# Borrowers erode traditional lender protections in leveraged finance deals



In recent years, a fundamental principle of leveraged finance—the borrower's promise to repay debt at maturity at par—has been progressively weakened, according to an analysis in the Financial Times by the founder of Fox Legal Training. The erosion has been marked by borrowers increasingly using their bargaining power to ease the terms under which they meet their debt obligations, causing concern among lenders and investors.

Historically, lenders extend financing with the expectation of receiving interest payments and the full repayment of the principal amount when the debt matures, a standard expectation in lending markets. However, recent developments indicate that this cornerstone promise can no longer be taken for granted in leveraged finance deals. The trend is highlighted by a growing list of borrowers, including well-known names such as J Crew, PetSmart, Neiman Marcus, Serta Simmons, At Home, Altice, and Ardagh, who have utilised provisions allowing them to restructure debts through so-called "liability management transactions," often leaving lenders at a disadvantage.

A key concern is the increasing complexity and looseness of covenant clauses, especially those related to borrowing capacity. For example, the introduction of "super-grower baskets" enables borrowers to increase debt levels without regard to declines in earnings before interest, tax, depreciation, and amortisation (EBITDA). Data from Octus, a financial analytics provider, reveals that nearly a quarter of European high-yield bond deals featured EBITDA-based "super-grower" baskets in 2024, a sharp rise from under 10% the previous year. This provision effectively undermines the purpose of financial thresholds designed to limit borrowing.

Furthermore, the trend extends to how losses are treated within debt agreements. Traditionally, loss-making by a borrower would reduce the amount of dividends that could be paid out, safeguarding lenders’ interests. However, 18% of 2024 European high-yield deals include clauses that do not deduct borrower losses when calculating dividend-paying capacity, signaling a diminishing alignment with the borrower's financial reality. Another example of this disconnect is the increase in deals allowing borrowers to exclude working capital debt from leverage ratio calculations, rising to over 30% in 2024 from just under 25% in 2023.

Despite these trends, some lenders are pushing back by incorporating protections against borrower overreach. For example, almost 40% of 2024 high-yield deals contained provisions restricting the removal of significant intellectual property assets from the lender’s reach—measures coined as "J Crew Blockers" after J Crew’s similar move in 2016. This reflects a notable increase from 30% in 2023 and only 10% in 2022.

Additionally, a recent high-yield bond deal from marketing and printing company RR Donnelley introduced a novel contractual provision preventing borrowers or their subsidiaries from exploiting contractual flexibility to renege on the commitment to repay principal at par at maturity. This clause has begun to appear in other recent bond issues, such as those of Getty Images, and is viewed by the Fox Legal Training founder as essential for future leveraged finance agreements. He stated, "If you want a lender’s money, then offer up a contract that forces you to make good on your promise to pay it back. Full stop."

The Financial Times reports an emerging shift may be underway in the balance of power between lenders and borrowers, influenced by recent capital market volatility and increasing lender pushback. Lenders' insistence on stronger protections in loan agreements could mark the beginning of a new phase in leveraged finance, where the traditional lender’s promise of full repayment is more robustly upheld.

Source: [Noah Wire Services](https://www.noahwire.com)

## Bibliography

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