Investing in U.S. Senior Secured Institutional Term Loans

The U.S. senior secured institutional term loan asset class provides a number of benefits to investors, including a floating-rate coupon, a large and liquid market, lower credit and interest-rate risk than high-yield bonds, and many ways to gain exposure.

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THE LOAN SYNDICATIONS AND TRADING ASSOCIATION

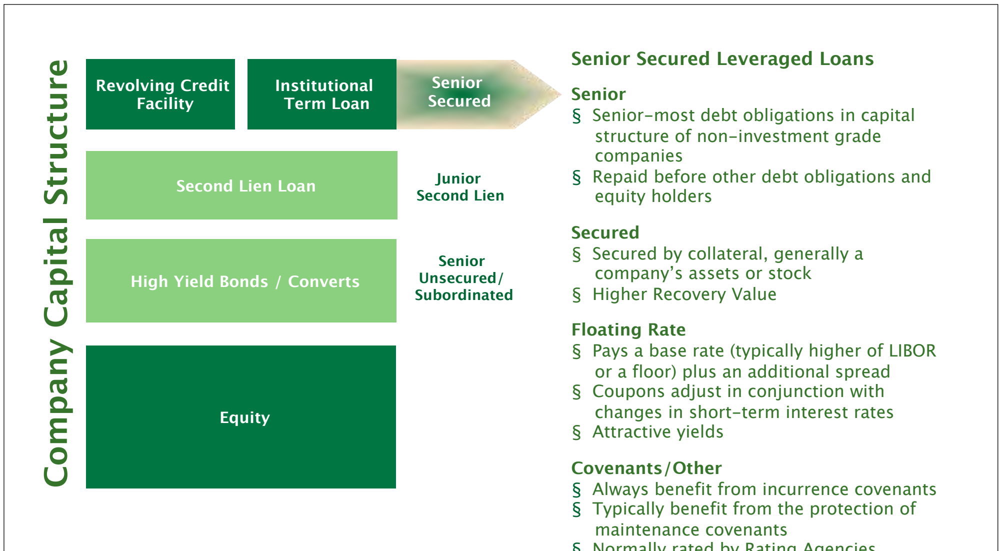
A Large and Growing Credit Asset Class

U.S. senior secured institutional term loans - which are a component of leveraged loans - are a large and growing credit asset class that investors find attractive for many reasons. Below we discuss attributes of leveraged and institutional term loans, the loan market, and the investors that invest in institutional term loans.

Leveraged Loans: A Senior, Secured Investment Opportunity

- Leveraged loans are loans made to non-investment grade companies rated below BBB- or Baa3. The vast majority of companies in the United States are non-investment grade, and many have prominent reputations around the world.
- Leveraged loans typically include a revolving credit (which is drawn and repaid repeatedly, like a credit card) that is sold to banks. Leveraged loans also have an institutional term loan (which is drawn once and repaid over time), which is purchased by institutional investors, like insurance companies, mutual funds, CLOs and separately managed accounts.
- Leveraged loans are typically senior in a company's capital structure, they are secured by the collateral of the company and they are protected by an extensive suite of financial covenants in the credit agreement (Fig. 1).

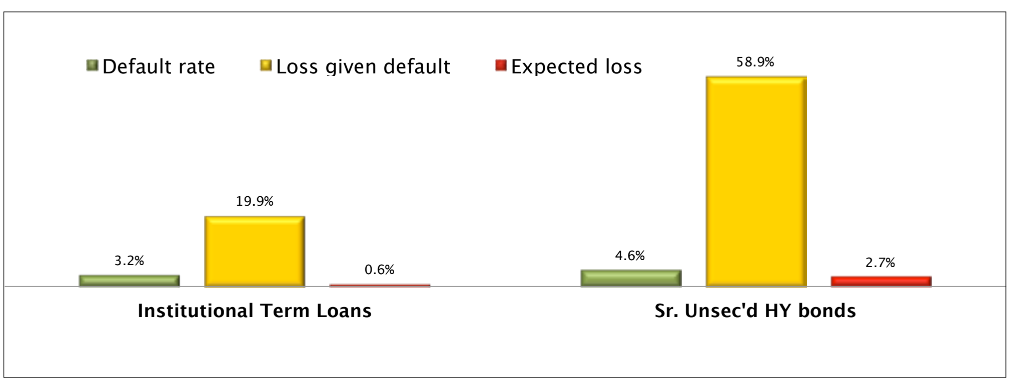
Fig. 1: What are Senior Secured Leveraged Loans?



