Banking & finance annual report 2017: Feeling edgy

Brexit dealt a blow to banking and finance lawyers as investors got nervous, and this uncertainty looks set to continue – however, this problem will be partly offset by a new wave of foreign investors and direct lenders that are targeting the Iberian market

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Banking and finance lawyers claim that, in general, the market is improving and that there are currently good opportunities for law firms. However, it's not all been plain sailing. Brexit, in particular, had the effect of unsettling investors, and a number of lawyers in Spain report that the flow of deals slowed as businesses' took time to digest the implications of the UK's historic referendum. Though investment activity picked up again in the latter part of 2016, the UK government's recent invoking of Article 50 – which begins the process of withdrawing from the European Union – could mean that deals start stalling once again, lawyers warn. That said, it's not all doom and gloom – institutional investors are targeting Spanish assets, while there is also high demand for legal services from construction companies seeking to refinance debt. In addition, an array of non-traditional lenders are also currently looking for business in Spain.

Meanwhile, in Portugal, banks are frantically trying to clear up their balance sheets – there is a consequently a massive amount of non-performing loan portfolios, for example, that need to be shifted and this is an area that is providing rich pickings for lawyers in Lisbon. Meanwhile, new players are entering the market as the country's banks pass into foreign ownership. In addition, shadow banking – specifically, lending by private equity funds and insurance companies – is on the increase.

Deal flow was affected by the Brexit vote last year, says Allen & Overy partner Ignacio Ruiz-Camara. "There was a slowdown for a couple of months," he adds. Despite this, Ruiz-Camara says it was a busy year in which a wide range of financing options came to market, with project bond structures being "particularly successful". He adds that there were also a significant number of sales of non-performing loans.

"There was a slowdown of transactions due to Brexit and my concern is that this slowdown may return following the UK's invoking of Article 50."
Rafael Aguilera
Gómez-Acebo & Pombo

Volatile market

According to one partner, 2017 has been "somewhat uncertain and volatile". He adds that, though deals continue to flow, there is a degree of political uncertainty – the partner, who works in the Madrid office of a 'Magic Circle' firm, expresses some doubt that Brexit will "actually happen", despite the UK's invoking of Article 50, which begins the formal process of withdrawal from the European Union. He continues: "For investment bankers in London, it's business as usual."

One of the most significant developments in the last year has been banks offering more friendly terms for borrowers says one partner. "Banking deals now have terms that are more appropriate for borrowers," she says. Meanwhile, Uría Menéndez partner Ángel Pérez López says the traditional banks are now facing significantly more competition "not only among themselves but also with some direct lenders as well as the capital markets". Pérez López also says that Spanish real estate investment trusts, SOCIMIS [Sociedades Anónimas Cotizadas de Inversión en el Mercado Inmobiliario], are the most active players in real estate financing, acquiring commercial real estate such as shopping malls, office buildings and hotels. In addition, distressed M&A deals are also generating significant work for banking lawyers, as are sales of non-performing loans. In this regard, Pérez López says the volume of transactions involving secured non-performing loans now exceeds that involving unsecured non-performing loans. He adds that 2017 is expected to be a "very active year for distressed M&A due to new banking regulations on risk policies and loss allowances, which will be effective on 1 January 2018 and will foster plenty of divestments before that date."

There is currently a massive amount of liquidity in the market, according to Gómez-Acebo & Pombo partner Rafael Aguilera. He adds that Spanish credit funds have entered the market in the last year, as well as institutional investors, to finance Spanish companies. However, Aguilera adds that he is pessimistic about Brexit: "There was a slowdown of transactions due to Brexit and my concern is that this slowdown may return following the UK's invoking of Article 50."

Considerable opportunities for banking lawyers are being generated in the construction sector as construction companies look to refinance their debt, lawyers say. Meanwhile, Brexit could mean that Spanish law is increasingly used when drawing up contracts, according to Cuatrecasas partner Iñigo de Luisa. “Because of the Brexit-related uncertainties, we already see more reliance on Spanish law with regard to finance documentation,” he says. “There could be more international funds relying on Spanish law, not only for restructuring situations but also for new facilities.” Pérez López adds that there is “uncertainty as to the proceedings and timings for the recognition of English court rulings in Spain after the UK leaves the European Union”.

