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Annual Spring Meeting

Private Credit Implications: Markets, Restructurings and Trends

David M. Hillman, Moderator

Proskauer; New York

Samantha Fang

The D. E. Shaw Group; New York

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Proskauer»

ABI: 2024 Annual Spring Meeting

Private Credit
Implications: Markets,
Restructurings
and Trends

April 19, 2024

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Moderator:

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David has over 28 years of experience with an emphasis on representing private credit lenders, private funds, sovereign wealth funds and other alternative lenders and distressed investors in special situations and restructurings both in and out of court. He has substantial experience in every phase of restructuring and distressed investing, including credit bid sales under section 363, debt-for-equity swaps, chapter 11 plans, out-of-court restructurings and foreclosures, as well as navigating inter-creditor issues involving liability management transactions and the relative rights of majority and minority lenders. David also litigates the issues facing private credit lenders, including issues involving plan confirmation, solvency, valuation, inter-creditor disputes, financing and cash collateral disputes, fraudulent transfers, equitable subordination, recharacterization, breach of fiduciary duty and similar disputes.

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Michael serves as a Managing Director with SC&H Capital, where he provides advice to both public and private companies, institutional investors, statutory committees, and special situation buyers and investors on a variety of strategic transactions to maximize value for his clients. Mr. Fixler has spent more than 25 years strategically advising middle-market companies and their stakeholders with a particular expertise in distressed mergers and acquisitions, capital raising and other restructurings, including bankruptcy cases.

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Topics

1. What is Private Credit?
 1. Private Credit Strategies
 2. Market Stats & Key Players
 3. Key Differences Direct lending v. BSL
 4. Loan Types
 5. Deal Types
 6. Industries
 7. Doc Issues: Cov Light/Cov Loose
 8. Relationship between Private Credit and Private Equity
1. Default Overview
2. Liability Management Strategies – Direct Lending Club Deals v BSL
3. Restructuring Trends – Out of Court v. In Court. What drives success?
4. Restructuring Trends – Golden Shares and Golden Director and Board Flips
5. Opportunities



Table of Contents

1. Private Credit: Characteristics and Risks
FEDS Notes
2. Trends in Private Credit 2024
Proskauer Rose LLP
3. Private Credit Default Index for Q4 2023
Proskauer Rose LLP
4. Trends in Private Credit Restructuring: Out of Court "Change of Control" Transactions
Proskauer Rose LLP
5. Private Credit Restructuring Trends: New Delaware Law Aids Secured Creditors in Getting Deals Done Out of Court
Proskauer Rose LLP
6. The "Board Flip": How Effective is the Pre-Petition Exercise of Proxy Rights in the Face of Bankruptcy?
Proskauer Rose LLP
7. The "Golden Share": All That Glitters Is Not Gold
Proskauer Rose LLP

The Fed - Private Credit: Characteristics and Risks

 federalreserve.gov/econres/notes/feds-notes/private-credit-characteristics-and-risks-20240223.html

[Skip to main content](#)

Board of Governors of the Federal Reserve System

The Federal Reserve, the central bank of the United States, provides the nation with a safe, flexible, and stable monetary and financial system.

February 23, 2024

Private Credit: Characteristics and Risks¹

[Fang Cai](#), and [Sharjil Haque](#)

On February 26, 2024, a correction was made to fix a typo for the data source from Pitchbook to KBRA DLD in Figure 13.

What is Private Credit?

Private credit or private debt investments are debt-like, non-publicly traded instruments provided by non-bank entities, such as private credit funds or business development companies (BDCs), to fund private businesses.² Private credit is typically extended to middle-market firms with annual revenues between \$10 million and \$1 billion, but has grown rapidly in recent years to fund larger companies that were traditionally funded by leveraged loans.

Private credit typically involves the bilateral negotiation of terms and conditions to meet the specific needs and objectives of the individual borrower and lender, without the need to comply with traditional regulatory requirements. Such bilateral origination of a loan between a single borrower and lender is often referred to as "direct lending" but deals that involve a small group of lenders can be considered direct lending as well. Loans from direct lending funds are typically senior secured while other private credit strategies can invest in more junior parts of the capital structure; almost all private credit loans are floating rate.³

Given the absence of a liquid secondary market for many private credit instruments, lenders typically hold these loans until maturity or a refinancing event. As a result, these loan contracts can include features uncommon to traditional bank loans, such as a structured equity component, high prepayment penalties, or a role in oversight or management of the company.

