

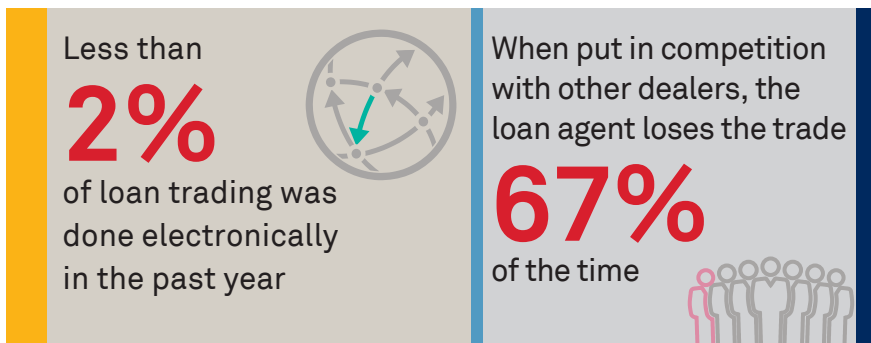
# Syndicated Loan Market Poised for Technology Adoption



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## Executive Summary

Loan markets have been busy this past year. But despite the uptick in issuance, trading volume and investor demand, trading of par and leveraged loans remains largely manual. By most accounts, today's loan market looks the same as the corporate bond market did 20 years ago. Some trading via request-for-quote (RFQ) exists, but the majority of trading is done via the phone, and most pricing data comes from scraped chat messages.

Past attempts to inject technology into this critical market have largely failed, but following a technology surge at the hands of working from home in 2020, change now feels possible. For instance, electronic trading in high-yield bonds jumped to over a quarter of the overall market in 2020, a level that only five years ago felt impossible.

Further, traders forced to work somewhere other than near their trading assistants and operations teams quickly realized electronically trading orders made their life a whole lot easier. And we can't forget about the newfound maturity of distributed ledger technology (DLT), now well positioned to help the loan market's complex settlement process.

Markets do not, of course, electrify overnight. Even with the right technology and market participant willingness, such behavioral change takes time. Loans markets bring their own set of market-structure complexities that require solutions not found in other fixed-income markets—incentives to trade with the loan agent, two-week settlement times and a lack of consistent market data.

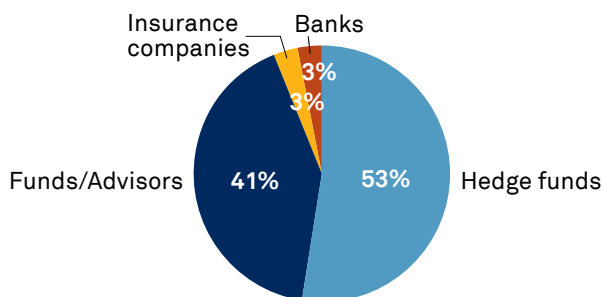
Based on our research and conversations with loan market participants, we believe the willingness to change this market now exists and the technology needed to improve the end-to-end workflow is ready for prime time.

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## METHODOLOGY

This research is based on conversations with 82 institutional loan investors in the United States in 2020. Interviews were also conducted with loan agents, dealers and electronic-trading platforms in the spring of 2021. Conversations focused on the current market structure for trading and investing in leveraged loans, and expected adoption of new technology and electronic trading in the coming years.