> “Technically only banks and credit institutions are authorised [to lend in Portugal], but I don’t think entities [such as private equity funds] licensed elsewhere can be stopped.”
> Filipe Lowndes Marques, MLGTS

However, Ruiz-Camara argues that English law will continue to be used outside the UK, regardless of Brexit. He adds that Brexit will create a lot of work for lawyers as “it will activate transactions which would not have happened otherwise and deals will have to be restructured”. In a global context, there is an understanding that the US government could be set to abolish some existing banking regulations. Jabier Badiola, partner at Dentons says that, if this was to happen, it could lead to “financial business being transferred there [the US]”.

Disappointed investors

There have been some “inconsistencies in the interpretation of the law by different insolvency courts” that have disappointed investors, according to Ruiz-Camara. However, he adds that there have been more deals, particularly disposals and securitisations. How will law firms adapt to the changing market conditions? Ruiz-Camara says that some firms could adopt the approach of having smaller teams and being more selective in the deals they take on.

If work is of a commoditised nature, clients are not willing to pay significant fees, say lawyers. However, there is a perception that, if the client believes the law firm is adding value to the deals, they will pay larger fees. Lawyers also report that some clients have panels and that some law firms agree to offer some services for free in order to be given the opportunity to bid for future work. Freshfields’ partner Ana López says that one of the major developments in recent years is that it is becoming more difficult to predict exactly how deals will be “structured and refinanced given the wide range of financial instruments and flexibility that are available in the market”.

Alfredo Barona, partner at DLA Piper, says in general, the market is improving and there has been an increase in leveraged deals. However, he adds that global political uncertainty is a concern. In addition, Barona observes that the market is now much more challenging for lenders due to the increase in competition and the difficulty in finding attractive business that requires financing.

There is an increased interest in direct lending, but there is considerable competition and limited opportunities for lenders at present, according to Clifford Chance partner Rodrigo Uría. He adds: “The new lenders entering the market are here to stay – it’s currently a borrowers market and they are driving the deals.”

EU: Uncertain future

Pérez López says that the sophistication of both products and players in the Spanish finance market continues to increase, and there is considerable finance-related M&A, particularly in relation to assets in the renewable energy sector. However, he also says that a decrease in restructuring work – which has been “one of the main work streams for banking lawyers in recent years” – is a concern, as are uncertainties surrounding the future of the European Union. Pérez López adds that competition between banking clients as well as law firms is fierce and the pressure on fees continues.

With regard to the activities of the legal arms of the ´Big Four’ auditors in the banking and finance market, Barona says that, while they are not usually “seen on big deals at present, they are doing things really well and could potentially be serious competition to big law firms and they need to be respected”. Meanwhile, one partner says the ‘Big Four’ have the contacts that enable them to “penetrate corporates” as well as significant resources.

De Luisa remarks that there are significant opportunities for financial transactions in Latin America, particularly Mexico, Colombia and Peru. He adds: “All Spanish firms are deploying resources there and in many situations, firms’ finance practices are taking the lead in key infrastructure and energy projects in these jurisdictions.”

Spain: What are currently the biggest opportunities for law firms in banking and finance?

"Lending activity is expected to continue benefiting from low borrowing costs. In addition, any deregulation resulting from Brexit or US efforts to dismantle certain bank regulations could lead to additional capital becoming available to be deployed elsewhere." **Michael J. Willisch, partner, Davis Polk & Wardwell**

"We expect the number of Spanish banking entities to be reduced through consolidation. In addition, depending on Brexit, there might be an increase in business opportunities in Spain and a corresponding increase in work for Spanish law firms. We think the Spanish economy is growing faster than certain other EU countries, which makes Spain an attractive European market." **Vanessa Armas, of counsel, Jones Day**