Who Invests in Private Credit and Why?

1/16

Survey evidence from academic studies show that the largest investors, or Limited Partners (LP), in private credit funds are pension funds, insurance companies, family office, sovereign wealth funds and high net worth individuals.⁴ These institutional investors invest in private debt due to various factors such as portfolio diversification, low correlation to public markets and relatively high returns.

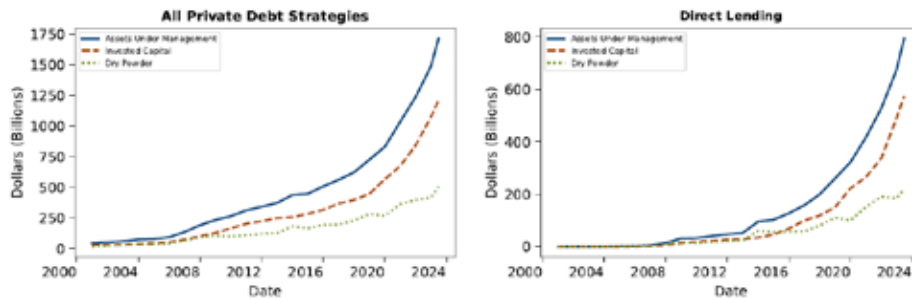
The Federal Reserve Board's *Financial Stability Report* (FSR) published in May 2023 showed that, based on Form PF data as of Q4 2021, public and private pension funds held about 31 percent (\$307 billion) of aggregate private credit fund assets. Other private funds made up the second-largest cohort of investors at 14 percent (\$136 billion) of assets, while insurance companies and individual investors each had about 9 percent (\$92 billion).⁵

Over the past decade, the asset class, particularly direct lending, has generated higher returns than most other comparable asset classes, including 2-4 percent over syndicated leveraged loans. Borrowers have been willing to pay a premium for the speed and certainty of execution, agility, and customization that private lenders offer. Additionally, private debt funds have attracted highly leveraged borrowers that are unable to get adequate funding from heavily regulated banks.

Market Size and Recent Growth of Private Credit and Direct Lending

Figure 1 reports the growth of private credit since 2000, including all private credit strategies (left panel) and direct lending only (right panel). The left panel shows that total private credit has grown exponentially in recent years, reaching nearly \$1.7 trillion, comparable to those of leveraged loans (roughly \$1.4 trillion) and high-yield (HY) bond markets (about \$1.3 trillion). The right panel shows that the growth of private credit is most pronounced for direct lending, which amounts to \$800 billion, or about one half of the total.⁶ There is also growing amount of committed but uninvested capital (or 'dry powder') in the industry, suggesting supply of private credit funding is outstripping demand for private loans.

Figure 1. Growth in Private Debt Allocations



Note: 'Dry Powder' refers to committed but not invested capital. Invested capital is committed & invested capital (typically in the form of loans). Assets under management is the sum of invested capital and dry powder. Data as of June 2023. AUM data reported with a 6-month lag.

Source: Preqin
[Accessible version](#)

Figure 2 reports top 20 U.S. private credit fund managers including all strategies (left panel) and direct lending only (right panel), based on total dollar value of assets under management as of June 2023. The sector is heavily concentrated in a few large fund managers such as Oaktree, Ares, Goldman Sachs, HPS Investment and Blackstone. A large share of dry powder is also held by the top 5 fund managers, suggesting disproportionately high demand for these fund managers by LPs. Staff estimate that top 10 U.S. private debt fund managers hold about 40-45 percent of all dry powder in the U.S., across all private debt strategies.²

Figure 2. Top 20 Private Debt Managers



Note: This chart plots aggregate assets under management (split by called capital or invested capital, and dry powder) sorted by private credit firm. For each firm, all fund level private credit funds are aggregated.

