What will SME lending look like in 2028?

What might the maturity wall bring? And will banks be back in force in the SME lending space by 2028?

Christopher Faille 1 October 2024

Looking four years out, two broad questions will shape much about lending to the mid-market in North America: first, how will Covid-era investment and speculative bonds be refinanced as they reach maturity, given an impending wall? Second (related) is the regulated banking industry going to resolve the push/pull of its interest in and its fear of SME lending?

Keerthika Melissa Subramanian, an equity partner with the capital markets group of the law firm Winston & Strawn, speaks of the origin of a maturity wall. It began in the Covid crisis of 2020-2022 when many companies issued debt at low interest rates. Some of this consisted of borrowing by companies hard hit by the pandemic, the travel industry especially.

A study by think-tank Brookings issued in the midst of the covid crisis spoke bluntly of corporate bond market dysfunction. Though the market for corporate bonds had "functioned well in the global financial crisis," the report said, it "did not in the Covid-19 crisis."

Bespoke transactions

Subramanian expects that maturities on Covid-era issuances will peak in 2026. "Maturities will tick up in 2028 near 2026 peak levels, but we should be clear of it after 2028." She also said borrowers will need to pursue bespoke liability management transactions such as exchange offers, tender offers, consent solicitations and complex equity and debt financings over the next 18-36 months, because they and their advisors will want to evaluate their options at least 18 months in advance of the significant maturity dates.

As to the timing of the wall, her views are akin to those of Ari Lefkovits, managing partner at Delos Capital, especially with regard to the timing of the wall. Lefkovits, discussing the matter prior to the September meeting of the Federal Reserve (but after the Fed chairman had telegraphed a coming cut), was asked whether concerns about the maturity wall are alleviated by the prospect of lower rates. Lefkovits said, "Even if the Fed does lower rates by 75 to 100 basis points by the end of this year, that will only mitigate some borrowers' refinancing needs

between now and 2028. It will not eliminate the need of many companies for bespoke financings to facilitate the refinancings of their capital structures."

This is, fortunately, what the private debt market is good at. It exists and has thrived of late precisely because of its flexibility, and the mid-markets will need that now. Winston & Strawn, a global firm headquartered in Chicago, has seen "some conventional refinancing activity and amends and extends, which have helped address more near-term maturities, but not all borrowers will be able to pursue traditional refinancing methods," in Subramanian's summary of the situation.

The shape of debt financing in the middle market in four years will be the result, in large part, of the lenders who will by then have helped middle market companies over this wall. That observation brings us naturally to the other outstanding question: where are banks headed?

Ongoing retreat

Beginning at least as far back as the global financial crises of 2008-09 and regulatory reactions thereto, banks have been on the retreat from volatility, and this has included a retreat from loans to small and medium sized enterprises. This was compounded by the 2023 bank blow-ups, in and out of Silicon Valley. As a telling sign that the retreat may be ongoing: Subramanian referenced the financial software company Finastra, which in August received a record-setting $4.8 billion unitranche loan from several lenders, including Blue Owl and Oak Hill, in order to refinance bank debt.

There is, though, a complicated push/pull at work. For a period, roughly, 2013 - 20, US banks refrained from investing in debt funds as a matter of regulatory compliance. [See box]. They of course remained active in the BSL market, but the effect of the Volcker rule was to limit their ability to offer clients a one-stop shop that would include a private debt fund serving middle-market portfolio companies.

There has been some movement in that direction, though, since the amendment to the Volcker rule in 2020 allowed it. Citigroup, Barclays, Morgan Stanley and JPMorgan have all taken an active part in building out their lending operations.

Banks have discovered that offering those one-stop shops will involve hiring from within a limited pool of talent. An analysis in PWM, a newsletter for the wealth management industry, noted, "[P]rivate credit deals often demand more rigorous due diligence than PE counterparts [so we] must cast our nets wide, sourcing top talent from across the financial spectrum, investing in their development to create the next generation of financial leaders." That sounds burdensome. If done right, it is.

The *Fowler* litigation illustrates how contentious the quest for talent can get. Corinthia Global Management, a newly founded private credit platform, the creation of Australian entrepreneur Paul Weightman, poached more than 20 employees from Barings, the $409 billion asset manager in the MassMutual family, in March 2024. As of this writing, litigation continues.

In part because of the talent issue, Subramanian thinks that banks will continue to be wary of SME. The onus, along with the opportunities of serving the leverage needs of small and medium enterprises will remain chiefly with the private lenders.

That prospect suggests continued growth for the private funds, and for the most creative and flexible among them.