Lead Left Interview – Daniel Winick & Andrew Young (Part 2)

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This week we continue our conversation with Daniel Winick, a partner in the banking and finance group of Clifford Chance US LLP, and Andrew Young, a senior associate in the same group. Their practice includes representing sponsors, corporates, lenders and participants in multijurisdictional leveraged and other finance transactions. Clifford Chance is a multinational law firm that is one of the ten largest globally. *Second of two parts – View part one.*

The Lead Left: *From what we've seen, the issues surrounding incremental loans seem to be as much about MFN protections as anything else. What trends are you seeing in the market with respect to the MFN?*

Daniel Winick: Borrowers continue to negotiate creative ways to maximize financing flexibility and minimize incremental loan costs and constraints.

MFN exceptions that are growing in popularity include ones based on (1) the specific incremental basket utilized (for example, no MFN if only the fixed basket is drawn), (2) a designated amount expressly excepted, or (3) application of the incremental loan for a specific purpose (for example, an investment or acquisition).

Others exceptions have included broadening of classic ones, namely, yield buffers and sunsets. Traditionally, MFN clauses required an increase in pricing to remain within 50 basis points of any incremental loans. In 2017, sponsors and strong borrowers have pushed for 75 basis points. These higher spreads have been common in Europe, but not so much in the U.S. Somewhat surprisingly, in most cases lenders have successfully rejected higher MFN spreads, although at least some have cleared.

Andrew Young: Just as a point of information, the credit research team at Covenant Review reported that 19 deals have cleared market with MFNs of 75bps so far in 2017.

In terms of sunsets, virtually all new debt issuances propose an expiration on MFN protection, typically anywhere from 6 to 18 months following the closing date. Here, again lenders have been fairly successful in rejecting MFN sunsets. Covenant Review's data showed that 113 deals (about 20%) have cleared with MFN sunsets so far this year.

TLL: *Any other notable developments on exceptions to the MFN or other lender protections?*

DW: A growing list of borrowers have achieved flexibility in respect of the tenor of incremental loans. This includes (1) excepting from the MFN loans maturing outside a certain date (for example, two years after the existing loans) and (2) designating a certain amount of incremental debt to mature earlier than the existing loans. In the case of incurrences of such earlier-maturing debt, this presents a form of subordination that could impact the value of the existing loans.

The devil can also be in the details. For example, it's become common for borrowers to negotiate limits on the nature of incremental debt that will be subject to the MFN provision. Specifically, only incremental "senior secured term loans" that are "syndicated" may trigger the MFN. Other examples include where first lien debt capacity is permitted via the debt covenant but there is no related MFN trigger, or where the MFN applies only to the initial incremental term loan incurrences.

TLL: *Very helpful. Any closing thoughts on incremental loans and expectations in the future?*

AY: From the borrowers' perspective, incremental loans provide quick access to liquidity and borrowers should not be penalized when they seek to finance a potential value-enhancing transaction, hence the growing list of MFN exceptions. From the lenders' perspective, lenders are assuming the risks of incremental loans carrying higher pricing and devaluing their paper. Thus, the duration and scope of the MFN has remained a final battle frontier to preserve one of lenders' most important economic protections, particularly when interest rates are expected to rise in the future.

DW: In summary, the evolution of incremental loans and MFN protection has always been a product of loan market conditions. The strong issuers' market over the last year has inspired innovative ways to facilitate more financing flexibility. The incremental sizing trends and MFN exceptions noted are just some examples and there may be more to come before 2017 ends. At the same time, if and when the market turns, it will be interesting to see how these features are revisited.

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