2018 was a record year for the syndicated loan market. According to LPC, overall U.S. syndicated lending (including investment grade loans) topped $2.5 trillion for the first time ever. This is entirely due to investment grade lending which surpassed $1 trillion. Looking at the leveraged loan space, nominal leveraged lending was down, but real money lending (M&A, LBOs) was up. This is the expected result in a softer market like the one we saw in 2018, because refinancings decline. LPC recorded leveraged lending as declining by 12% in 2018. Institutional lending dropped more materially, falling 21% to $730 billion. These numbers may not tell the whole story, however. In a market where spreads were flat to wider, it was the optional refinancings that evaporated, leaving only the “real” lending. As merger activity rebounded, so did the financing supporting it. LPC saw $381 billion of leveraged M&A which surpassed the previous record in 2007. At $142 billion, LBO lending remained well short of record levels but was still the second strongest year tracked by LPC. The strong “real” lending observed also added considerably to the outstandings in the S&P/LSTA Leveraged Loan Index which climbed 20% to $1.15 trillion.

Looking at deal structure and terms, the borrower-friendly trend continued for most of the year due to the supply-demand imbalance in the market. Greater flexibility in terms and conditions was seen across the board, although terms began to tighten in December. It remains to be seen whether that will continue this year, but some market participants certainly hope that it does as covenant degradation is an area of increased lender focus.

Aside from covenant protections, the market is also grappling with the uncertainty that LIBOR will continue to be the prevailing benchmark of the corporate loan market (and broader financial markets). Although the UK’s Financial Conduct Authority, the regulator of ICE LIBOR, has announced that panel banks have agreed to submit quotes through 2021, many believe that LIBOR will be phased out in the coming years. When, and if, the financial markets transition to a new benchmark, there will be many conversion issues to consider with respect to legacy deals. In addition to including the flexibility to transition to a new rate in credit agreements being signed today, the loan market is beginning to work on answering the larger questions around how to ensure the new benchmark is comparable to LIBOR. To help the loan market in this process, the LSTA co-chairs the business loans working group organized by the Fed-sponsored Alternative Reference Rates Committee (ARRC) tasked with spearheading the transition away from LIBOR. The ARRC sees the most important step for the financial markets to be that new financial instruments have robust fallback language addressing a LIBOR discontinuance. To that end, in 2018 the ARRC released market consultations on fallback language for syndicated loans and bilateral loans (as well as consultations on floating rate notes and securitizations). For loans,
two approaches to fallback language were proposed. The first is an “amendment approach”, which takes the language that has been commonly found in 2018 credit agreements, and improves upon it. The amendment approach requires, upon a specified trigger event, that i) the agent and borrower determine that a LIBOR discontinuance event has occurred, ii) they then develop a replacement rate (and potentially a spread adjustment to make LIBOR and the new rate more comparable), and iii) the “Required Lenders” get an objection right. The advantage of this approach is that it uses loans’ amendment flexibility to allow market participants to make substantive decisions about a LIBOR replacement in the future. The second approach proposed in the consultation is a “hardwired approach”. The hardwired approach, if adopted, would be a new step for the loan market. This approach gives up flexibility but offers a set of predetermined terms for a transition away from LIBOR, which allows for more certainty, less gamesmanship and reduces the operational burden of transition. The hardwired approach provides that, upon a trigger event, the replacement rate would automatically be a term version of SOFR or if that is not available, a compounded average of SOFR, to which a spread adjustment would be added. If neither of those rates (or the applicable spread adjustment) is available, then the replacement rate would be selected via the amendment process described above. Based on the market feedback, there is mixed support for the amendment approach and the hardwired approach. However, of the current proponents of the amendment approach, many see the hardwired approach as appropriate and desirable when more information about the term version of SOFR and the applicable spread adjustment is known. This market feedback will be considered by the ARRC as it refines the proposed fallback language to develop its final recommendation. That recommendation is expected possibly by the end of 1Q2019 and market participants can then choose to incorporate the language in their new credit agreements.