Source: Credit Suisse

- Because of their attributes, leveraged loans are relatively safe. Even if one of these loans does default, the typical "loss given default" is around 20 cents on the dollar. Because their default rate is lower than high-yield bonds and their "loss given default" is lower, loans have a much lower loss rate than high-yield bonds. In fact, the loss rate on loans is well less than half that of high-yield bonds (Fig. 2).

Fig. 2: Losses Low on Secured Loans, Higher on High Yield Bonds

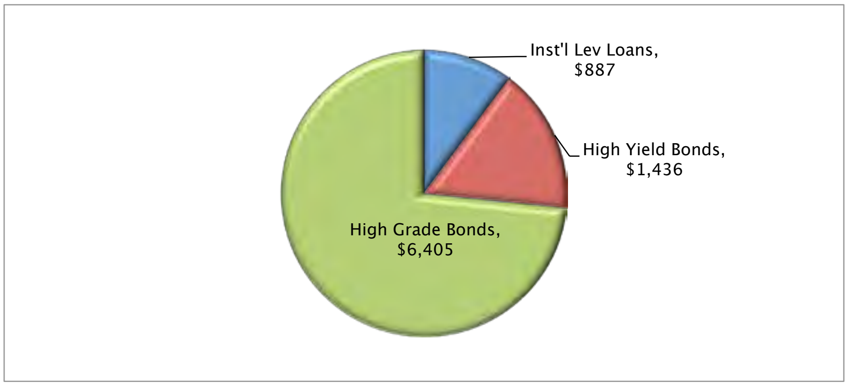


Source: S&P Capital IQ/LCD, Moody's Investors Service, Bloomberg

A Large and Liquid Market

- The institutional term loan market is a large and growing market. As an investible asset class, institutional loans are most similar to high yield bonds. Institutional loan outstandings are approximately $890 billion, as compared to $1.4 trillion for high yield bonds (Fig. 3). Like high-yield bonds, loans are generally publicly rated by S&P, Moody's or Fitch. The size of institutional loans typically ranges from $250 million to more than $5 billion. Loans are syndicated (sold in pieces, typically ranging from $5 - 50 million) to many different investors. Both loans and bonds are fairly liquid investments, with similar turnover ratios, and both loans and bonds are priced daily by multiple pricing services. There is roughly $600 billion of U.S. institutional loan trading per year, which permits investors to actively manage their portfolios.

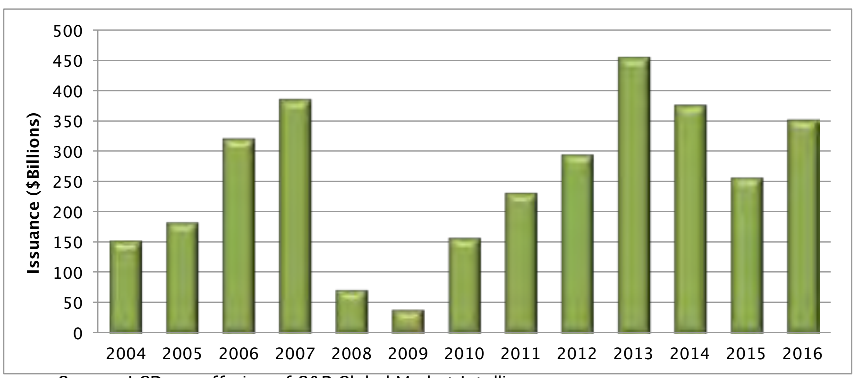
Fig. 3: Breakdown of U.S. Fixed Income Credit Asset Classes ($Billions)



Source: Credit Suisse, S&P/LSTA Leveraged Loan Index

- Institutional loan issuance was $350 billion last year, and has averaged more than $250 billion per year since the early 2000s (Fig. 4).

