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Syndicated loans

Private credit

Private credit is a term used to refer to investor capital that private funds loan to businesses or other projects. Some of the ways loans can be provided include direct lending, syndicated loan financing, and collateralized loan obligations (CLOs).

This is an overview of syndicated loans, an important part of the private credit ecosystem that enables the growth of small- and mid-sized businesses and generates returns for institutional investors, including pensions, foundations, endowments, and banks.

What are syndicated loans?

A syndicated loan is a **type of financing** that a group of lenders (the syndicate) offer to a single borrower. The lenders form a syndicate to provide funds to a single borrower when the borrower needs more funds than any single lender is able or willing to lend. Sharing the risk allows lenders to spread the risk between themselves. Syndicated loans also may be used to fund a corporate buyout. Interest rates may be fixed or floating, may involve a fixed amount of funds and/or a line of credit, and can be restructured or revised efficiently by amending the loan documents.

Each syndicate member is responsible for conducting its own due diligence and **enters into a standardized loan agreement** with borrower. The **borrower** may be a corporation, a sovereign nation, or a project. The expansion of the Panama Canal, for example, was financed with a syndicated loan.

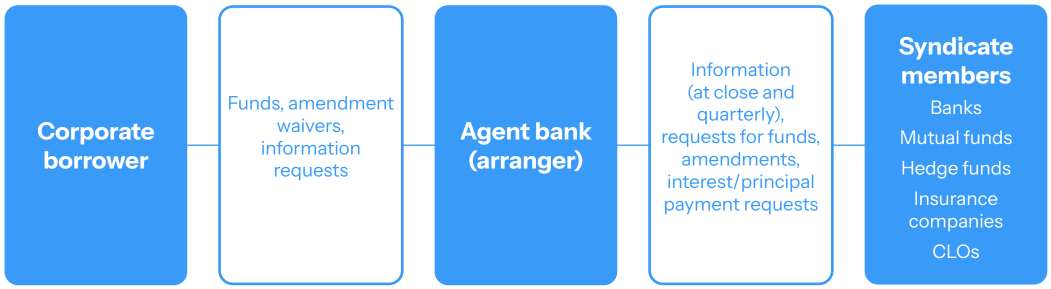
Syndicated loans, like securities offerings, may be effected in different ways. In an **underwritten** syndicated loan deal, the syndicate members guarantee the entire commitment and, if the arranger(s) cannot arrange a syndicate that can loan the entire amount, the arranger is forced to absorb the shortfall. In a **best-efforts** syndication, if the entire loan amount is not subscribed, the loan may not close or the syndicate members' allotment (and potentially the interest rate and terms) may be adjusted. In a **club** deal, a smaller group of lenders will agree to lend a smaller loan amount, with the arranger being on more equal footing with syndicate members than in an underwitten or best-efforts syndication.

Syndicated loans versus CLOs

Each lender in a syndicate is extending credit to a single borrower. Syndicated loans reduce each syndicate lender's risk exposures because the loan is spread between several different lenders. A CLO on the other hand provides investors with exposure to a diversified, underlying pool of corporate loans. The CLO investor is able to select investment tranches of the CLO that match the investor's risk-reward profile. A CLO often includes syndicated loans within its portfolio of loans.

The role of the syndicated loan arranger

Syndicates typically involve a lead bank, often known as an arranger or lead lender, which performs a role somewhat analogous to a lead underwriter in a securities offering. The arranger may obligate itself for a larger portion of the overall loan, and often acts as a conduit for information and the transmittal of funds and information between borrower and syndicate member. The arranger also manages borrower requests to amend or restructure the loan. The borrower pays the lead lender a fee for this service, based on the complexity and riskiness of the loan. Syndicate members are typically banks, but can also include finance companies, insurance companies, mutual funds, and other institutional investors such as pension funds, or private funds (including CLOs). The following depicts a typical loan syndication structure:



Distribution of syndicated loans

Once issued, the syndicate member (especially if it is a bank) may sell the loan to remove the credit risk from its balance sheet. This can be accomplished by selling the loan outright – potential purchasers include another bank, a CLO, a mutual fund, or an institutional investor such as a hedge fund or pension plan. The syndicate member also may seek to combine the syndicated loan with other similar loans it has made and securitize them by issuing asset backed securities to investors in a public or private offering. The loan agreement typically contains restrictions or consents required to transfer.

Regulation of syndicated loans

Application of securities laws to loans

The underlying syndicated **loans are loans – not securities – for purposes of the federal and state securities laws**. The underlying loans are not publicly traded, nor are they offered to the public – they are bespoken between each syndicate lender and borrower and documented by a loan agreement. Each lender is entitled to interest payments pursuant to its original loan agreement.

Loan syndication process

The lead arranger will contact other institutional lenders to determine whether a lender is interested in participating. There is **no general solicitation** by the lead arranger to the other lenders, and often times several affiliated lenders will participate (e.g., different mutual funds, private funds, or institutional accounts of the same investment manager). Again, each lender is responsible for conducting its own due diligence and entering into a **separate loan agreement** with the borrower.

Regulation of syndicated loans
(continued)

Regulation of arranger and syndicate loan members

The arranger is typically a large bank that is subject to prudential regulation as a systemically important financial institution. Other banks that are lenders will also be subject to regulation by the Federal Reserve or other banking regulator. Managers to lenders that are mutual funds or private funds are **regulated by the SEC** and subject to the **full array** of SEC regulatory and examination requirements. If the adviser uses derivatives, it is further **regulated by the CFTC and the National Futures Association (NFA)**. The asset manager also is required to make detailed disclosure of its practices in its **Form ADV** and provide information about loans to regulators on its **Form PF**.

Valuation

Many syndicated loans trade on institutional, secondary markets and as such there are observable prices for advisers and others to make valuation decisions. Lenders also often rely on the assistance of third-party valuation experts.

Systemic risk

Syndicated loans by non-bank lenders, such as CLOs, mutual funds, and private funds, do not create systemic risk because these non-bank lenders are using investor assets to fund the loan, not depositor assets. Non-bank lending is **not backed, insured, or guaranteed by the federal government. There is no taxpayer risk or risk of contagion arising from a default (or series of defaults) in a syndicated loan issued by a private fund or mutual fund.**