Confidential

Inquiry Manager
Audit Market Investigation
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

13 August 2013

By email

Dear Sir/Madam

Re: Audit MIR Remedy proposal 3: Auditor clauses in loan agreements

As noted in our letter to the Competition Commission of 2 May 2012, in HSBC's experience the most common use of the type of clauses that the CC has concerns about is in highly leveraged finance transactions. Again as noted in that letter, to the best of HSBC's knowledge, the choice of auditor has never been a contentious issue as between the borrower and HSBC (or any other bank in the same syndicate), whether in highly leveraged transactions or otherwise. Where an auditor clause exists or is proposed which does not include the borrower's preferred firm, in practice the borrower simply seeks the approval of the banks to use the preferred firm (either up front, by including the name in the clause, or ex post by asking for consent) – and HSBC cannot recall an example of such consent being refused.

In our view, the reality is that the decision whether to appoint a particular auditor has been and remains primarily a matter for the borrower. It is not our intention to get in the way of effective competition in the audit market.

It is the case, however, that HSBC (like other lenders) has a legitimate commercial interest in ensuring that the borrower's auditors are of sufficient skill and reputation/good standing that they can be relied on to do a robust job. In particular a lender needs to be able to rely on i) the accuracy of the audited accounts and ii) the reports the auditor gives on the borrower's compliance with the covenants in the loan agreement.

In practice, this interest is addressed as part of the general financial due diligence which forms part of the credit process involved in any decision to lend. As such a lender will satisfy itself at the outset that the borrower's auditors are of a sufficient skill and quality and appropriate for the relevant borrower and transaction. However the borrower may change its

auditor during the lifetime of a loan facility and a lender needs some assurance that it can continue to protect its interests over that lifetime.

From our perspective there appear to be three main ways to protect this legitimate interest. The loan agreement could include a clause:

1. stipulating a specific auditor that the borrower must use;
2. stipulating that the borrower must obtain lender consent to change its auditor (such consent not to be unreasonably withheld or delayed); or
3. using a more general formulation to convey the idea that the auditor must be of sufficient skill and reputation/good standing (and, if necessitated by the circumstances of the loan, have sufficient geographic reach to be able to conduct audits on a consistent basis across the operations of the borrower in different countries).

We note that at paragraph 3.296 of its consultation the CC states:

"*We have taken into account views that a lender may have legitimate commercial reasons as to the appointment of a particular auditor. We have not proposed prohibiting companies and a lender (or lenders) entering into negotiations to appoint a specific auditor, for example due to an auditor's expertise in a relevant sector.*"

We welcome this conclusion. In our submission, if lenders are to be allowed to stipulate a specific auditor (option 1 in our list above), it would be counterintuitive for the CC then to take action which prevents lenders from using options 2 or 3, given that the latter are in fact less restrictive means to achieve a similar end. Our view is that in most cases option 2 would be the simplest route for the lender to take as this enables a lender to maintain the basis on which it lent at the outset and does not seek to restrict the general choice of auditor to a particular list or category

We therefore request that the CC clarifies that the proposed order "*prohibiting provisions in loan agreements which restrict or have the effect of restricting a company's choice of auditor to certain categories or lists of statutory auditors*" will not prevent lenders using clauses that fall into any of the three categories we outlined above.

To the extent that the CC is concerned that allowing the milder formulation envisaged under option 3 would fail to eradicate completely the problems it perceives with "big four" clauses, we respectfully submit that it would nevertheless strike the right balance between removing what the CC feels is a possible barrier to greater competition in the audit market and protecting the legitimate commercial interests of lenders and their willingness to lend - and thereby protecting the interests of leveraged borrowers by ensuring continued availability of bank financing.

Yours faithfully

Emily Smith
Associate General Counsel, HSBC Bank plc