Growth in leveraged loan issues[1] and in issues of securitisation instruments using leveraged loans as their underlying asset, especially Collateralised Loan Obligations (CLOs), and the possible easing of credit standards associated with these instruments, have been identified by various regulators[2] as significant risk factors for the stability of both the European and the US financial systems. Chart A shows that the overall volume of leveraged loan issues has indeed been very significant in recent years, with record issuance in 2017 of over €220 billion in Europe and over €1.36 trillion in the United States and with just a slight moderation in these volumes in 2018 (on average, US issuance amounts to six times European issuance throughout the period 201318). The aggregated data also show the declining significance, both in the United States and Europe, of high-yield (below investment grade) bond issues compared with leveraged loans provided directly by the banking sector to fund corporations with the most highly leveraged financial structures.

CLO issuance in Europe tripled between 2013 and 2018, while in the United States it rose by around 60%. However, in each of those years, the volume of issuance remained much higher in the United States than in Europe (see Chart B). In any event, CLO issuance[3] is growing against a backdrop of broader recovery in the securitisation market; in fact, towards the end of the period indicated, CLOs declined as a proportion of the total volume of Collateralised Debt Obligations (CDOs), which is a broader category of which CLOs are a fraction.

Beyond identifying these overall patterns, this Box aims to provide an in-depth analysis of leveraged loan issuance in Europe and of Spanish banks' exposure to leveraged non-financial corporations. If European corporations' leveraged loan issues are broken down by controlling parent company nationality (see Charts C and D), the United Kingdom comes out top both in 2017 (€131 billion) and 2018 (€74 billion), although in 2018 with a considerably narrower margin over the second-placed country (Germany, with €53 billion). The leveraged loan issuance volume of corporations whose parent group is based in Spain is much smaller (€26 billion in 2017 and less than €10 billion in 2018) and behind that of other countries (see Chart C). In all the countries considered there is a high percentage of loan issues in which significant banks (identified as participants in the EBA's transparency exercise for each country in the study) that share the same country of residence as the borrowers' parent companies participate. This figure is over 70% in both years in France, Spain and Italy, which is the country with the highest rate of national participation.[4]

1 There is no single definition of a leveraged loan; a debt instrument may be classified as such according to its rating or risk premium or according to accounting measures, such as a debt-to-EBITDA ratio over 6.

2 In its May 2018 Financial Stability Review, Box 5: Leveraged loans: a fast-growing high-yield market (pp 74 78), the ECB identified these developments as potential financial stability risks. The Federal Reserve, in its November 2018 Financial Stability Report, also identified an increase in 2017-18 in risky debt issuance (leveraged loans and speculative grade bonds) by non-financial corporations (pp 19 20) and in CLO issuance (pp 28 29), and noted the high tolerance for risk-taking with respect to non-financial corporations' debt as a vulnerability factor.

3 Leveraged loans are not the only possible underlying asset in CLOs, but they are the best proxy for the volume of securitisations linked to these loans.

4 On the data available, it is only possible to identify the participation of national banks in syndicated loans marked as leveraged loans on Thomson Reuters, but not the amount of risk assumed.

Chart A
ISSUANCE OF LEVERAGED LOANS AND HIGH-YIELD BONDS (a)

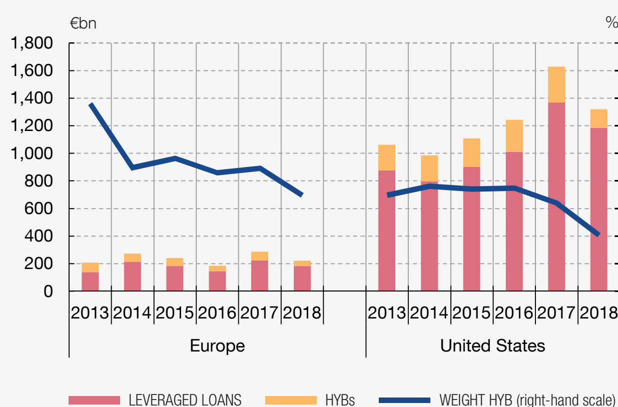
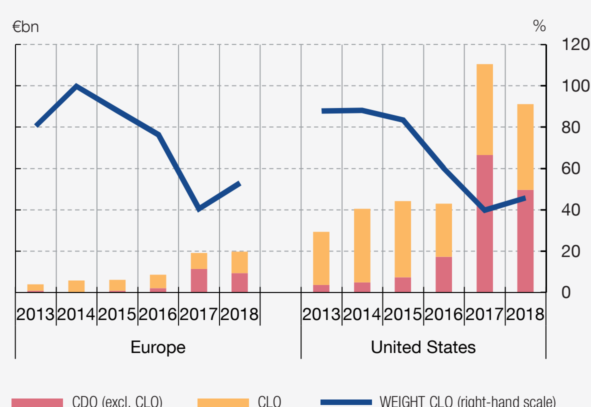