"Global firms that can offer seamless capabilities across a large number of jurisdictions will be best positioned to take on the most relevant work. The banking and finance space will increasingly see foreign laws interplaying with local laws and overseas lenders aiming to participate in transactions that were previously thought to be local. A good example is how some financing instruments such as high yield bonds – which are subject to New York law – are now widely used across Europe. The high yield bond is typically accompanied by a revolving credit facility that may be subject to English law. And both the bond and the facility may benefit from local security. This will entail that the firm must have full capabilities to advise under all these laws." **Fernando Navarro, partner, Ashurst**

"The growth of alternative financing and shadow banking. This type of financing is quickly positioning itself in the market as a source of lending operating in parallel to traditional banking finance and it is very quickly becoming a growing presence in the Spanish lending market." **Ramón Ruiz de la Torre Esporrín, partner, Ontier**

"The appetite of foreign investors for real estate assets in Spain, including premium office buildings in Madrid and Barcelona, as well as hotels and commercial centres will continue to boost real estate finance practices. On the other hand, the reactivation of the M&A market in Spain may lead to the comeback of leveraged buyout transactions." **Xavier Foz, partner, Roca Junyent**

"The current market is especially attractive for those law firms brave enough to innovate and explore offbeat ways of providing legal services. Major changes are happening in the global and local financial sectors, and those who have an entrepreneurial spirit may be able to shine. Brexit is a clearly potential source of new business and advice is already being sought by clients." **Abraham Nájera, partner, CMS Albiñana & Suárez de Lezo**

Portugal: Banks under stress

The Portuguese banking sector is under stress, according to Servulo managing partner Paulo Câmara. "There are regulatory constraints, staff cuts and new owners," he says. "There is less investment from Angola and more from China." Another major issue facing banks is non-performing loans and, specifically, whether there should be a single universal solution to this problem, or whether solutions should be tailored to meet local requirements, Câmara adds. He also says that smaller banks and consumer credit organizations are entering the market. However, there are fewer initial public offerings (IPOs), partly because businesses "fear the regulation costs involved when listing," according to Câmara. Yet there are considerable opportunities for law firms to advise banks, he adds, to the extent that his firm is hiring more people to meet demand.

A lot of banking lawyers' work is devoted to clearing banks balance sheets – particularly selling off non-performing loans – says Uría Menéndez partner Pedro Ferreira Malaquias. He adds that private equity funds have a growing role in the Portuguese banking sector. Meanwhile, Ferreira Malaquias says lawyers also dedicate "many hours" to banking regulation work, in particular matters concerning how the Portuguese government will interpret EU banking regulations. He adds that there are around €40 billion worth of non-performing loans that are up for sale in Portugal and some private equity funds are keen to buy them.

Foreign banks are becoming more active in Portugal due to Portuguese banks' lack of availability with regard to lending, says Filipe Lowndes Marques, partner at MLGTS. He adds that the uncertainty in the Portuguese banking system is highlighted by Novo Banco being up for sale, Millenium BCP being subject to state intervention and therefore having its "hands tied", as well as shareholder disputes at Banco BPI. Lowndes Marques also says that there are now more non-traditional lenders – such as Caixa Credito Agricola – appearing in syndicated financing deals, though they are "still feeling their way in the market".

Shadow banking

Shadow banking is another growing trend in the Portuguese market, according to Lowndes Marques. He adds: "Private equity funds and insurance companies want to lend [in Portugal] – technically only banks and credit institutions are authorised, but I don't think entities licensed elsewhere can be stopped from lending in Portugal – for example, if a credit fund is set up in Luxembourg or France, can

Portugal: What are currently the biggest opportunities for law firms in banking and finance?