### Distribution of Total Trading Volume, by Institution Type



Note: Based on 82 respondents.  
Source: Coalition Greenwich 2020 North American Fixed-Income Study

## Introduction

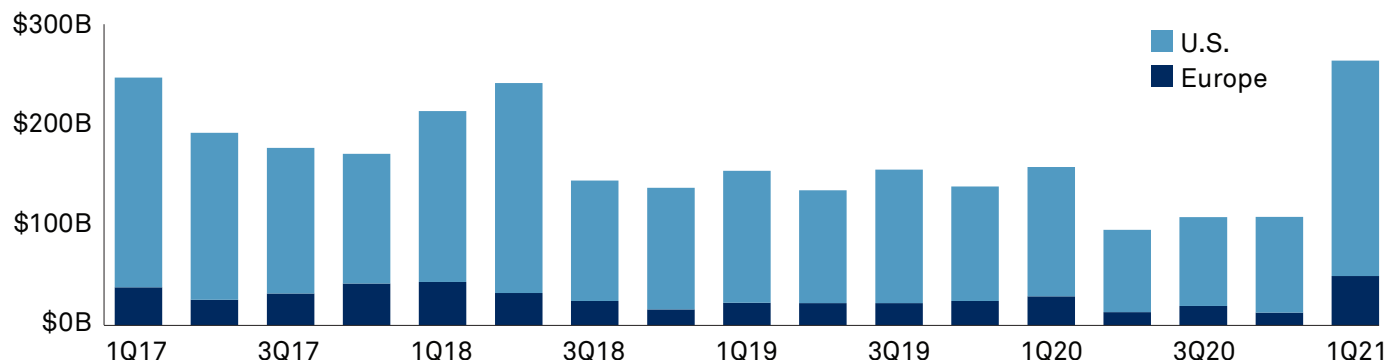
The syndicated loan market is busy these days. In the first quarter of 2021, \$263.9 billion in new loans were issued in the U.S. and Europe<sup>1</sup>—a record in the U.S. and the second highest total ever in Europe. Collateralized loan obligations (CLOs), which are the biggest buyers and holders of loans (currently holding about two-thirds of loans outstanding), also saw record issuance of \$39.3 billion<sup>2</sup> in the first quarter. Retail demand is strong as well, with exchange-traded funds (ETFs) and mutual funds increasing their loan holdings over the past year.

The search for yield coupled with demand for floating-rate instruments (common when interest rates are expected to rise) drives much of the institutional and retail investor demand. Borrowers keep borrowing, as the cash feels almost free. And lastly, investor demand for CLOs equates to CLO demand for loans, which only encourages low-rated borrowers to tap the market even more, given the favorable terms available to them—a virtuous cycle.

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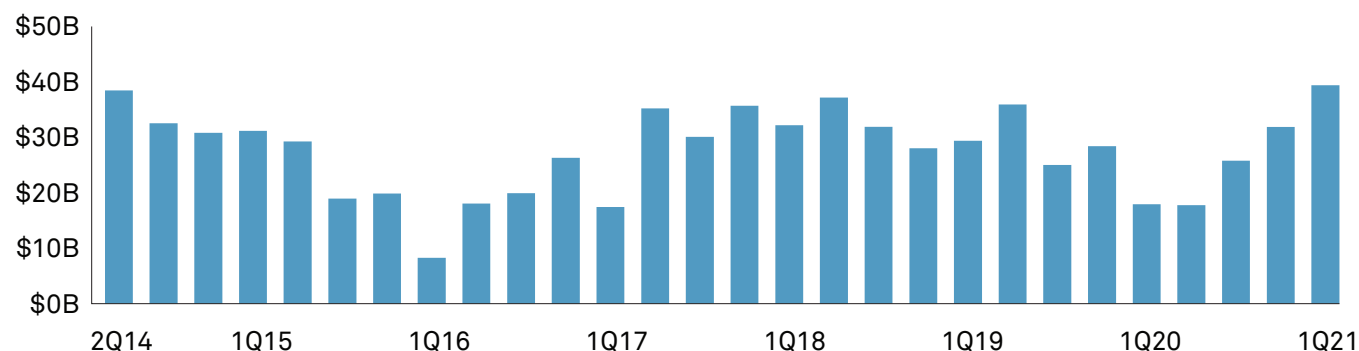
<sup>1,2</sup> Source: LCD, an offering of S&P Global Market Intelligence

## Global New Issue Loan Volume—Quarterly



Source: LCD, an offering of S&P Global Market Intelligence, data through March 31, 2021.