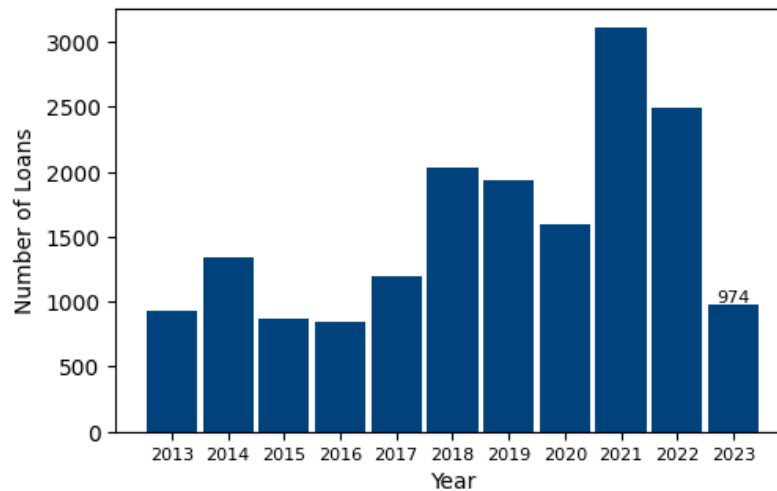
Source: Preqin
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Characteristics of Private Credit using Loan-level Data

As private credit continues to grow rapidly as a new frontier for nonbank lending, the scarcity of available data has made it challenging to assess risks in this market. Private credit funds invest in loans with varying characteristics. These loans are generally senior secured and floating rate. This section discusses some key characteristics of private credit loans, based on a new sample of around 17,000 unique private credit loans originated by 718 private debt funds and BDCs from Pitchbook, where both borrowers and private debt lenders are U.S.-based. The sample covers all private credit strategies from 2013-2023.⁸

Figure 3 reports the number of loans and Figure 4 shows average loan and deal size. We observe the average size of loans has increased in recent years and exceeded \$80 million since 2022, which is much larger than the standard loan size in bank-dependent borrowers observed in the Federal Reserve's Y-14Q H1 collection on commercial loans.⁹ A single loan is typically part of a loan-deal (with multiple credit facilities), and we also note that the average deal size is much larger compared to the average loan size. For majority of these loans, the data show that the borrower is backed by a private equity sponsor.¹⁰

Figure 3. Number of Loans in Pitchbook

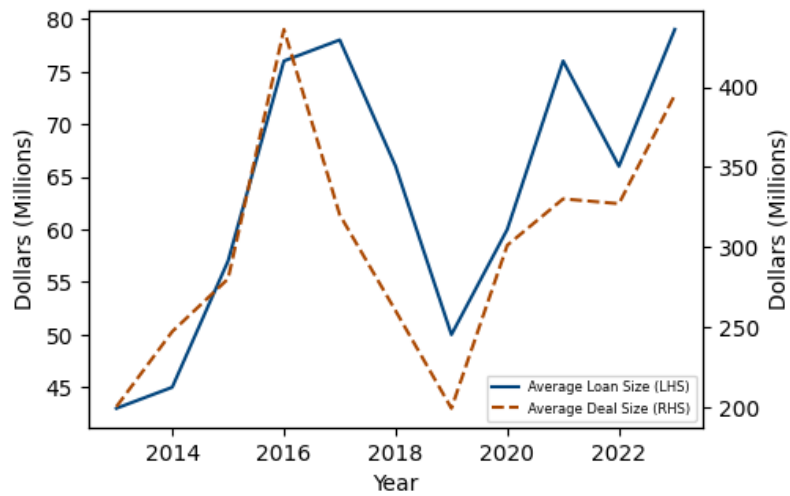


Note: This chart reports the raw number of newly originated loans in a given year.

Source: Pitchbook

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Figure 4. Average Deal and Loan Size



Note: This chart reports the mean deal and loan size across the loan-year distribution.

Source: Pitchbook and authors' calculations

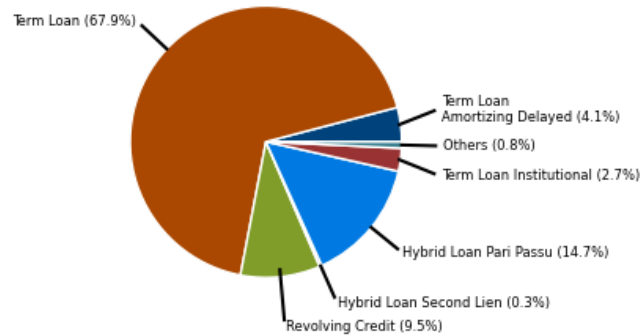
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Loan Type and Pricing

Figure 5 shows that more than two thirds of private credit is term loans. In addition, about 15 percent of private credit takes the form of hybrid loan pari passu, which is more junior in the capital structure in the event of default and thus implies greater risk than senior secured loans.