Chart B
CDO/CLO ISSUANCE (b)



SOURCES: Thomson Reuters, Dealogic, SIFMA-AFME, SIFMA, Datastream and Thomson Reuters Leveraged Loan Monthly - March 2018 and Year End 2018, Reuters Bond News November 2018.

a Leveraged loans are syndicated loans classified as leveraged or highly leveraged loans by Thomson Reuters based on a list of credit quality criteria. High-yield bonds are bonds classified as lower than investment grade in the Dealogic issuance database. The European issues relate to debtors the nationalities of whose parents are the major European economies (Germany, United Kingdom, France, Italy and Spain). Issuance data from Thomson Reuters shown in dollars are converted to euros using the euro/dollar exchange rate at the issuance date.

b SIFMA data on issuance of CDO and CLO securitisations, as well as Thomson Reuters' data on CLO issuance in the United States reported in dollars are converted each year at the related average euro/dollar rate. European CLO issuance data for 2018 relate to the January-November period.

Chart C
FLOW OF LEVERAGED LOAN ISSUANCE BY COUNTRY OF BORROWER (a)

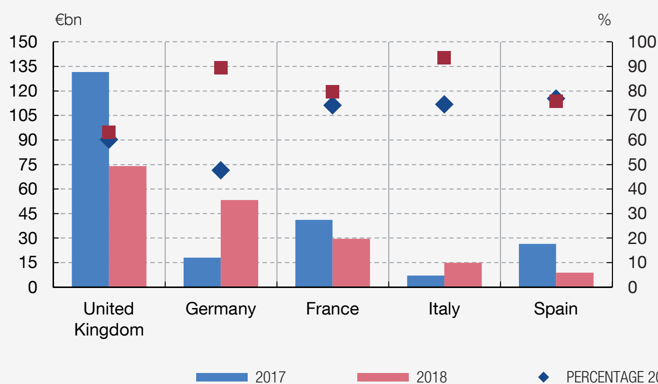
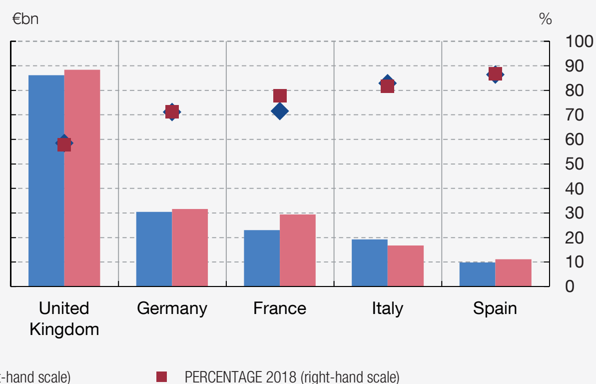


Chart D
STOCK OF LEVERAGED LOAN ISSUANCE BY COUNTRY OF BORROWER (a)



2017 2018 PERCENTAGE 2017 (right-hand scale) PERCENTAGE 2018 (right-hand scale)

SOURCE: Thomson Reuters.

a The chart relating to issuance flow considers loans arranged in 2017 and 2018. The stock of issues in a given year considers all issues with arrangement dates until December of that year and loan maturity dates after December of that year, i.e., the balance of issues outstanding is considered. Percentages in 2017 and 2018 indicate the proportion of issues linked to borrowers in a country in which banks of that country intervene (significant institutions participating in the latest EBA's transparency exercise) in their capacity as TIer 1 agents of the bank syndicate providing the loan. The borrower's country is identified with the country of residence of its latest parent company.

