The LSTA Comments on the Leveraged Loan Market

November 15, 2018 - There recently have been several voices expressing concern about the state of the leveraged loan market. The Loans Syndications and Trading Association (LSTA) would like to take this opportunity to answer some questions and dispel some of the misperceptions about the leveraged loan market.

We agree with observers that loans to corporate borrowers should always be made in a considered and responsible manner, but disagree with some of the characterizations of the current market. Importantly, suggestions that access to this important, job-creating market should be artificially restricted are misguided. We tackle some of these issues below.

Importance of the loan market. The leveraged lending market has provided $1.5 trillion of loans to job-creating US companies. These businesses, which provide over 7 million jobs, span across all industries and are important and popular companies like American Airlines, Hilton Hotels, Dell Computer, The Weather Channel, Burger King and more. Leveraged loans provide capital for these companies to innovate and grow, ultimately leading to more jobs and a stronger U.S. economy.

How fast has the loan market grown? Some concerns stem from the market's purported recent explosive growth. This conflates refinancing activity with actual growth. In fact, the average annual growth rate of the outstanding loan market has been a modest 7% since 2008. Furthermore, total financial leverage of companies in this market is actually below what it was in 2007, according to S&P/LCD. And, while it is true that loans are floating rate, that doesn't mean it will suddenly become a problem. First, many borrowers are contractually required to hedge their floating interest rate loans. Second, while interest rates are rising, many independent analysts have said that companies can easily absorb another 1 percent of interest rate increases.

Are loan investors an issue? Some observers have raised concerns that some loan investors, particularly Collateralized Loan Obligations (CLOs), may create undue risk. But these concerns, too, are unfounded. CLOs, which performed extraordinarily well through the financial crisis, are long-only vehicles with no derivatives or synthetics, and are professionally and actively managed. Moreover, individuals can invest in loans only through professionally managed mutual funds which currently make up just 14 percent of the market; unlike most other instruments, individuals cannot buy loans directly.

In sum, leveraged loans provide $1.5 trillion of financing to US companies to expand and create jobs. The loan market and CLOs performed well through the financial crisis and pose nothing like the risks that subprime mortgage securities posed back then. Indeed, the leveraged loan market is on sounder footing today than it was in 2007. This is good news for the financial markets – and the thousands of US companies and millions of American workers that benefit from loan financing.