## More Demand: CLO Issuance Sets Records for the 2.0 Era

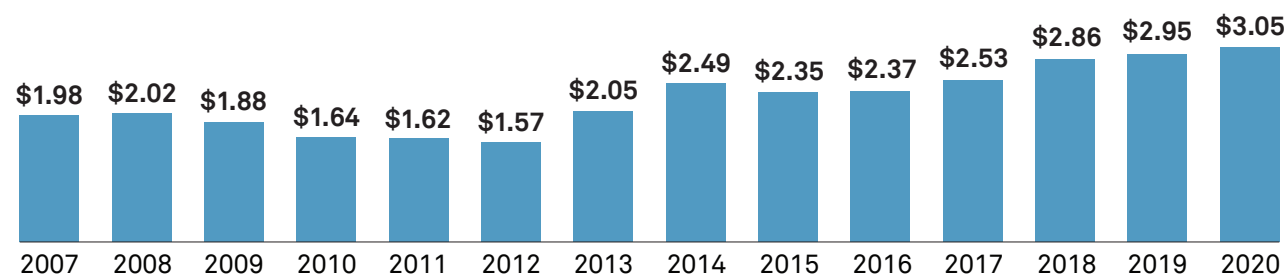


Source: LCD, an offering of S&P Global Market Intelligence, data through March 31, 2021.

Robust issuance, unsurprisingly, has driven secondary market trading as well. \$772 billion of leveraged loans were traded in 2020, up 30% from 2015. This equates to about \$3 billion a day from which dealers generated annual revenues of over \$1.1 billion in 2020, according to Coalition Greenwich data.<sup>3</sup>

## Leveraged Loan Secondary Market ADV

In USD billions



Source: LTSA

<sup>3</sup> \$1.1 billion represents the aggregate 2020 revenues from secondary trading of par/distressed loans (including agency fees, excluding CLOs across the 12 international banks tracked most closely by Coalition Greenwich.

# The Electronic Tailwind

One might suspect that an ecosystem as active as the one for loans would have brought with it electronification over the past decade, similar to the e-trading growth seen in corporate and government bonds. Our data shows that U.S. high-yield corporate bonds, for instance, now see about one-quarter of total notional volume traded electronically, up from virtually zero less than a decade ago. And all-to-all trading now accounts for one-third of MarketAxess' U.S. corporate bond volume via Open Trading—a level that would have been hard to believe a decade ago.

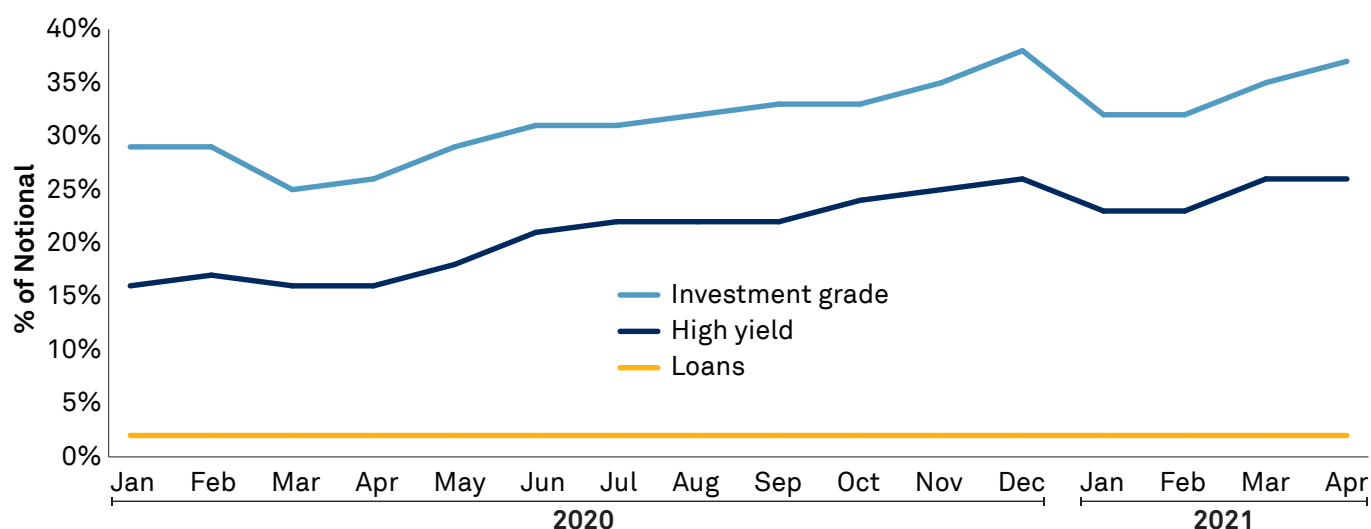
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## On the surface, more electronic trading in the coming years feels inevitable.