Chart E
SYNDICATED LOANS TO NON-FINANCIAL CORPORATIONS

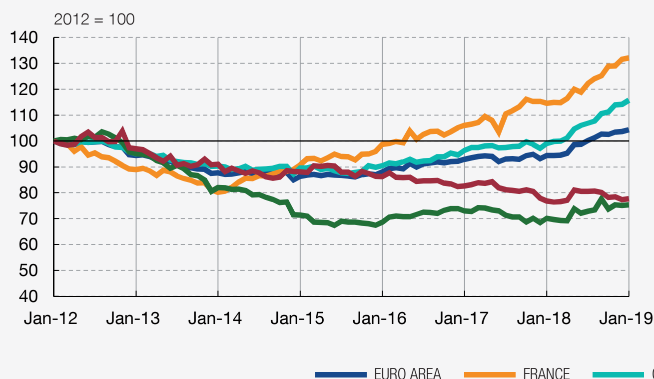
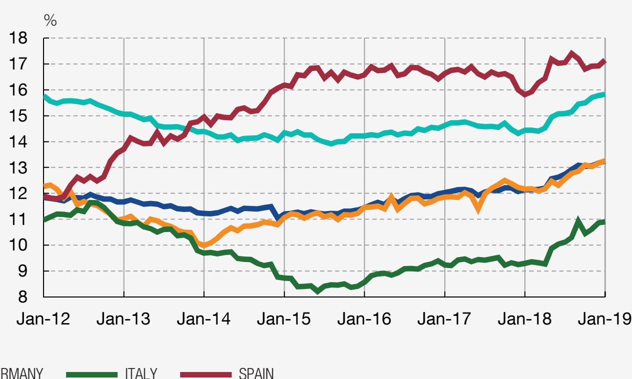


Chart F
SYNDICATED LOANS TO NON-FINANCIAL CORPORATIONS
As a percentage of loans to non-financial corporations



EURO AREA FRANCE GERMANY ITALY SPAIN

SOURCE: ECB.

Analysis of the total stock of outstanding leveraged loans at December 2017 and 2018 (see Chart D) offers similar conclusions to the flow analysis. Once again the United Kingdom is the most frequent country of residence for groups issuing leveraged loans (with €441 billion in 2018), significantly ahead of the second-placed country (France, with €158 billion in 2018). Considering total issuance, issues corresponding to Spanish borrowers are higher than issues corresponding to Italian borrowers (€83.3 billion compared with €53.3 billion in 2018).

Leveraged loans are generally classified as a subsegment of the broader market for syndicated bank loans, which do not only include loans extended to highly leveraged corporations.[5] In any event, European banks' exposure to syndicated loans (see Chart E) is another useful proxy for exposure to leveraged loans, as it represents a maximum level. Euro area banks' exposure to syndicated loans to non-financial corporations saw no significant change in the period 201218, but there are notable differences between one country and another. Cumulative growth in these syndicated loans in the period 201218 was approximately 16% in Germany and 30% in France, clearly expanding since 2014 and 2016, respectively. By contrast, both Spain and Italy saw cumulative declines of around 22%.

In 2018, exposure to syndicated loans at the European level (EU average) amounted to approximately 13.2% of total credit exposure to non-financial corporations, 1.3 pp more than in 2012 (see Chart F). This ratio has evolved quite differently from one

5 Thomson Reuters includes, in its list of leveraged loans, syndicated bank loans that are classed as leveraged or highly leveraged based on a list of credit quality criteria.

