# The New Trend of Nonbanks Funding Large Syndicated Loans

lending commercial industrial competition shared national credits

**Summary:** As the banking industry has pulled back its lending activity, nonbanks, such as private equity firms, have moved in to fill the lending gap among large syndicated loans. We discuss what this could mean for CFIs and their participation in the syndicated loan market.

Pink has been Barbie's signature color since the day the first Barbie doll made its debut at the American International Toy Fair in March of 1959. So, it is no surprise that the set for the "Barbie" movie was bathed in countless shades of bright pink to create a real-world version of Barbie's dream house. But with the filming of the movie taking place so soon after the COVID-19 pandemic, when global supply chain issues remained a factor, the movie's set actually led to a global shortage of fluorescent pink paint for the filming industry — which uses a specialized paint that provides optimal contrast for television and video systems.

The banking industry knows a little something as well about how certain trends can leave the status quo out of balance. Following regulators' efforts to minimize risks within the banking industry after the global financial crisis, banks are increasingly loath to lend the large amount of capital typical of syndicated loans. This leaves a gap in the market for nonbanks and private equity (PE) firms to swoop in. PE firms now hold the largest share of special mention and classified loans, according to the Shared National Credit (SNC) program.

**Change in the Air**

While banks still dominate the lending arena, nonbanks have been increasing their presence, particularly in classified loans. When the global financial crisis spurred heightened regulatory oversight and caused banks to scale back their corporate lending, PE firms saw an opportunity and jumped into the syndicated loan market, based on recent data from the SNC program. Created by the government to assist regulators in keeping a closer eye on the classification and risks related to large syndicated loans, the SNC program analyzes loans of $100MM or more issued by a minimum of three federally supervised regulators.

According to the SNC program's 2022 data, traditional banks still hold the biggest share of the $5.9T in syndicated loan commitments, representing 44.7% of such assets, compared with 32.3% held by foreign banks and 22.9% held by nonbanks. But it is a different story when it comes to large, non-investment grade syndicated loans. Non-investment grade loans comprise roughly $1T of the $1.1T in leveraged loans. Of that, nonbanks hold 19.2%, compared with 3.2% held by US banks and 3.6% held by foreign banks.

One major driver of this shift is the fact that PE firms typically finance leverage buyouts with syndicated loans. Another factor is that less regulatory oversight has made such loans appealing and boosted nonbank ownership. In a journal article titled "How Private Equity Fuels Non-Bank Lending," members of the Federal Reserve Board of Governors and HEC Paris discuss the role of private equity in this shift. By comparison, it seems that loans with PE participation have lower credit risk, when measured by expected losses, as opposed to non-PE-backed loans. The report also notes that more non-bank lending fosters a larger loan supply and friendlier terms for borrowers, as PE-backed loans typically feature fewer covenants. Consequently, heightened lending among nonbanks is expected to continue driving up the loan supply.

**The Impact of Nonbank Syndicated Loans on CFIs**

Financial institutions have traditionally relied on syndicated loans because of the flexibility their liquidity provides, given that they can typically be sold fairly easily in the secondary market. In certain interest-rate environments, syndicated loans can be a way for community financial institutions (CFIs) to generate greater returns and diversify their lending portfolios. However, banks are becoming wary of devoting so much capital to a large loan, in the midst of a liquidity crisis — a situation where nonbanks are more than happy to pick up the slack.

Bloomberg recently reported that in just the past year, regional banks dropped from owning a quarter of lending deals to just 15% now. PE firms are quickly becoming the go-to for corporate borrowers, and it may be difficult for banks to regain their typical market share of syndicated loans, even once the economy is in better standing. Deals to PE firms are reaching previously unheard-of amounts, and there's no sign of this changing. PE lender Oaktree is working to raise $18B, which would be the largest private credit fund in history. Companies like PayPal are even selling Buy Now, Pay Later (BNPL) loans to PE firms.

Another challenge is that if PE financing continues to rise, it could result in greater opacity regarding information about private market deals. PE firms aren't held to the same regulatory standards as banks, and performance data is much harder to monitor than with public banks. With PE firms taking over more of the market, it will be more difficult to gauge the health of syndicated loans and could leave some missing pieces in the puzzle of the economy.

Despite the hesitancy that banks have toward syndicated loans at the moment, they do still retain the market share in some types of loans. However, the growing trend of PE firms lending to corporations — especially in non-investment grade situations — could be a hindrance to banks, once they start feeling comfortable with larger loans again. Whether this is a short-lived anomaly or a sign of enduring change remains to be seen, but we will update as the outlook becomes clearer.

In the meantime, there are methods to optimize how you invest in syndicated loans. Some loan programs, like PCBB's C&I loan program, offer an opportunity to find quality syndicated loans in an ever more opaque and complicated market. Our program allows CFIs to cut through the headwinds and find appropriate risk and loan opportunities to meet their regulatory and internal requirements.

## EXCESS LIQUIDITY THAT YOU WANT TO INVEST?

Is your institution looking for more lending opportunities? Fully-funded, senior secured floating-rate loans put your liquidity to good use and allow you to gain income. Learn about how our C&I Loan Program can help your loan growth objectives.

## ECONOMY & RATES

Rates As Of: 08/31/2023 05:56AM (GMT-0700)

| Treasury | Yields | MTD Chg | YTD Chg |
|---|---|---|---|
| 3M | 5.56 | 0.01 | 1.14 |
| 6M | 5.51 | -0.02 | 0.75 |
| 1Y | 5.36 | 0.00 | 0.65 |
| 2Y | 4.88 | 0.00 | 0.46 |
| 5Y | 4.26 | 0.08 | 0.26 |

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|---|---|---|---|
| 10Y | 4.11 | 0.14 | 0.23 |
| 30Y | 4.22 | 0.21 | 0.25 |

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|---|---|---|
| **FF Market** | **FF Disc** | **IORB** |
| 5.33 | 5.50 | 5.40 |
| **SOFR** | **Prime** | **OBFR** |
| 5.30 | 8.50 | 5.32 |