To date, however, electronic activity in loans remains notably limited. Only one multidealer platform run by MarketAxess and one single-dealer platform offered by Bank of America Merrill Lynch exist to facilitate electronic loan trading, which we estimate is only 1–2% of total secondary market activity on a notional basis. One of the most sophisticated asset managers indicated that they traded 3.5% of their loan volume electronically last year—a high watermark that might suggest marketwide growth to come.

On the surface, more e-trading in the coming years feels inevitable. Such statements have been made before, but we might be so bold as to say it's different this time. The past 18 months have created an e-trading tailwind for a large swath of the fixed-income market, with traders and investors accepting the benefits of more technology as they worked from home. U.S. high-yield corporate bond markets, for example, saw their e-trading volumes jump 50% from the beginning of 2020 through the end of the year.

## U.S. Corporate Bond Electronic Trading 2020–2021 YTD



Source: Greenwich MarketView

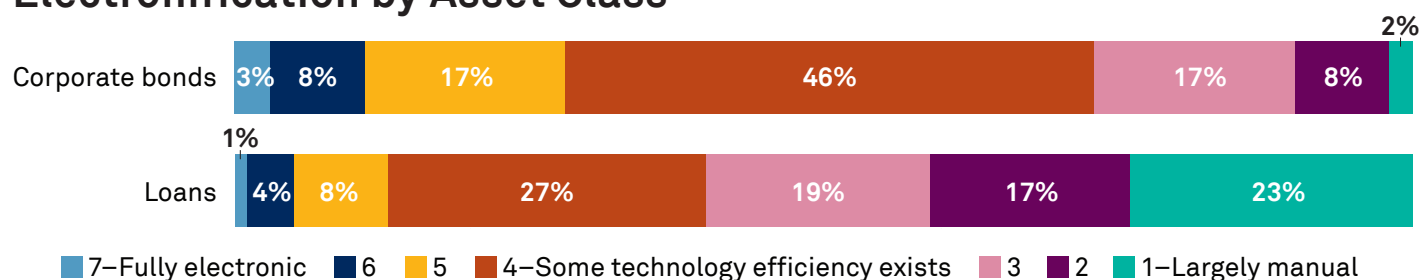
More broadly speaking, recent [Coalition Greenwich research](#)<sup>4</sup> found that 79% of market participants feel that the increased use of technology has made institutional markets “better and more efficient.” This mentality shift should carry over to loan markets, as credit investors comfortable with bond e-trading also play in the loan market.

**“...you like the market, you click, you’re done. [Electronic trading] makes life so much easier.”**

*~U.S. Asset Manager*

Our research in the first quarter of 2021 found that while loan markets were ranked last by market participants in terms of their current adoption of technology (23% rated them as “largely manual”), they were conversely ranked No. 2 on a list of markets with the biggest opportunity for efficiency gains via technology (only behind corporate bonds). The research went on to define these efficiency gains as increased transparency, higher quality execution, and lower prices for clients—all things that would benefit loan markets.