Chart G
DISTRIBUTION OF THE DEBT TO ASSET RATIO BY EXPOSURE DRAWN DOWN IN SYNDICATED LOANS (a)
December 2018

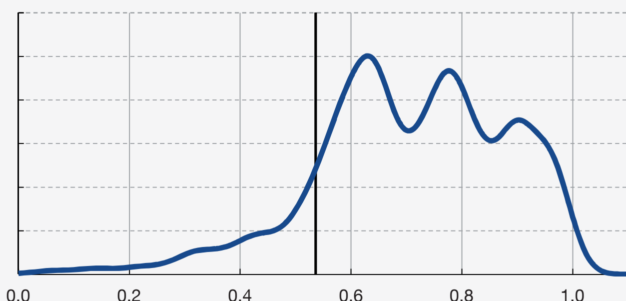
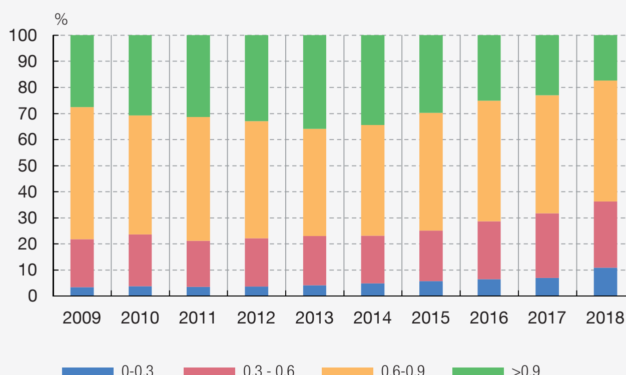


Chart H
PERCENTAGE OF VOLUME DRAWN DOWN BY DEBT RATIO BUCKET. LARGE FIRMS (b)



SOURCE: Banco de España.

a The panel shows the density function (or frequency distribution) of the debt ratio (total long- and short-term debt as a percentage of total assets) for firms with syndicated loans from Spanish deposit-taking institutions, weighted by the CCR credit amount as at December 2018 for each ratio category. This density function is approximated through a kernel estimator which allows a non-parametric estimate of the density function, yielding a continuous and smoothed graphic representation of that function. The vertical line indicates the median of the debt ratio measured for the group of large firms in the Central Balance Sheet Data Office (CBSO) of the Banco de España at the latest available date.
b The distribution of this panel is obtained by cross-checking the CBSO data, selecting such institutions that individually meet the requirements to be classified as a large firm in terms of number of employees, sales or total assets in accordance with Regulation EU 651/2014, with the CCR. CBSO data are used to classify the firms based on their debt ratio and CCR data provide the volume of drawndown exposure of Spanish banks to each of these categories. The year shown in the panel refers to measurement of the drawndown amount in the CCR (e.g. 2018), with the classification by debt ratio relating to the previous December (e.g. 2017).

country to another. In the case of Germany, Italy and France, a Ushaped pattern is observed, returning in 2018 to the 2012 level in the case of Germany and Italy and continuing to rise moderately in the case of France. By contrast, in the case of Spain the ratio is clearly climbing: as a percentage of total loans to non-financial corporations, syndicated loans rose from 11.9% in 2012 to 17.1% in 2018. This, together with the drop in absolute terms in syndicated loans granted by Spanish banks observed in Chart E indicates that the decline in volume in these loans has been less than the decline in volume in overall lending to non-financial corporations.

Although not all syndicated loans are granted to highly leveraged corporations, Chart G shows that in December 2018 the distribution of the debt ratio (total short and long-term debt to total assets) by volume of syndicated loans at Spanish deposit-taking institutions is concentrated at relatively high levels of the ratio.

The fact that the leveraged loan and associated securitisation business is concentrated in the United States and, within Europe, in the United Kingdom, does not mean that the proliferation of these instruments poses no risk to the Spanish financial system. The risks assumed through leveraged loans in Europe and the United States affect global sensitivity to possible shocks to the review of the required risk premia or corporations' financial position, and shocks originating in other systems may be passed through commercial and financial channels.

In addition, as shown in Chart F, as a proportion of total credit exposure to non-financial corporations, Spanish banks are not less exposed to syndicated loans than their European peers.

Lastly, Spanish deposit-taking institutions' exposure to leverage at large corporations is analysed, beyond the syndicated loan segment which, despite being an important risk category, might not include all exposures to highly leveraged corporations. Since 2009, data matching by the Banco de España's Central Balance Sheet Data Office (CBSO) and its Central Credit Register (CCR) shows lower credit exposure to more highly leveraged corporations (see Chart H), even though they account for a considerable proportion of total credit to large corporations in 2018. Specifically, the proportion of credit to corporations with debt ratios of 0.6-0.9 and of over 0.9, respectively, fell from 51% and 28% in 2009 to 46% and 17% in 2018. Exposure to less leveraged corporations mitigates the risks to the stability of the system, although the distribution of leverage observed indicates that the ability to pay of some corporations in this segment could be sensitive to a deterioration in macro-financial conditions, were the risks identified in this FSR to materialise.