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For 2021, our columnist is focused on Libor transitions, CLO flexibility and loan managers fighting among themselves

Perhaps 2021 will be the first year of the next expansion

Almost everyone is happy to see the back of 2020, but few would have predicted in March that we would do so with loans and CLOs generating positive returns. The Credit Suisse Leveraged Loan Index, as well as the JP Morgan CLOIE AAA and BB indices, are all in positive territory for the year, as *Creditflux* goes to press.

This is a far cry from mid-March when uncertainty gripped developed and emerging markets globally, and the loan index fell 10% in the month. Many were predicting a spike in corporate defaults by the end of the year.

But ending the year with positive total returns feels like a good way to close 2020. Bar a late-December meltdown, this will represent the Credit Suisse loan index's 27th year of positive total returns in its 29 years of publication.

This consistent performance is remarkable. We are aware of no other 'risk' asset class that has generated positive returns so consistently over the long term.

It seems unlikely Libor will end in 2021

2020 was a calm year(!), which poses the question, what excitement will 2021 bring? Perhaps a farewell to Libor?

Regulators are definitive that Libor will be de-emphasised before 2022. While nothing is done until it's done, considering the nearness of the scheduled cessation date, the loan and CLO markets still have a lot of wood to chop. Some loans are still being issued today referencing Libor without having a definitive replacement baked into the documents. Can your internal systems handle Sofr yet?

With Intercontinental Exchange now saying Libor may continue being published through 2023, perhaps we can breathe a sigh of relief. Where we sit today, with no loans or CLOs converted and issuances still using old rates, being fully converted before 2022 feels like a stretch.

Whenever the index ends, we know the thousands of loans and CLOs outstanding will not all change reference rates on the same day. This will introduce a new basis risk into the loan and CLO markets, as well as other complications.

Lender-on-lender warfare will continue

Thinking of the number of high-profile restructurings where the "51% consent required to amend" language has been used by lenders to benefit themselves at the expense of other lenders holding the same instrument, it is frustrating to see the loan market continue to accept this language in newly issued loans.

A far more reasonable path forward for the loan market would be to require 75% or 90% consent for a material change (which is still a lower hurdle than the typical 100% consent requirement for a material change in a CLO). With demand for credit strong, regrettably, we do not foresee much progress on this issue in the loan market in 2021.

Even if the loan market made an immediate and decisive change for all new issues, knowing many existing loans have 51% language, lender-on-lender warfare will be a reality of the loan market for many years to come.

CLOs need freedom to invest in workouts

The battles between CLOs and distressed credit funds are expected to continue throughout 2021.

Despite amendments to the Volcker rule and the clear harm that certain CLOs have faced from CLO-unfriendly restructurings, some CLO investors still push back on even modest flexibility to invest cash in non-loan workout securities. Few CLO investors — debt or equity — like par loss. Tying a CLO's hands in distressed situations hurts both individual investments and the market overall.

Most weak borrowers have defaulted

The coronavirus pandemic cleared out many weak corporate borrowers through accelerated defaults. While the 2020 corporate default rate will end up above average, many borrowers that filed during the year were on thin ice before anyone had heard of covid-19.

We will see further defaults driven by the pandemic in 2021, though many of the credits most likely to struggle have already been identified in the market. Overall, with corporate liquidity in better shape than it has been for some time, perhaps 2021 will be the first year of the next expansion.