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LOANS VS. BONDS:

Examining the Nuances of Affected Creditor Serta Protection in Recent Secured Financings

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Loans vs. Bonds: Examining the Nuances of Affected Creditor Serta Protection in Recent Secured Financings

The Bottom Line™:

- In a recent Loans vs. Bonds report, we compared how Serta Protection in recent leveraged loans compares against the corresponding provisions of parity lien bonds issued as part of the same financing transaction in the U.S.
- Based on additional subscriber questions, we take a closer look at the nuances of affected creditor Serta Protection in recent secured financings.
- The ultimate answer to the question of "which asset class is tighter on providing affected creditor Serta protection" is unclear, and depends on whether one is assessing the presence of affected creditor Serta protection (including provisions containing exceptions) or assessing the presence of affected creditor Serta protection containing no exceptions.
- A greater percentage of credit agreements require affected lender consent to payment subordinate or lien subordinate than is the case for high yield bonds, but the vast majority of these credit agreements allow for significant exceptions that could potentially be used to structure liability management exercises.
- Of the 52 financings we reviewed, nearly 60% of the credit agreements required affected lender consent to modify payment subordination and lien subordination, but the vast majority of these deals contain one or more exceptions to this Serta protection.
- Of the 52 financings we reviewed, nearly 54% of the high yield bonds required affected holder consent to modify payment subordination, and the vast majority of these deals contain no exceptions to this Serta protection.
- Only 17.3% of high yield bonds required affected holder consent to lien subordinate, but a majority of these deals contain no exceptions to this Serta protection.
- Finally, in over 71% of the high yield instruments we reviewed, supermajority consent (typically 66 2/3%) is required to effect lien subordination, but with no exceptions to the general rule.

Overview

At Covenant Review, our subscribers often ask us: "How do the terms of an issuer's high yield bonds compare with the terms of its leveraged loans?" Unfortunately, the answer to this question is not straightforward, and it's almost always unsatisfactory. As a general matter, comparing a credit agreement against an indenture is like comparing "apples to oranges." This is because the architecture of a typical credit agreement contains significant structural differences from that of a high yield indenture.

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However, since 2019, we've published several reports where we compared a number of discrete covenant provisions in both credit agreements and indentures that do lend themselves to a meaningful comparison on an "apples to apples" basis. The most recent of these reports is available here.

In October 2024, we published Loans vs. Bonds: A Comparison of Serta Protection in Recent Secured Financings. In this report, we examined how Serta Protection compares among broadly syndicated first lien leveraged loans and first lien leveraged bonds, based on a review of 44 separate secured financings from July 2023 through September 2024, where both first lien term loans and first lien bonds were offered as part of the same financing transaction. We refer to this report as the "Previous Report", and we assume that each reader of this report has read the Previous Report.

Since we've published the Previous Report, we've received questions from our subscribers about the various qualifications that are often seen in credit agreements and indentures where affected creditor Serta Protection exists. In this report, we examine affected creditor Serta Protection in these instruments and provide additional detail on these qualifications across both leveraged loans and high yield bonds.

Previous Research on the Structural Differences Between Leveraged Loans and High Yield Bonds

Before we get into the results, we once again remind our readers that, even in instances where the loans and bonds are secured on a parity lien basis, leveraged loans and high yield bonds have many significant structural differences. Covenant Review has previously published extensive research on the structural differences between U.S. leveraged loan credit agreements and U.S. high yield indentures (the "Structural Reports"):

- Loans vs. Bonds: An Overview of Structural Differences Between Credit Agreements and Indentures (Part 1)
- Loans vs. Bonds: An Overview of Structural Differences Between Credit Agreements and Indentures (Part 2)
- Loans vs. Bonds: An Overview of Structural Differences Between Credit Agreements and Indentures (Part 3)
- Loans vs. Bonds: An Overview of Structural Differences Between Credit Agreements and Indentures (Part 4)

We assume that each reader of this report has read each of these Structural Reports, as they provide critical color on the many subtle (and not so subtle) distinctions between leveraged loan credit agreements and high yield indentures.[1]

A Quick Note on the Nuances of Affected Creditor Serta Protection

To briefly summarize the Serta liability management exercise, which was announced in June 2020, the existing Serta first lien term loans were contractually subordinated in right of payment and lien subordinated to new priority lien debt[2], and this was accomplished with the consent of only a majority of the face amount of the loans.[3]

[1] In addition, we've also published a four-part series on the structural differences between European credit agreements and European high yield indentures. Those reports are available on the Covenant Review website as part of our overall Loans vs. Bonds series.

