SYNDICATED LENDING

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To commence, I would like to say two things. Firstly, to make it clear that I have no legal qualifications of any nature and have no pretensions or desire to commence learning at this stage of my life. At the best, I am a bush lawyer from the university of hard knocks but I have learned to respect the legal advice that bankers often receive and then ignore on the grounds of taking commercial decisions.

Secondly, to say that I support the bulk of the viewpoints expressed by John O'Sullivan in his excellent paper.

In the short time available to me, I intend to comment upon four principal areas -

1. My view of the role of a syndication manager in Australia using the terminology and interpretation made by John.

2. Make several points on the vexed question of conflict of interest between a principal relationship banker and a syndicate that the bank lead manages.

3. A number of examples of where ill thought through voting rights have caused problems.

4. Why I consider that the rights and ability to assign credit should be closely controlled.

In Australia, it would be very rare for syndications to be undertaken other than by one of the client's principal relationship bankers. Although we are somewhat changing our previous views on syndication, the principal motivation to syndicate in the past has not been to leverage the returns available but -

- to shed risk when an individual client's exposure is reaching high levels; and

- when the absolute size of the transaction requires the sharing of risk.

Therefore, it would be rare for a syndication to proceed, let alone succeed, if the principal relationship bank was not prepared to take a larger amount than anyone else. This compares with the US market where, to our regret, we have sometimes taken credit risk participations, with very little rights attaching, only to find that the syndication manager eventually retains only a nominal amount of the risk. In cases where the credit runs into trouble, you can well imagine that the syndication manager has very little motivation or inclination to assist with the problem.

With the Australian trading banks invariably taking the larger share of the risk on a disclosed basis, it is reasonable to assume that the other participants will have the benefit of full disclosure of all information held by the principal banker. CBA regards it as mandatory that no material information, available at the time of syndication, be withheld from other banks. In turn, our experience has been that invitations received from other banks, have been supported by quality information on a reciprocal basis. The fundamental problem has always been the completeness and validity of the information made available from the client. Bankers do not have the powers of auditors and although our questioning is intense, our reliance on receiving the total picture is very much a client's option.

In any event, the market in Australia comprises local trading banks and foreign banks who are highly skilled in their credit analysis. There are very few instances where a participant agrees to join a syndicate simply because it is being led by a major Australian trading bank. There is a healthy degree of cynicism existent in the process.

Therefore, I would fully agree with John when I say that there is no commercial recognition of any fiduciary relationship between the manager and participant banks in the local market. Syndicate members buy the product with their eyes open. Whilst they do take comfort to some extent from the participation of the local relationship trading bank, the credit analysis work will invariably be completed to individual participant's satisfaction.

The problem with duty of care and possible conflict of interest commence subsequent to closing of the syndication when the principal relationship bank may be informed of matters which indicate a possible deterioration in the client's position. On this score, CBA takes the view that information available to an officer within the bank represents information available to the bank at large. In other words, we would not hide behind the distinction between an account relationship manager and the part of the bank conducting an agency role for the client.

To this extent, I cannot share John's view that the role of the agent is rather less difficult.

The debate becomes a matter of what is commercially responsible following receipt of the information or what is legally required of the agent bank under the documents. Commercial bankers are placed in a very difficult position upon obtaining such information. The view may be formed that whilst there has been a downturn in outlook, the client is confident of being able to handle the situation. We may possibly agree. If, however, we felt constrained to pass on such information on a voluntary basis to all participants, they may not necessarily take the same commercial view.

Depending on voting rights, the relationship manager and the client could see themselves forced into a position of potential default simply because the information is conveyed.

John made mention of the relief available to an agent in this area by the insertion of carefully drafted "ostrich" clauses. Personally, I am not over-keen on such clauses but would prefer to deal with any such cases on their merits.

A word now on the so-called problem of syndicate democracy. Whilst accepting that there must be some level of equality in a syndicate, and that no individual bank should be effectively disenfranchised on important issues, I simply cannot support the view that a participant speaking for, say, $5m in a $500m syndicate should have other than voting rights equivalent to his stake in the game. In such a transaction, if I have $100m on the table, then I would expect it to be heard in proportion to its size in the deal.

During the 1980s when bankers were more inclined to discard the possibility of an eventual default, insufficient thought was given to the basis of voting rights in documents and their inter-relationship with each other. Various definitions of a majority were seen which alternatively allowed small groups or larger participants to hold sway. This has caused enormous problems when we have seen smaller participants try every trick in the book to escape difficult syndications. In Australia, we are currently following the broad principles espoused by the Bank of England in dealing with difficult credits, ie if there are prospects of recovery, then it is the expectation that all lenders will stay in. To offer to refinance one small bank invariably leads to an exodus from others.