## Electronification by Asset Class



Note: Based on 170 respondents.

Source: Coalition Greenwich 2021 Capital Markets Collaboration Technology Study

Furthermore, it is easy to see the parallels between the loan markets of today and the corporate bond market of 15 years ago. Bond traders eased into e-trading by streamlining the phone-based request for quote (RFQ) process, which wasn’t too much of a shock to the system and allowed the maintenance of long-held relationships crucial to new-issuance access. Loan markets today are in a similar state.

## The Roadblocks

In a market that is seen as functioning well by its participants despite the lack of technology, very little change happens for the sake of change. Aside from new regulatory requirements, producers and consumers must see some real incentive to change their behavior and to make the required investment. In fixed-income markets, the buy side’s search for better executions and a more efficient trading process has been and will continue to be the biggest driving force of the current evolution. Natural market forces have made major dealers find new ways to be competitive, but in the end, client demands trump almost everything else.

<sup>4</sup> <https://www.greenwich.com/market-structure-technology/future-capital-markets-collaboration>

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## “Clients care and they like to see markets digitize.”

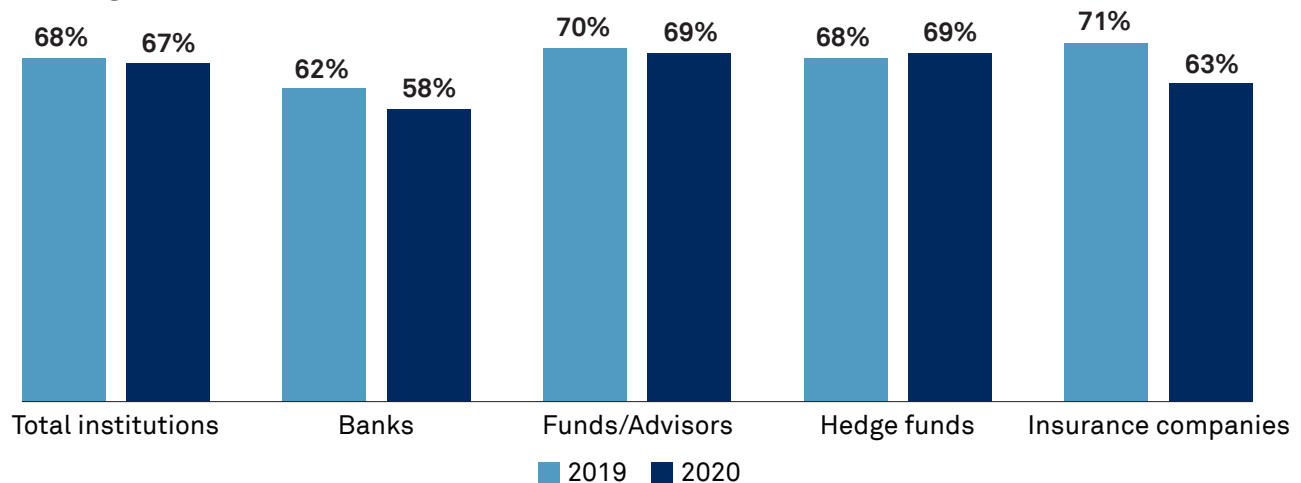
~Top-Tier Dealer and Issuer

Loan markets have the advantage of using the knowledge and technology built up in other markets to evolve more quickly than their predecessors. Further, our conversations with the buy side confirm there is real demand for a more efficient method of trading. The technology built by Bank of America Merrill Lynch in particular suggests the banks, at least to some extent, are trying to meet those buy-side demands. Nevertheless, electronifying a market is never as simple as copying functionality from another similar market—just ask those equity e-trading heads who made the jump to fixed income over the past decade.