Fig. 4: U.S. Dollar Institutional Term Loan Issuance



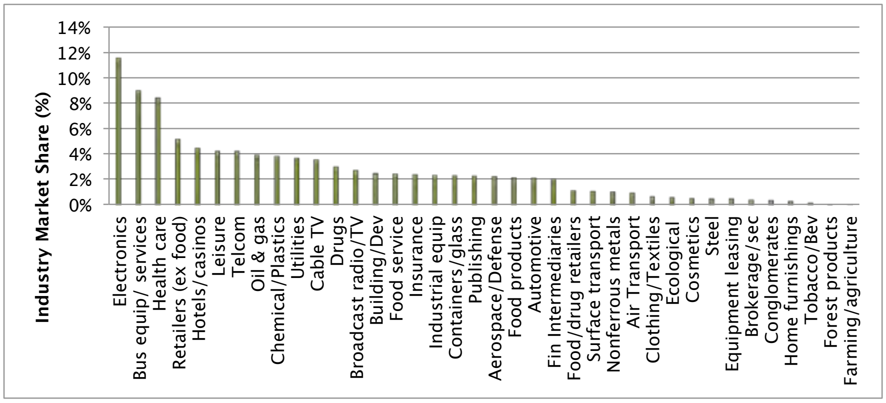
Source: LCD, an offering of S&P Global Market Intelligence

- While loans may be most comparable to high-yield bonds, loans are seen as a safer investment because they are senior and secured by most of the collateral in a company (which reduces loss in a default scenario) and are floating rate (which protects loan values in a rising interest rate environment).

- Returns for loans are comparable to many other asset classes in normal times. For instance, over the past 10 years, annual loan returns have averaged 6.2%, as compared to 9.1% for high-yield bonds, 5.6% for investment grade corporate bonds and 5.3% for 10-year Treasuries. However, this was during a period when interest rates were declining. As interest rates rise, loans – which are floating rate – have the potential to outperform other fixed income asset classes.

- The institutional term loan asset class also is highly diversified by industry. The S&P/LSTA Leveraged Loan Index tracks loans to more than 900 companies in nearly 40 distinct industries. No industry accounts for more than 12% of the market. This high level of diversity reduces correlation and leads to more stable returns (Fig. 5).

Fig. 5: Institutional Loan Market is Highly Diversified by Industry



Source: S&P/LSTA Leveraged Loan Index

A Diversity of Investors

- There is a broad and diverse U.S. institutional term loan investor market. S&P tracked more than 270 active institutional loan investor groups in 2016.

- There are many different kinds of investors in institutional loans. Collateralized loan obligations (CLOs, 51%) and loan mutual funds (14%) are the largest investor segments. Other investors include insurance companies, hedge funds, separately managed accounts and commingled accounts. Different investment vehicles have different characteristics and are attractive to different types of investors. (See Fig. 6 for attributes of several different investment vehicles.)

Fig. 6: Some Loan Investment Vehicles and Their Characteristics

Separately Managed Accounts
- Customized
- Large Investment
- Liquidity

Commingled
- Current Income
- Medium Investment Size
- Liquidity

Loan Mutual Funds
- Retail Funds/ETFs
- Small Investment Size
- Small Institutions/ Pensions
- Insurance Companies
- High Current Income
- Capital Preservation
- Daily Liquidity

CLOs
- Structured Vehicle
- Different Risk Tranches
- Floating Rate Notes vs. Equity
- Primary vs. Secondary

In sum… U.S. institutional term loans are most analogous to high-yield bonds – with several key differences. Loans are a large and growing asset class, they trade actively in the secondary market and are actively managed by a large group of professional managers. There are many ways to invest in loans based on investors' risk and return preferences. But, unlike many other credit investments, institutional loans are senior and secured in a company's capital structure (reducing their credit risk) and are floating rate (reducing their interest rate risk).

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