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Transferability: Does There Need To Be a Re-Balance?

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In the period leading up to (and during) a default or distress, the ability to trade loan positions takes on renewed significance, with transferability provisions in sharp focus. In recent years, the move towards more borrower/sponsor friendly documents has resulted in more restrictive "approved" lists and blanket restrictions on transfer to certain types of transferees (without consent). With those constraints driving more limited liquidity in the secondary market, it may be time to reflect on the extent of transfer restrictions, particularly where in practice, it may be beneficial to a borrower to move the debt away from the traditional lenders.

Introduction

In the aftermath of the global financial crisis (GFC), relatively unrestricted (and standardised) transferability of loan positions became a feature of the European leveraged loan market. Lenders were generally free to transfer their participations without the consent of the borrower to:

- existing lenders (or an affiliate or related fund of an existing lender);
- an entity included on an "approved" list (pre-negotiated and agreed between the original lender syndicate and borrower); or
- when an event of default was continuing.

Borrowers typically could not unreasonably withhold their consent to a transfer (if required) and borrower consent (if not forthcoming) was generally deemed obtained after the lapse of a short period.

At that time, provisions that (slightly) favoured lenders made sense. In the post-GFC world, lenders held greater bargaining power and more control over documentary terms, including transfer provisions. When the subsequent move towards cov-lite loans eroded lender protections, borrowers generally accepted that lenders should retain the ability to transfer positions with relative ease (the quid pro quo, essentially, for documentary flexibility more generally).

The Evolution of Transfer Provisions and Restrictions

In recent years, an extended period of low interest rates, coupled with a competitive financing market and general availability of capital, has seen an expansion in debt document flexibility and a general move towards sponsor/borrower control of documentary terms. Transfer provisions are no exception and the balance between a lender's desire to ensure maximum flexibility in how its assets are managed and its

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investments traded and a borrower's (or its sponsor's) desire to control the identity of its lender group has arguably tipped more in favour of the borrower and its sponsor.

The increasingly restrictive nature of approved lists is one indication of this shift in balance. The approved list concept is not new; as noted, lenders have long been able to transfer their interests in loans to any entity included on a pre-approved list without obtaining borrower consent. Generally, borrowers could also remove (or add) entities to a list approved at syndication, usually up to a limited number each year. More recently, however, the entities included on (and the ability to make modifications to) approved lists have been subject to additional constraints. Borrowers have (for example) sought to avoid including caps on entities that can be removed from an approved list during the life of a loan and resisted requested additions to the list.

Alongside heightened control over, and limitations on, the entities admitted to or included on approved lists, there has been a contemporaneous move towards blanket restrictions on the transfer of loan interests to certain types of entities (in each case, without the consent of the borrower, its parent and/or its sponsor). Borrowers have sought to restrict transfers to industry competitors, as well as "loan to own" or distressed investors (and in some cases, seek to remove these entities from already agreed approved lists). In many cases, these blanket exclusions are broadly (and often ambiguously) defined, capturing wide classes of prospective transferees.

The scope of transfer restrictions has also expanded. Previously, they were primarily limited to outright transfers of interests, but it is now common for controls on transfer to extend to voting sub-participations: a logical continuation of a borrower's desire to understand and control its lender syndicate for waiver, consent or other voting purposes.

What Do (Or What Might) Other Lenders Know About Transfer Restrictions?

While we have seen a trend towards enhanced borrower/sponsor control on transferability, the structure and applicability of transfer provisions has not changed in recent times. When committed to the page of a facility or credit agreement, the parameters and constraints on transfers of interests apply equally to all lenders, whether the original syndicate or secondary participant (provided they can clear the appropriate hurdles). There are rarely varying transfer regimes and/or preferential transfer provisions for different lenders (if at all); what is negotiated applies equally to all members of a syndicate at any given time. Lenders present at the time of (or shortly after) syndication will have equivalent visibility on (and equivalent leverage to negotiate the terms of) the transferability provisions and any related approved lists, and an incoming lender should have equivalent visibility on the documentary terms in advance of acquiring an interest in a loan.