First, loan investors still have an incentive and tendency to trade with the original agent (or issuer) of the loan. Our data from 2020 shows that leveraged loan investors traded an average of two-thirds of their volume with the agent. This creates a huge advantage for the biggest issuers, a list that includes J.P. Morgan, Citi, Goldman Sachs, and the other top-tier banks. It also can discourage investors from obtaining multiple price quotes to buy or sell those loans, as just going to the dealer directly can result in a better price, more liquidity and faster settlement. Lastly, in the case of J.P. Morgan, trading J.P. Morgan-issued loans away from J.P. Morgan comes with an additional material fee.

### Trading Volume Done with an Agent

Leveraged Loans Investors—United States



Note: Based on responses from 92 par loan investors in the United States in 2019 and 61 in 2020.  
Source: Coalition Greenwich 2020 North American Fixed-Income Study

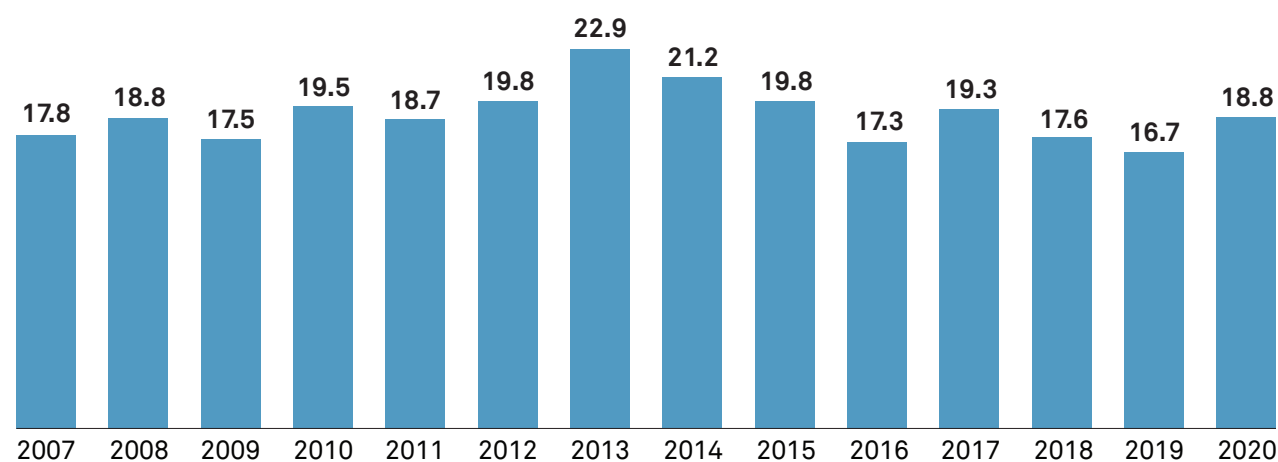
However, it could be hard over time for loan investors to guarantee they received the best price without receiving multiple bids or offers. While on one hand, large dealers can suggest to customers that they will receive a better price by coming straight to them and no one else, it is equally easy to believe that the lack of competition for a single order could leave the investor paying more than they otherwise would have. Data from MarketAxess shows that when the loan agent is put in competition with other dealers, the agent loses 67% of the time based on price. While it is hard to prove this is causal, the high percentage certainly suggests opportunity for price improvement exists.



# Settlement

In general, settlement times are also much shorter when trading with the agent, which some investors see as worth a potentially worse execution price. But even in those cases, settlement times are subpar. In U.S. equity markets, there is a renewed focus on speeding up the settlement time from T+2 (two days following the trade date) to T+1. In loan markets, the average settlement time in 2020 was nearly 19 days according to the LSTA—a percentage difference that is so big and obvious it's not even worth calculating.

