution for issuers in the private debt market.

## Liquidity issues in the secondary market

Whilst liquidity is ample in the primary market, primary market participants have been reluctant to sell their holdings in the secondary market because of a lack of active buyers. Settlement efficiency also remains a key concern for parties in the secondary market and technology investment will be required to reduce settlement times further, particularly to offset the regulatory pressure of KYC requirements.

## The need for strong infrastructure finance

Like the rest of the loan market, deal flow has been low and competitive in the past 12 months, pushing down prices so low that the fund market is taking up fewer of these financing opportunities. Infrastructure investment across Europe is not held back by a lack of financing but has been stalled by governments not authorising large scale projects. It is estimated that between $57-90 trillion will be required by 2030 to finance global infrastructure projects, and whilst these numbers may be overstated the requirements are still substantial. Increased regulation makes it more difficult for banks to lend long term and, following an extended period of austerity, governments do not have money to finance projects either. The widening gap between required and actual funding can be filled by institutional investors, sovereign wealth funds and insurance companies, who are more natural lenders into this sector given the tenors involved.

### 2017 and beyond

It is expected that corporate M&A activity will increase in 2017, both in investment grade and leveraged markets, as the volatility which arose after the Brexit referendum dissipates. The loan market is likely to become more complex due to the blurring of lines between different product and investor types, but it is promising that these future changes will create new opportunities for arranging banks to keep abreast of.