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Markets

Old-School Leveraged Loan Market Inches Toward the 21st Century

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- ▶ Investors like electronic trading, but that's still rare
- ▶ MarketAxess reports 96% increase in electronic loan trading

On a good day, the leveraged-loan market looks stuck in the 1990s, with trades getting done through phone calls and instant messages.

Then there are the days when your transaction finally settles after weeks or even longer, and the 1970s or earlier feels like the apt comparison.

More than two decades into the 21st century, this vital yet sluggish business stands out in an era of blockchains and stock traders' battles over slivers of a second. Yet there are early signs that investors in leveraged loans, a roughly $1.4 trillion industry that fuels M&A including buyouts by private equity firms, are embracing technology, or at least are open to the possibility.

A new survey from Coalition Greenwich, a research firm, found that about 80% of institutional loan investors in the U.S. view increased use of technology as making markets better and more efficient.

The question is whether that helps electronic trading get traction. Just 1% to 2% of secondary market loan trading currently takes place on electronic platforms, according to Coalition Greenwich. That compares with 37% for investment-grade bonds and 26% for high-yield debt.

"More electronic trading in the coming years feels inevitable," Kevin McPartland, head of research for market structure at Coalition Greenwich, said in an interview. "The buyside is going to be the driver of it."

The pandemic rapidly accelerated electronic trading in corporate bonds. But leveraged loans, another place where businesses can raise money, were left behind. Hampered by non-uniform structures, slow settlement times, and incentives to trade with the loan's administrative agent to forgo fees, nearly all loan trading still takes place over the phone and through instant messages.

For credit investors, e-trading has perks. Electronic trading improves transparency, allows users to quickly get competitive bids from more than one dealer, collect and see more data, and access more liquidity by allowing anyone to bid through all-to-all trading -- where anyone can trade with anyone else, the sort of model that powers stocks, for example.

Just two platforms for trading loans electronically exist currently, according to Coalition Greenwich. MarketAxess Holdings Inc., known for its bond market, operates the only electronic trading platform for loans with multiple dealers on it. Bank of America Corp. offers a single-dealer platform to facilitate electronic trades.

A major hurdle to moving trades online is that the large market-making banks don't have a big incentive to change existing protocols. In 2020, leveraged-loan investors traded two-thirds of their volume on average with the loan's original agent, according to Coalition Greenwich data.

Going back to the original dealer to facilitate trades can result in better settlement times -- which are notoriously slow in the loan market. Some banks, like JPMorgan Chase & Co., generate significant revenue from fees they charge when their loan deals are traded away and executed with other banks.

'Clients Are Demanding This'

Ultimately, banks' buyside clients may force them to change ways, especially after seeing large chunks of trading in other fixed-income markets move online in the past 18 months.

"The driver really is that clients are demanding this. They're seeing what their counterparts are enjoying both in high yield and IG," said Howard Cohen, head of leveraged loans at MarketAxess.

Cohen is leading MarketAxess's effort to expand e-trading for loans. MarketAxess saw loan trading volume increase 96% in the first half of 2021 compared with the first half of 2020, according to a spokesman. The company doesn't disclose exact volume numbers.

(Bloomberg LP, the parent of Bloomberg News, competes with MarketAxess to offer fixed-income trading, data and information to the financial services industry.)

In addition to working out the technical hurdles to bringing a new market online, part of the challenge lies in convincing traders who have spent their whole careers picking up the phones that another way of doing things could be beneficial.

"There is a bit of a challenge to remove clients from the old school way of thinking that you had to trade, to come and try electronic trading," Cohen added. "But it makes so much sense."