## Annual U.S. Par Settlement Time T+ Business Days



Source: LSTA

Delays (or accelerations) of settlement can equate to real money. For most loans, interest starts to settle to the buyer on T+7. That can mean that the loan buyer is collecting interest on a loan that will not be paid for until two business weeks later. This delay creates risk and return implications to both counterparties in the transaction. In addition, the risk of human and operational errors can be enormous, given the manual nature of the process. [Citi's erroneous \\$900 million payment to Revlon creditors is a case in point.](https://www.bloomberg.com/news/articles/2021-03-19/citigroup-c-and-revlon-behind-the-500-million-accidental-payment)<sup>5</sup>

Blockchain and other DLTs have been suggested as a solution to the loan settlement issue for at least the past six or seven years. The hope is that if loan ownership can be digitized and more easily transferred, then settlement times would improve. Unfortunately, such solutions have yet to have much if any impact on the market. As one participant in our study pointed out, even if DLT began serving as the universal ledger for the loan market, people will still be left entering trade terms manually.

<sup>5</sup> <https://www.bloomberg.com/news/articles/2021-03-19/citigroup-c-and-revlon-behind-the-500-million-accidental-payment>



# Data

The past 20 years have also taught us that data, or lack thereof, presents one of the biggest catch-22's of market electronicification. Traders and investors need quality pricing, reference and trade data to more frequently transact electronically. And the more they trade electronically, the more data exists for both buy- and sell-side participants for trading in the future. This means not just the execution price of a given trade, but the cover price, how often dealers respond, how often they win, and so on. This and other data like it allow all market participants to make more informed decisions.

There is no expectation in the market for mandated reporting of loan trades, as the SEC and FINRA are focused on U.S. Treasury markets and improving TRACE reporting for corporate bonds. That means market solutions are the answer. Dealers are the largest data generators in this market, given their unique knowledge of the loans themselves and activity in the secondary market. Large market-data providers also play a big part here, including IHS Markit, S&P Global and ICE Data Services. But most of those prices are model-driven and updated daily, which isn't always enough for traders active throughout the day.

Trading platforms are the missing link in this data story. When volumes through these venues become robust, the market-data exhaust created from that activity is unique and can become quite valuable for everything from pre-trade analytics to post-trade best-execution analysis. Making those markets robust, of course, is the tricky part.

## Driving Change

Only a small percentage of the syndicated loan market trades electronically today, primarily via MarketAxess and Bank of America's Instinct Loans. While Instinct only allows clients to trade with BofAML, MarketAxess operates as a many-to-many RFQ-driven platform. Electronically traded loan activity today tends to center around lists and odd-lots—activity that for many investors and dealers creates more operational burden than it does profit. The technology does not disrupt current practices or relationships, but electronifies the process, allowing the counterparties to interact more quickly and capture more data about the interaction to be used in post-trade and future pre-trade analytics.

The current state of loan e-trading is not unlike the state of corporate bond e-trading 15 years ago. The RFQ technology used in those markets at the time did little more than mimic the phone or integrated business (IB) workflow, and the venues were considered “odd lot” platforms. While we don't expect the revolution seen in U.S. corporate bonds to hit the syndicated loan market with such force in the next few years, we do fully expect the technology innovations developed for less liquid products and the trader's willingness to transact digitally to progress the market notably forward.

# How Platforms Can Attract More Volume

Trading desks continue to get smaller as market volumes increase. Our data shows that the average buy-side trading desk shrunk by another 0.5% in 2020 and sell-side trading desks by 1%—small amounts year over year, but the continuation of a decades-long trend. As such, improving processes via technology is critical to keeping up with secondary market activity.

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## **Loan markets could and should think about all-to-all interactions as part of their first step into e-trading.**

For loan markets, that means getting away from the manual and time-consuming process of collecting price quotes over the phone or via IB, and then manually rekeying execution data into an order management or other booking system. This is no simple task, given the huge amounts of reference data needed for each loan. While loan documentation standards have been in place for some time, no two loans are alike, so ensuring that not only the trade price but the loan details themselves are entered properly is critical. Nevertheless, the process remains largely manual.

