Bank Loans Primer for Insurance Companies & Government Risk Pools

Bank Loans are a risk asset class that is comprised of corporate debt issued by below-investment-grade borrowers.

Bank loans, which are also commonly known as leveraged loans or senior loans, are typically issued by large and well-recognized financial institutions. These loans are used for refinancing, recapitalization, acquisitions, and other general corporate operations.

Insurers and risk pools investing in bank loans, typically via mutual funds, receive coupon income based on a floating rate. This floating rate resets every 40 to 60 days *(on average)* with issuers using LIBOR as its base or reference interest rate.

LIBOR:
London Interbank Offered Rate
A benchmark interest rate, averaged across the leading global banks, for the interest charged to other banks on short-term loans

Why Insurers and Risk Pools Consider Bank Loans

- The floating rate structure makes the asset class less sensitive to interest rate movements
- Since the floating rate resets rather quickly, they have a very low duration, especially when compared to other asset classes.
- Given issuers are below investment-grade, the potential for higher yields is generally greater than investment-grade and high-yield bonds (but with greater risk of loss).
- Bank Loans are generally considered "senior and secured," meaning they have the highest priority in an issuer's capital structure; should the issuer declare bankruptcy then these bank loans would be repaid ahead of any other owed debt.

Duration:
Defined as a measure of price volatility; how the price of a security will change as its yield changes.