Figure 5. Loan Type

2024 ANNUAL SPRING MEETING



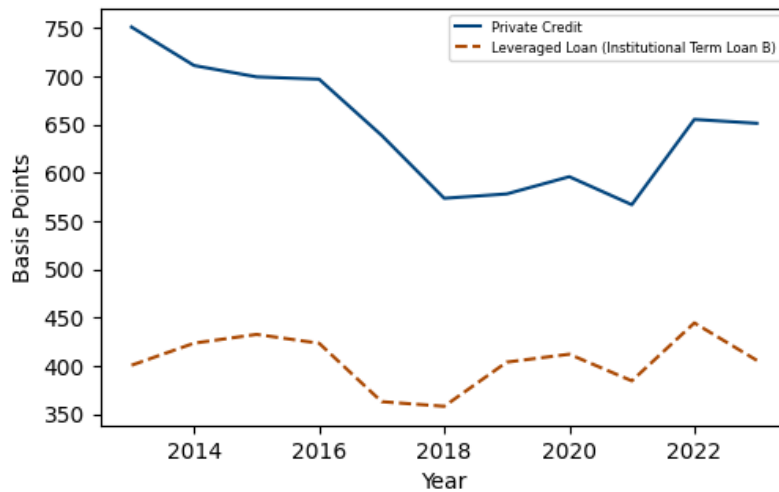
Note: Hybrid Loans refer to loan facilities where senior and subordinated debt is combined into one single loan facility, with a blended interest rate that falls between the two debt types.

Source: Pitchbook

[Accessible version](#)

Figure 6 shows that the average loan spread declined in recent years before rising again in 2022, following the Fed's rate hike cycle. Comparing private credit loan spread with spreads observed in institutional Term Loan B in the leveraged loan market, we observe that the spread on private credit loans is generally higher, and the gap in spreads between the two types of loans declined in recent years to below 200 basis points before widening again in 2023. The difference in spreads is consistent with the riskier profiles of private credit borrowers relative to syndicated loan borrowers. Part of the difference could also be attributable to private debt funds requiring additional compensation for holding these loans in their books.

Figure 6. Credit Spreads



Note: This chart plots average spreads above a benchmark interest rate (LIBOR or SOFR, mostly SOFR from 2022 onwards) in a given year for private credit and leveraged loans.

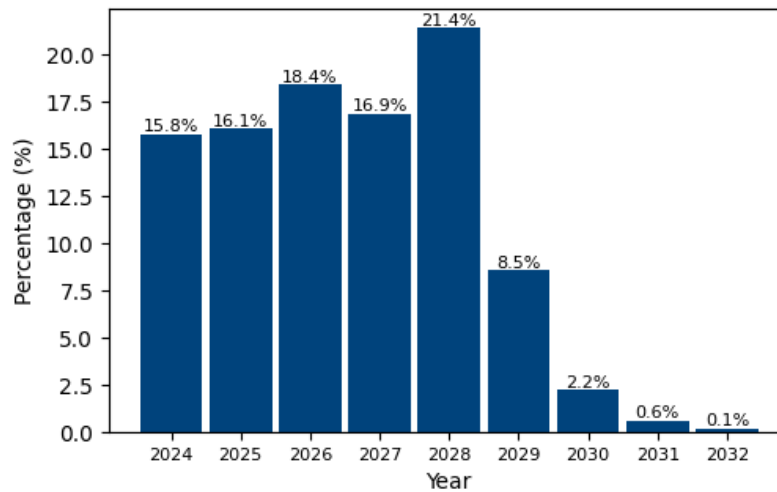
Source: Pitchbook and authors' calculations
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Rollover Risk

To examine rollover risk, we consider the maturity wall of private credit (Figure 7) and observe that debt maturities are spread out evenly over the coming years, with around 16 percent of outstanding debt due in 2024. The average maturity in private credit has generally been around 5 years (Figure 8).