Even trading loans electronically still requires manual work for dealers when compared to other electronic markets. Algorithms do not respond automatically to RFQs. Traders must still calculate a price, often via a spreadsheet, and then either manually enter them into the trading venue or cut and paste prices for list trades. However, this is both considerably more efficient than non-electronic methods and somewhat easily improvable via an order management system (OMS) or even Excel integration.

To that point, liquidity providers must continue to invest in their pricing algorithms, moving from spreadsheets to more robust and real-time enterprise solutions. The aforementioned catch-22 applies here as well—pricing engines thrive on more market data, but the market data is ultimately driven by the success of pricing engines. For this to progress, dealers and platforms need to cooperate in order to benefit their mutual clients. Such pricing data is valuable intellectual property for liquidity providers, so platforms must respect that and put in place mechanisms that incent their use. Despite the solid relationships of dealer syndicate and trading desks, dealers can extract tremendous value from the networks created by trading platforms.

The last 10 years have taught us that equity-market technology cannot be cut and pasted into bond markets. Similarly, loans cannot simply begin trading on platforms designed for bonds. However, just like in the equities-to-bonds analogy, there still exists at least a decade of lessons learned that should allow loan markets to leapfrog some of the bond market's stepping-stones.

For instance, institutional all-to-all trading for corporate bonds took nearly 10 years to really catch on, as market participants wrapped their head around the idea and the technology improved. Loan markets could and should think about all-to-all interactions as part of their first step into e-trading. Currently, a bank still needs to intermediate every trade, but why not let investors (and even dealers) find one another in an anonymous pool?

Lastly, the past few years have taught us that electronification is not just about e-trading but about improving the pre-trade to post-trade workflow. In the loan market, this will require cooperation among not just dealers, clients and trading venues, but also OMS providers, reference data managers, indexers, and pricing services. Post-trade will be in particular focus in the loan market's evolution, given its subpar settlement-time track record. Speeding up settlement times when trading away from the agent could, for instance, have a huge impact. But simply speeding up settlement won't be enough, nor will more electronic buy and sell matches if the rest of the process can't keep up.

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**“If I sell something away from the agent, and I can't get it closed, it's a problem.”**

*~U.S. Hedge Fund*

## Is it Different this Time?

Loans are likely to be one of the next big electronification stories. It could, in fact, be different this time.

First, the tailwind of e-trading and electronification of capital markets broadly was accelerated by the pandemic-distributed workforce. Manual workflows that were tolerated on a trading floor became nothing short of annoying when everyone was in a different location.

Second, technology and workflows exist today that did not five to 10 years ago, when talk of loan-market modernization was most recently in the spotlight. Corporate bond markets have presented several new trading protocols and [seen all-to-all trading grow](#),<sup>6</sup> helping market participants find the other side of the trade when trading in illiquid and hard-to-price instruments. Evaluated pricing has improved in speed, breadth and quality by utilizing artificial intelligence, cloud computing and years of experience. And DLT has gone mainstream, presenting new and improved ways to manage contract terms, ownership, payments, and settlements for a variety of assets.

Finally, there is just no excuse not to change. Investors certainly value the color and market research presented to them by their dealer counterparties, and dealers bring a level of expertise and capital to the market that cannot be replaced. But that does not mean that technology cannot step in to enhance those interactions without replacing them. Recent announcements by bank consortia to launch both a CLO-trading platform and a platform to manage reference data in the loan market show that it's not just clients that are pushing for more efficiency, but the big banks as well.

The exact path forward is impossible to predict. While this evolution feels all but inevitable, organic change takes time. Most market participants would agree that naturally evolving markets are better than those forced by regulation. The unique market structure of the loan market means its final state won't mirror those of other fixed-income markets. But even incremental change in a market as big and manual as syndicated loans will have a huge impact on the markets' functioning overall.

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<sup>6</sup> <https://www.greenwich.com/fixed-income/all-all-trading-takes-hold-corporate-bonds>

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