"The overall stabilisation of the financial sector in Portugal and the stronger capitalisation of the banking sector will allow key financial players to accelerate the deleveraging process creating important opportunities. Also, the offloading of non-performing loans and non-performing exposures will trigger opportunities." **António Payan Martins, partner, CMS Rui Pena & Arnaut**

"Due to high levels of non-performing loans on financial institutions' balance sheets, we anticipate demand for legal advice on new measures for reducing costs and strengthening balance sheets, including divestment from non-core activities, the sale of assets and the transfer and management of non-performing loans." **Mafalda Oliveira Monteiro, partner, Miranda & Associados**

"The economic crisis stalled the M&A market and insolvency and corporate recovery cases increased significantly. Nevertheless, the number of M&A transactions is now increasing – in particular, M&A operations in the banking and financial sector given that it still requires a certain degree of consolidation." **António Vicente Marques, founding partner, AVM Advogados**

"The issues related to recapitalisation and non-performing loan portfolios that the Portuguese banking sector still needs to address. Also, disputes around the resolution of Banco Espírito Santo." **Maria Castelos, partner, Campos Ferreira, Sá Carneiro & Associados**

"Banks still have balance sheets with enough real estate to generate important opportunities to advise on the sale of those assets. This also applies to other types of collateral held by banks, such as stakes in companies outside the financial sector. Bank mergers, with sales of shareholdings (for example, involving BPI, La Caixa, Banif, Santander, Millennium and Chinese Fosun) also led to excellent opportunities for law firms." **Nelson Raposo Bernardo, managing partner, Raposo Bernardo**

"Advising on the sale of non-performing loan portfolios to foreign investors, as well as advising banks on the sale of real estate assets." **Edmundo Batalha Reis, partner, SPS Sociedade de Advogados** regulations in Portugal stop them lending here?"

There is, in general, a greater emphasis on the management of balance sheets in the banking sector, says Linklaters counsel Gonçalo Veiga de Macedo. "There is a focus on the sale of non-core assets – banks are currently selling loan portfolios and residential mortgages," he continues. However, Veiga de Macedo says there is now a "spotlight on Portugal as a new destination for investment – real estate assets have more value".

Achieving a "certain, large, scale" is an increasingly important objective for banks, Câmara argues. "It is difficult for a bank to deal with regulatory constraints if it is small," he adds. "Banks now need to have a certain scale, otherwise they face difficulties, as we now see with smaller banks."

PLMJ partner Hugo Rosa Ferreira says the "continuing recovery" of Portuguese banks is creating plenty of opportunities for law firms "be it in recapitalization or quasi-capital raising transactions". He adds: "Also, the consolidation of the market looks to continue – some smaller banks continue to look for exit strategies and this is something that always brings a lot of work to law firms. With regard to Lusophone Africa, Veiga de Macedo says that there is "significant project investment" in Angola and Mozambique that is generating plenty of opportunities for lawyers.

Portugal: What are the biggest challenges clients in the banking and finance sector currently face?

"If we look at banks operating in Portugal, we can identify two major challenges: (i) from a regulatory standpoint, to continually adapt and adjust internal policies to meet the demands of increasing regulation; and (ii) being able to continue to be active and competitive in the loan markets. As for other types of financial institutions and investors, mostly operating in the restructured assets submarket, the main challenges are associated with having the capability to easily and efficiently buy, structure, workout and dispose of assets." **Nuno Azevedo Neves, partner, DLA Piper ABBC**

"Assuming banks slowly return to traditional activity – which is to lend money to companies and individuals – we believe it is a challenge (both to lenders and borrowers) to properly hedge the lending/borrowing activity and the compliance restrictions, mainly with regard to cross–border financial transactions." **Alexandre Jardim, partner, PBBR**

"Considering that the requirements for banks' credit approval have been more severe, it will be important to obtain financing from alternative sources, notably through more direct lenders." **Madalena Pizarro, senior associate, CCA Ontier**

"Challenges posed by the Portuguese economy have led to a major restructuring not only of almost all of the credit institutions and financial companies, but also of the way they do business. These challenges include the need for these entities to comply with increasingly demanding regulatory rules and requirements, in particular with regard to the capital ratios that must be fulfilled by the banks." **Rafael Teles, lawyer, Caiado Guerreiro**

"The transposition of several directives and the application of EU regulations that will force financial entities to adjust their activity and the way they do business. They include the establishment of a new regulated trading platform called Organised Trading Facility (OTF), rules related to electronic payments, rules on insurance distribution, and regulations concerning packaged retail and insurance-based investment products." **João Espanha, partner, Espanha e Associados**

Meanwhile, the increasing use of digital banking is also creating considerable regulatory work for law firms, lawyers say. Law firms´ banking practices used to be largely transaction-based, but now there is an increasing need for them to be more proficient in the regulatory aspects of banking. "Banks need considerable outside support [with regard to regulation] and this is an opportunity for law firms," one partner says.