Figure 7. Maturity Wall in Private Credit

2024 ANNUAL SPRING MEETING



Note: This chart reports the share of loans (in dollar value) that will mature, based on maturity date provided for a single loan facility in Pitchbook.

Source: Pitchbook and authors' calculations

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Figure 8. Average Maturity in Private Credit

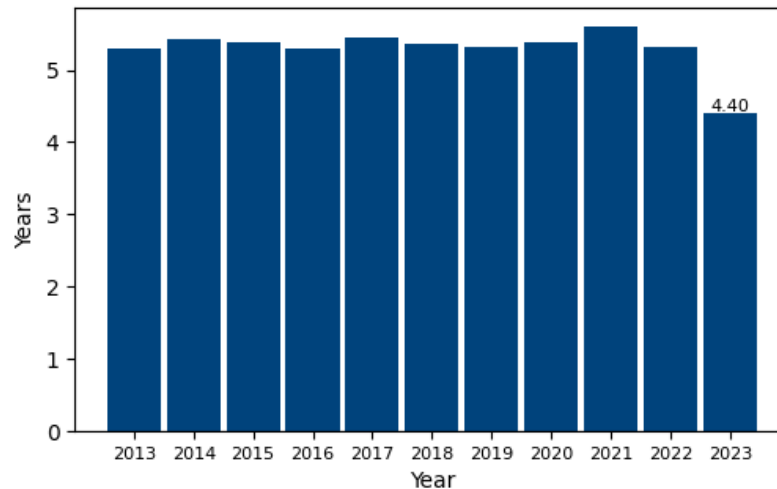


Figure 9 shows the top Deal Types (uses of proceeds) are for general corporate purposes (e.g., working capital needs), debt refinancing and private equity deals (leveraged buyouts and growth equity investments). It is worth noting many refinancing activities are also driven by borrowers backed by a PE-sponsor. Examining private credit spreads by these different deal types, we observe private equity deals (growth/expansions and leveraged buyouts)

experienced substantially larger increase in borrowing cost during the 2022 rate hike cycle (Figure 10). Higher sensitivity to the rate hike cycle indicates PE deals generally involve relatively riskier borrowers, for example, because they carry more leverage.¹¹

Figure 9. Deal Types

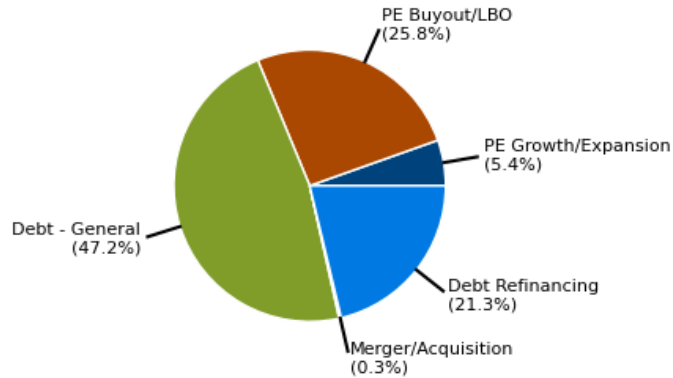
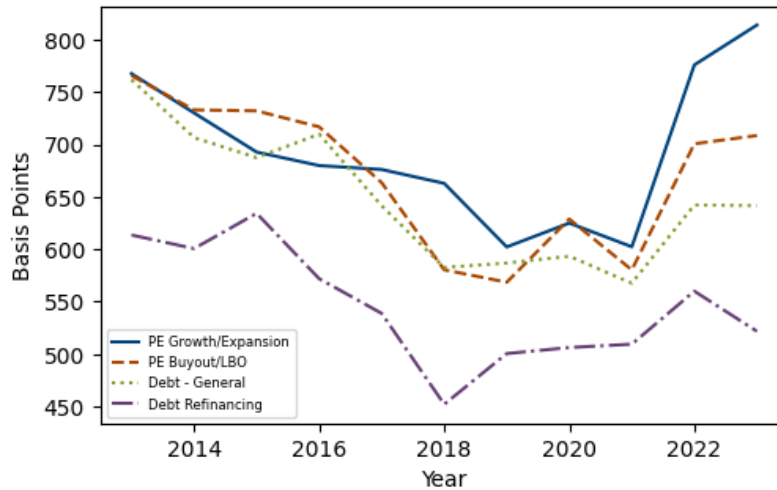


Figure 10. Average Loan Spread By Deal Type



Note: This chart plots average loan spreads on private credit loans split by deal type.