Similarly, where it is proposed that the transfer provisions and/or an approved list be amended, the then existing lenders should receive the same information about the nature of those changes, even if they do not have a consent right in connection with those changes (for example, it is common for the borrower or its agent to be permitted to remove up to five names from an approved list each year on simple notice to the Facility Agent). While there may be variability in transfer provisions between (for example) the senior and mezzanine or subordinated facilities of a borrower, as between the lenders within a syndicate, the same provisions should apply.

Where there may be less visibility for lenders, however, is in connection with sub-participations. While, as mentioned, it is now relatively common for the borrower's consent to be required in connection with a voting sub-participation, it is far less common for the borrower or the relevant lender of record to disclose that sub-participation to other lenders. Practically, that may be of little consequence where the restrictions that apply to transfer by way of assignment or novation apply to the sub-participation, as the identity of that sub-participant, even if not widely known, will align with any transferee lenders of record. A similar comfort can be taken where a sub-participant is to be "elevated" to a lender of record, as the transfer restrictions will equally apply (although there is also no obligation for other lenders to be notified of the identity of that new lender of record). The move towards requiring borrower consent for voting sub-participations is again demonstrative of heightened borrower/sponsor negotiating leverage and a desire to control and understand the (ultimate) counterparties that they will

need to engage with should the need for an amendment or waiver arise. In that way, the original benefit of a sub-participation — to which transfer restrictions did not traditionally apply — is removed.

Restrictions on Transferability: What Is the Wider Impact?

Borrowers and sponsors have sought to leverage their enhanced negotiating position and attempted to ensure that should the need to negotiate with lenders arise post-syndication, the lender group remains known, tight and manageable. However, the impact of blanket transfer restrictions and approved lists in today's economic environment is potentially far-reaching.

Existing lenders may struggle to exit stressed positions while the very entities that are likely to provide new money to help turn around businesses are rendered unable to take positions in those same credits. That is driving more limited liquidity in the secondary market. In addition, as borrowers negotiate with traditional lenders and/or CLOs (which may be more inflexible in the solutions they can accept, or their ability to vote in favour of a deal), we may see restructuring timelines increase and/or implementation complexities arise. In turn, if agreement cannot be reached, insolvency may follow.

But how can this be addressed, or tempered? The leverage afforded to lenders in A&E processes may be a good place to start. When a borrower and/or sponsor approaches lenders seeking a maturity extension, lenders should seize the opportunity to (attempt to) normalise the terms of their debt documents, including removing approved list requirements. We would expect sponsors to continue to resist normalisation of debt documents (particularly where they make an equity contribution in connection with the extension), while lenders may not want to push too hard for risk of being overlooked on allocations of new loans in subsequent primary syndications. Absent complete removal, the impact of approved lists can be softened on the road to normalisation: the borrower's ability to unilaterally delete names can be removed and/or the Facility Agent (on Majority Lender instruction) permitted to add a certain number of names each year. Deemed consent provisions can be reinstated or the period in which consent is deemed given shortened. Of course, addressing restrictions at this stage requires the company to already be in a distressed cycle, and the benefits of trading debt in advance of the process perhaps not capable of being fully realised in the process, but it is a step in the right direction.

Conclusions

In days gone by, the transferability provisions in a loan agreement may have been considered "boiler plate", relatively standardised and uncontested in negotiations. In recent years, however, the move towards increased borrower/sponsor control of documentary terms has seen these provisions more heavily negotiated, and the resulting constraints on prospective transferees perhaps overly restrictive and potentially problematic, particularly as a borrower enters a period of stress or distress. While enhanced restrictions on lender rights of transferability seem unlikely to abate for some time, it may be time to reflect on whether the more borrower/sponsor friendly restrictions that are common in today's credit documents remain acceptable and whether a move to normalisation of documentary terms is more appropriate.

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