Transactions & Business

Practical Law

A COMPANION TO PRACTICAL LAW ONLINE | JULY/AUGUST 2017

THE JOURNAL

The Experts Weigh In

Mid-Year Trends in Loan Terms and IPOs

An Expert's View

JENNIFER B. EZRING
PARTNER
CAHILL GORDON & REINDEL LLP

Jennifer represents commercial and investment banks in leveraged finance and asset-based lending transactions, including acquisition financings, leveraged buyouts, going-private transactions, recapitalizations, project financings, bridge lending and loan commitments, and out-of-court debt restructurings.

Jennifer shares her thoughts on current issues in the loan market:

The first half of 2017 has been marked by a wave of repricings. What developments in the loan market do you expect to see in the second half of 2017?

It would be impossible to answer that question without noting the impact of direct lenders and unregulated financial institutions that have entered the leveraged loan market during the last few cycles. The presence of these new entrants has created a broader group of potential lenders that borrowers can contact for each transaction to take advantage of the various structuring strategies these lenders might provide. Not only does the increased competition often result in more aggressive terms, but combining multiple lending sources might lead to more creative financing structures as the year progresses.

However, these new borrower-favorable terms have increasingly caused borrowers to expect that recent market-clearing terms are locked in, often through the use of an underwritten document precedent which looks backward in time. As a result, we expect to continue to see the terms that cleared the market over the past few months brought to market through the second half of 2017.

Flex rights remain a hot topic in loan negotiations. In what ways have you seen flex rights being exercised so far in 2017, and what do you expect to see in the second half of the year?

Our financing commitments have indeed included an increasing number of flex items in early 2017, in part due to the aggressive nature of much of the new technology, which had not generally been asked of lending syndicates prior to this year. Many of today's terms were groundbreaking only a few months ago, and committed lenders agreed to present these innovations to the market while retaining the ability to revert to the previous norms if needed.

We saw syndicates accept new, more aggressive most favored nation (MFN) carveouts, basket growers for nearly all covenant carveouts, even including restricted payments, reclassification rights, and expanded incremental debt flexibility without the need to exercise all of that flex. However, we sometimes saw pushback on pricing terms.

In recent months, we have observed repeat flex events that include a few extra basis points (bps) of interest margin, a few extra months of soft call protection, and reduction of 75 bps MFN protection back to its previously settled 50 bps norm. Some of the innovations the market addressed in earlier rallies are now once again subject to negotiation, for example, a 12-month MFN sunset or a step-down to 50% in an otherwise standard 100% asset sale proceeds sweep, and might be taken to market now to succeed or be flexed out based on the strength of the specific company, or the timing of marketing.

Some borrowers have successfully argued for the inclusion of retroactive default cures in their loan agreements, although these might be strongly resisted by some arrangers. What are the main points of negotiation for lenders and borrowers regarding these provisions?

We have seen a few sponsors and their portfolio company borrowers raising this as an issue in recent months. Our experience generally has been anecdotal, and we have not seen the market as a whole include these retroactive default cures as a routine matter, whereby a later action by a borrower can essentially "undo" the existence of the initial default. We have seen strong resistance from lenders and arrangers in some cases, and in other cases compromises have been reached, particularly pertaining to the knowledge of the borrower's officers of the events surrounding or comprising the default in the first place.

For example, some discussions have centered on the requirement of an agent to deliver default notices in order to start a grace period, which in turn hinges on the delivery by the company of its own standard default notice requirement. Market participants have previously focused on the ability to cure certain defaults in other contexts, such as during the rise of SunGard-style closing provisions, and more recently in a trend that allowed certain misrepresentations to be cured during a delineated time period. In our experience, those surgical provisions which address a very clearly defined scenario are more likely to be found acceptable to a syndicate.