Risk Managers Expect Higher Leveraged Loan Defaults in 2021

While Many Worry About Risk Overall, Most Feel Their Organizations Are Not in Danger

JERSEY CITY, NJ, February 2, 2021 – New research from the Global Association of Risk Professionals (GARP) reveals that risk managers believe the risks associated with leveraged loans and collateralized loan obligations (CLOs) remain serious, but nearly all believe their organizations are appropriately prepared.

In a recent survey of risk managers, 96% of respondents said default risk has increased since the start of 2020. Two-thirds expect an increase in risks associated with leveraged loans in 2021, with 46% expecting a small increase and 21% expecting a large increase; 18% expect a small decrease and only 2% a large decrease.

Most respondents are not very concerned about the impact of leveraged loan and CLO risks on their own company if defaults become widespread, with about two-thirds predicting no impact or a minor impact and only 11% predicting a major impact. Most respondents feel their company is aware of the risks, with half believing their company’s level of concern is appropriate and 24% believing it is too low. The average respondent also believes the level of concern in financial markets is about right.

As part of its Risk Snapshots series, GARP surveyed 87 Certified Financial Risk Managers (FRM®) active in leveraged loans and CLOs to understand their views on these markets, which experienced a turbulent 2020. In Q1 and Q2, indicators of leveraged loan risk spiked due to the crash of business cash flows associated with COVID-19. Risk receded somewhat in Q3 and Q4 as policy actions took hold and the economy experienced a partial recovery. The survey was taken in late October 2020 with respondents approximately evenly divided between EMEA, the Americas, and Asia.

“Leveraged loans and CLOs remain vulnerable to another economic shock,” said Mark Carey, co-president of the GARP Risk Institute. “We are not out of the woods yet and risk managers need to consider this risk as part of their company’s credit portfolio.”

Other key findings include:

- Recovery rates on defaulted loans are a concern. More than half of respondents believe there is a moderately significant risk that recovery rates going forward will be much worse than in past episodes of stress, and another third view that risk as very significant. Unusually poor recovery rates could cause losses on riskier CLO tranches if default rates pop up to high levels.
More than 80% of all respondents feel policymakers should do more to address the risks associated with leveraged loans and only 16% feel policymakers should not do more. However, only 11% believe policymakers will take significantly stronger actions to address leveraged loan risks in 2021, with the remainder believing policymakers will take slightly stronger or no action.

To learn more about the risks of leveraged loans and CLOs, or to see more Risk Snapshots, visit garp.org.

About the Global Association of Risk Professionals

The Global Association of Risk Professionals is a non-partisan, not-for-profit membership organization focused on elevating the practice of risk management. GARP offers role-based risk certification — the Financial Risk Manager (FRM®) and Energy Risk Professional (ERP®) — as well as the Sustainability and Climate Risk (SCR™) certificate and on-going educational opportunities through Continuing Professional Development. Through the GARP Benchmarking Initiative and GARP Risk Institute, GARP sponsors research in risk management and promotes collaboration among practitioners, academics and regulators. Founded in 1996, governed by a Board of Trustees, GARP is headquartered in Jersey City, NJ, with offices in London, Washington, D.C., Beijing, and Hong Kong. Find more information on garp.org or follow GARP on LinkedIn, Facebook, and Twitter.

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