[2] For a brief overview of the different types of subordination, please see Covenant Primer: Explaining Subordination.

[3] Of course, this is a very simple summary of a very complex situation that we've covered extensively in previous research. For more details on the Serta liability management case study, please see our Serta research.

In this report, we examined 52 secured financings, and generally focused only on those financings where the instruments contain affected creditor Serta Protection to effect either payment subordination or lien subordination. In other words, we focused on financings where the consent of each affected creditor is ostensibly required to either payment subordinate the instrument to new debt or to lien subordinate the instrument to new debt.

Of these instruments that have affected creditor Serta protection, we examined the following additional nuances:

First, does the affected creditor Serta protection contain exceptions?

Second, if the affected creditor Serta protection does contain exceptions, which of the following exceptions does it contain?

- Payment subordination and/or lien subordination is permitted where there is a pro rata opportunity to participate in the new instrument.
- Payment subordination and/or lien subordination is permitted by a DIP Facility.
- Payment subordination and/or lien subordination is permitted pursuant to another negotiated exception.
- Payment subordination and/or lien subordination contains more than one of the above exceptions.

Secured Financings We Reviewed

We examined the following 52 secured financings from July 1, 2023 through November 15, 2024, where both leveraged loans and parity lien bonds were incurred as part of the same financing transaction.

Issuer	Month of Issuance	Issuer	Month of Issuance
BrandSafway	July 2023	Presidio	May 2024
Veritext	August 2023	Baldwin Group	May 2024
Greystar Real Estate Partners	August 2023	Gray Television	May 2024
Cushman Wakefield	August 2023	Sotera Health	May 2024
Bausch + Lomb	September 2023	Univision	May 2024
Syneos	September 2023	Acrisure	June 2024
Forward Air	September 2023	Solenis	June 2024
NCR Atleos	September 2023	B&G Foods	June 2024
Cetera Financial Group	October 2023	KIK Custom Products	June 2024
TransDigm	November 2023	McGraw Hill Global Education	August 2024
Veritiv Corp.	November 2023	Lightning Power	August 2024
Hilton Grand Vacations	January 2024	Ryan Specialty Group	September 2024
Caliber Collision	January 2024	Focus Financial	September 2024
Caesars Entertainment	January 2024	Victra	September 2024
Husky Injection Holdings	January 2024	Alliant Holdings	September 2024
Shearer's Foods	January 2024	Help at Home	September 2024
Howden Group Holdings	February 2024	S&S Activewear	September 2024
Crash Champions	February 2024	Windstream Services	September 2024
Artera	February 2024	NorthRiver Midstream	September 2024
Amer Sports	February 2024	Belron	October 2024
Clear Channel Outdoor	March 2024	Specialty Building Products	October 2024
Miter Brands	March 2024	Magnera	October 2024
Truist Insurance Holdings	March 2024	R1 RCM	October 2024
Dye & Durham	April 2024	Rise Baking Company	October 2024
GEO Group	April 2024	Great Canadian Gaming	October 2024
Genesee & Wyoming	April 2024	Jostens	November 2024
Endo International	April 2024	Ellucian	November 2024

The Results

Affected Creditor Consent to Effect Payment Subordination:

Leveraged Loans

- For leveraged loans, 59.6% of the credit agreements we reviewed (i.e., 31 deals) require the consent of each affected lender to payment subordinate. Of these credit agreements requiring affected lender consent to payment subordinate:
  - 16.1% (i.e., 5 deals) contained no exception to the general rule;
  - 6.5% (i.e., 2 deals) contained a single exception for where lenders have a pro rata opportunity to participate in the new instrument;
  - 3.2% (i.e., 1 deal) contained a single exception where payment subordination is permitted by a DIP Facility;
  - 3.2% (i.e., 1 deal) contained a single other negotiated exception; and
  - 71% (i.e., 22 deals) contained more than one of the above exceptions to the general rule (i.e., opportunity to participate, DIP Facility, and/or other negotiated exception).

High Yield Bonds

- For high yield bonds, 53.8% of the documents[4] we reviewed (i.e., 28 deals) require the consent of each affected holder to payment subordinate. Of these issuances requiring affected holder consent to payment subordinate:
  - 82.1% (i.e., 23 deals) contained no exception to the general rule;
  - 3.6% (i.e., 1 deal) contained a single exception where holders have a pro rata opportunity to participate in the new instrument;
  - No deals contained a single exception where payment subordination is permitted by a DIP Facility;
  - No deals contained a single other negotiated exception; and
  - 14.3% (i.e., 4 deals) contained more than one of the above exceptions to the general rule (i.e., opportunity to participate, DIP Facility, and/or other negotiated exception).