We have often said to smaller recalcitrant banks that we have the option of imposing a formal Scheme of Arrangement on them but in the interests of bank to bank relationships, this would be a last resort.

The result has been that we are now adopting, on a broader basis, the voting powers that would be required by the court should a formal Scheme of Arrangement be necessary - 75% by amount and 50% by number. Even in these cases we have encountered pressure from smaller participants seeking to increase the number of banks required to initiate action.

IEL example

With the kind consent of Industrial Equity Limited let me give you an example of that.

As part of the Adsteam restructure it was necessary to consolidate and refinance the current debts of IEL. The amount involved was $1.45 billion which was made available up to that time by 58 separate lenders under various negative pledge documents. We endeavoured to present a position of equality to the existing IEL lenders and also lenders to the Adsteam group at large - bearing in mind that the way they were going to get repaid in the Adsteam, Tooth and DJ companies was only through an orderly liquidation of IEL.

We offered them security, a clearly solvent company with generous interest provisions, good management, good fees and margins, and a clearly identified take-out - and we went out to 85 banks. Now that is the sort of deal normally a bank would salivate over. Only 14 banks agreed to participate. The rest wanted their money and they wanted to go home. The four majors, the State Bank of New South Wales and 9 international foreign banks eventually participated. Three of those foreign banks were positively "dragooned" into the transaction. The MTBs eventually provided $1.08 billion of the $1.45 billion - or 74.2% - not because we wanted to, but because this was the only way we could get it filled.

It was submitted to the syndicate that the majority of lenders would be required to vote on all issues on the basis of 75% by value and 50% by number. The major participants were obviously worried about the block vote of the major trading banks, notwithstanding the fact that 7 banks were required to satisfy the 50% by number test. Mind you, they did not object to the dollars, but they objected to the voting.

Eventually, what happened was this. In respect of any amendment to the facilities or documents, it needed to be unanimous. In respect of an event of default - 75% by amount, 66.2/3% by number - in other words 9 banks out of 14. In respect of acceptance of the IEL business plan (which was the major mechanism for monitoring this credit) for the period from 30 June 1993, if the debt was not reduced below $750 million it had to be 75% by amount and 75% by number - that is 11 banks.

Now what does that say for syndicate democracy? Not much! What is does say, of course, is the continued generosity on the part of the four major trading banks for which we are internationally famed!

I would sum up this point by saying that for small participants, the better decision is to take a judgment on whether you are prepared to accept that your percentage contribution will not allow you any significant say in the process. If you are unhappy with this process, then it would be wise for you to stay away.

This leads me to the question of the rights of lenders to assign all or part of their interest or sub-participate the risk.

CBA is ultra cautious about who it invites into syndicates. Some may say that the selection process is aimed at ensuring that the syndicates are filled with friends and people who will vote the way we would want them to. The question goes much deeper than this. CBA has a corporate culture in dealing with problem accounts which we find is not always shared by other banks. It is our view that ailing clients should be given a chance to recover and receive support while there is some hope. On the other hand, some banks are of the view that the first loss is the best loss. A syndicate made up of these different cultures will, invariably, lead to problems. Similarly, we like to involve people who have an active operation on the ground and who can positively contribute.

News Corporation example

When we did the News Corporation override agreement, we had the marvellous task of getting unanimous consent from 114 different banks. Some of them I had never heard of. The thing that was telling in that transaction was that of the 114 banks, 31 of them had purchased their exposures to News through the secondary markets. In other words, there were 31 banks that News did not realise they were doing business with. And the way some of the banks went on, I do not think they knew they were doing business with News either!

It became almost an impossibility to get these people to look at the matter logically. There was one Italian bank whose office was in Singapore, who having been given all of the documents said to me: "I am not going to read them, I have got no time to read them, I do not even understand them, but give me a phone call when everybody else has agreed and I will have a look at them then." Fine. I did not mind that. The trouble is there were 9 others who wanted to do the same thing! Everybody wanted to be last in. I said to myself then, on this question of just finding that you are having to deal with banks who have not the same nature as yourself, that it would be better to try and put some more order into matters.

I am, therefore, very strongly of the view that any assignment of credit sell-down should require the prior approvals of the borrower and the majority of banks.

Despite the recent difficulties, I believe the lessons learned will lead to a more healthy syndication market in the future. Borrowers and banks now know who are the performers. Importantly, borrowers and banks know who to avoid. Some banks may have done irrevocable damage to their reputation in dealing logically and honourably when hard times were encountered. Syndicates probably will be smaller, better organised and documented and comprise only banks with strong systems and credit experience.