Banking with Google?

With regard to the issue of fees, Veiga de Macedo says some clients that "recurrently work with international firms will prioritise quality rather than cost when selecting their lawyers". Lawyers also say that clients are less loyal to their legal advisers – one partner remarks that "substantial shareholder changes in banks mean there is often a reset in the client-lawyer relationship".

Banks cannot ignore the rise of the fintech sector, lawyers say; they also anticipate that companies like Google will have an ever-growing role in the banking sector. Such developments mean that banking lawyers have to become increasingly technologically minded, one partner says. "If you want to add value for clients, you have to have data protection knowledge," says one Lisbon managing partner. SPS Sociedade de Advogados partner Nédia da Fonseca Nunes says: "The investment in technology has played a crucial role in banking development, significantly changing the paradigm in the rendering of these services." However, despite the rise of the fintech sector, lawyers warn that the more traditional banks are not properly addressing this emerging threat at board level.

Spain: What were the major developments in banking and finance during the last year?

"2016 saw a strong performance for Spain's debt finance market, with an increase in 'new money' leveraged finance deals. This is in line with a return to liquidity levels previously seen before the financial crisis. There has been a significant increase in investments made by international private equity funds during 2016, with similar levels expected during 2017." **Gonzalo Martín de Nicolás, partner, Herbert Smith Freehills**

"The digital transformation of the banking and financial sector due to changes in customer behaviour, the emergence of new market competitors, such as fintechs, and the development of new technologies. This involved a big effort from the traditional players as they had to change business models in a short period of time." **Francisco Ramírez Arbués, partner, Deloitte Legal**

"The substantial increase of activity in the leveraged buyout market has been a major development. Banking and finance departments are less dependent on the flow of work associated with refinancings and restructurings. We have seen less refinancing work and more activity in the LBO lending space. Despite the influence of alternative lenders, traditional banks continue to play a major role in leveraged lending." **Manuel Mingot, partner, Squire Patton Boggs**

"The political uncertainty arising from the implications of Brexit, the US elections, and especially the Spanish political impasse which led to a period of almost a year of successive general elections and affected the number of lending transactions carried out after the first quarter of 2016. The number of larger deals decreased after the first general election in December 2015 – in the first seven months of 2016 the total volume of new lending fell significantly compared with the same period in 2015 due to a decline in new lending to large corporates. However, the number of mid-market transactions has been unaffected." **Ander Valverde González-Morejón, partner, Pérez-Llorca**

"In large-cap cross border leveraged loans, international sponsors and private equity houses are demanding more and more flexibility (such as incremental facilities and permitted acquisitions). This has resulted in the consolidation of English law (or even New York law) for this sort of deal and the continued migration of New York loan tools or even bond features (such as the US covenant-lite, covenant loose structures, and US-style events of default) into the Spanish loan market." **Fernando Colomina, counsel, Latham & Watkins**

"The headlines for the last twelve months are the consolidation of the digital revolution and the emergence of a vibrant Spanish fintech scene with the increasing involvement of traditional banks, together with the surprise of Brexit last summer. It is yet to be seen what effect the UK disconnection will have for the more than 2,000 UK financial firms active in Spain benefiting from EU passporting. However, to a great extent it will also depend on the 'open market' policy finally adopted by the Spanish government under MiFID II, which shall become applicable in January 2018." **José Luis Lorente Howell, counsel, Bird & Bird**

"Sales and purchases of non-performing loan portfolios. Also transactions involving fintech-related services, particularly in relation to payment systems and new lending structures." **Francisco Bauza, partner, Baker McKenzie**