[4] In most cases, our analysis was based on the preliminary offering document for the applicable bonds, and in a few instances, the indenture where that document was made publicly available.

<u>*Affected Creditor Consent to Effect Lien Subordination:*</u>

Leveraged Loans

- For leveraged loans, 59.6% of the credit agreements we reviewed (i.e., 31 deals) require the consent of each affected lender to lien subordinate. Of these credit agreements requiring affected lender consent to lien subordinate:
  - 16.1% (i.e., 5 deals) contained no exception to the general rule;
  - 6.5% (i.e., 2 deals) contained a single exception for where lenders have a pro rata opportunity to participate in the new instrument;
  - 3.2% (i.e., 1 deal) contained a single exception where lien subordination is permitted by a DIP Facility;
  - 3.2% (i.e., 1 deal) contained a single other negotiated exception; and
  - 71% (i.e., 22 deals) contained more than one of the above exceptions to the general rule (i.e., opportunity to participate, DIP Facility, and/or other negotiated exception).

High Yield Bonds

- For high yield bonds, 17.3% of the documents we reviewed (i.e., 9 deals) require the consent of each affected holder to lien subordinate. Of these issuances requiring affected holder consent to lien subordinate:
  - 56% (i.e., 5 deals) contained no exception to the general rule;
  - 11% (i.e., 1 deal) contained a single exception where holders have a pro rata opportunity to participate in the new instrument;
  - No deals contained a single exception where lien subordination is permitted by a DIP Facility;
  - No deals contained a single other negotiated exception; and
  - 33% (i.e., 3 deals) contained more than one of the above exceptions to the general rule (i.e., opportunity to participate, DIP Facility, and/or other negotiated exception).

<u>So, which asset class is tighter when it comes to providing affected creditor Serta protection?</u>

Unfortunately, the answer to this question is a completely unsatisfying "it depends."

For payment subordination, nearly 60% of leveraged loan credit agreements require affected lender consent, but 71% of these credit agreements contained more than one exception to this general rule, and only 16.1% (i.e., 5 credit agreements) contained no exception to the general rule. By contrast, nearly 54% of high yield bond documents required affected holder consent, but 82.1% of these documents contained no exception to the general rule (i.e., 23 high yield documents).

Accordingly, the question of which asset class is tighter on the issue of payment subordination depends on whether one is focused on the percentage of instruments with some version of affected creditor consent, including exceptions (in which case the loans are somewhat tighter), or whether one is focused on the percentage of instruments with affected creditor consent without any exception to the general rule (in which case the bonds are significantly tighter).

For lien subordination, nearly 60% of leveraged loan credit agreements require affected creditor consent, but 71% of these credit agreements contained more than one exception to this general rule, and only 16.1% (i.e., 5 credit agreements) contained no exception to the general rule. For high yield bonds, only 17.3% of the bond documents required affected holder consent, but 56% of these documents contained no exception to the general rule (i.e., 5 high yield documents).

Accordingly, the question of which asset class is tighter on this issue of lien subordination depends on whether one is focused on the percentage of instruments with some version of affected holder consent (in which case the loans are far tighter), or whether one is focused on the percentage of instruments with affected holder consent without any exception to the general rule (in which case the loans and the bonds are essentially the same).

To further muddy the waters here, in 37 of the 52 high yield bond documents we reviewed (i.e., in over 71% of the high yield instruments), supermajority consent (typically 66 2/3%) is required to effect lien subordination, but with no exceptions to the general rule. Accordingly, it's not clear to us whether an affected lender consent requirement with multiple exceptions is functionally tighter than a supermajority holder consent requirement with no exceptions.

Conclusion

To sum up, the question of how effective these affected creditor Serta Protection provisions would be depends heavily on the facts of the situation on the ground. For example, if a borrower is willing to offer a coercive exchange to all lenders, in over 70% of the credit agreements with some variation of affected creditor Serta protection, the loans in question could be payment subordinated and lien subordinated to new debt. In other words, the borrower could "pull a Serta" in these credit agreements ***even if all affected lenders do not consent***, so long as the deal is offered to all lenders.[5]

We will continue to monitor these trends among loans and bonds issued as part of the same transaction, and plan to publish future research on this topic.

— *Covenant Review*

[5] In essence, this affected creditor Serta Protection with an exception for instances where there is a pro rata opportunity to participate in the new instrument has a conceptually similar function to the high yield Payments for Consent Covenant, which does not block an issuer's ability to obtain consents to amend an indenture, but instead requires that the opportunity to consent be provided to all holders.

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