

**COMMENTS OF BDO LLP (“BDO”) ON THE  
COMPETITION COMMISSION’S COMMISSIONED<sup>1</sup> REPORT ON AUDITOR CLAUSES  
IN LOAN AGREEMENTS**

**1 REPORT ON AUDITOR CLAUSES IN LOAN AGREEMENTS**

- 1.1 The Report focuses on syndicated loan agreements, but bilateral loan agreements (i.e. single bank – borrower agreements) can be equally or more important in practice. Big Four only clauses are not confined to syndicated loan agreements. Paragraphs 34 and 37 show that bilateral agreements are often similar to syndicated loan agreements in this respect. Five out of ten banks surveyed used the same practice in bilateral loan agreements (see paragraph 34). Seven of the eleven law firms surveyed reported that they used the same approach for bilateral loan agreements as for syndicated loan agreements (see paragraph 42). Banks may rely heavily on LMA documentation, but it does not follow that (as stated in paragraph 35) the clauses are “*typically confined*” to Leveraged Loans/sub-Investment Grade loans.
- 1.2 BDO believes that Big Four only clauses should be prohibited as anti-competitive restrictions. The same applies to clauses which require mid-tier firms, but not Big Four firms, to be approved in advance by the lender(s), such as the LMA Leveraged auditor clause referred to at paragraph 21, which defines Auditors as one of the Big Four “*or any other firm approved in advance by the Majority Lenders (such approval not to be reasonably withheld or delayed)*”. Thus for a firm such as BDO, prior approval of the Major Lenders is needed, so the clause creates a barrier to the mid-tier firms.
- 1.3 If a change or choice of auditor away from a mid-tier firm to a Big Four firm is imposed on a growing company before it joins the FTSE 350, once it is in the FTSE 350, the company is highly unlikely to reverse that change. Therefore the effect of such requirements is to cut off custom for mid-tier firms and act as a barrier to them auditing present and prospective members of the FTSE 350. Paragraph 29 notes that the change of auditor “*would take place before the agreement was drawn up*”. Paragraph 60 refers to the “*expectation that large listed firms would already have a Big Four auditor*”. The high market share of the Big Four in the FTSE 350 therefore seems partly responsible for the absence of these clauses within the FTSE 350: those clauses apply most effectively outside the FTSE 350, particularly for companies with the potential to join the FTSE 350. They affect the pipeline of future FTSE 350 companies.
- 1.4 The Report says at paragraph 59 that “*this potential barrier to entry to the audit market...is not as serious as first thought*” because few FTSE 350 companies would have their agreement based on the leverage documentation. BDO disagrees, because the barrier arises earlier, for companies outside the FTSE 350, whose debt is not then investment grade. That is the point at which they often move to a Big Four auditor. As switching rates are low, companies do not switch back to a mid-tier firm at a later stage. They become “*locked-in*” to a Big Four auditor.
- 1.5 Intermediaries have in BDO’s experience claimed that ratings agencies prefer Big Four auditors, but the Report says at paragraph 47 that Standard and Poor’s say that auditor identity has no bearing on its analysis. Although Fitch and Moody’s say

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<sup>1</sup> Reference to paragraph numbers are to paragraphs of the relevant working paper (“WP”) unless stated otherwise.

auditor identity can influence ratings (see paragraph 48), Moody's said: "*in the vast majority of cases, the identity of the auditor is not a concern, but in a very small number of cases, it has had concerns about the abilities of the chosen auditor*". As ratings agencies provide ratings for under a third of the FTSE 350, the number of cases in which auditor identity will affect the ratings of a FTSE 350 company must be very limited indeed, contrary to claims by intermediaries. BDO notes that ratings agencies do not appear to have any concerns about BDO.

- 1.6 While the quality of the auditor may be very important, given the importance of accounting ratios, it should not be assumed that the Big Four have a monopoly on quality (see paragraph 61).
- 1.7 Annex 1 contains a briefing paper based on one CC staff member's experience of the UK loan market from previous employment at a UK bank. This is not a deep or substantial research base. It is not clear how long this one person was so employed and in what role, but in any event, one person's experience is not a sufficient basis on which to rely.