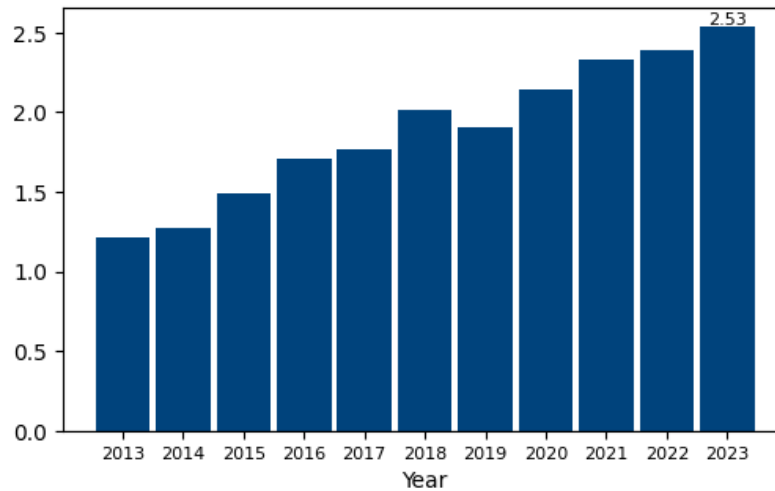
Source: Pitchbook and authors' calculations

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Rise of Club Deals

An interesting trend is that, for a given loan facility, the average number of private debt lenders has increased over time (Figure 11). This pattern suggests private creditors are increasingly relying on "club deals" to share credit risk exposure to a single borrower. Higher number of lenders in a single commitment also allows creditors to fund larger borrowers, consistent with the rise in average loan size shown above.

Figure 11. Average Number of Lenders in a single loan facility



Note: This chart reports the number of lenders in a given loan facility, which are identified directly by looking at the identity of each lender.

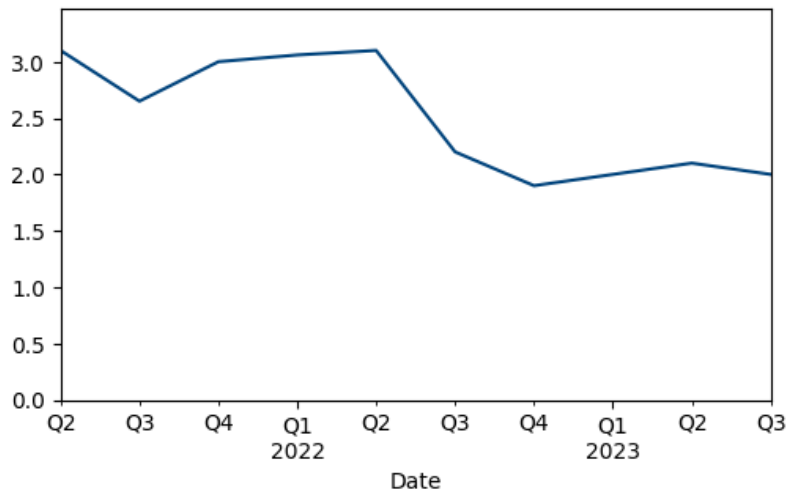
Source: Pitchbook and authors' calculations

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Interest Coverage

The average interest coverage ratio (ICR)—a key liquidity risk metric—displayed a significant decline in recent quarters (Figure 12), indicating weakening debt service capacity.¹² With mean interest coverage of around 2.0x, a significant slowdown in economic conditions could lead to further deterioration of cash flows (EBITDA) and greater difficulty in making debt payments. For comparison, ICR in leveraged loan borrowers is slightly higher at around 2.7x as of 2023, according to data from LCD.¹³

Figure 12. Interest Coverage Ratio has declined



Note: This chart plots average interest coverage ratio across the distribution of borrowers covered by KBRA in a given quarter.

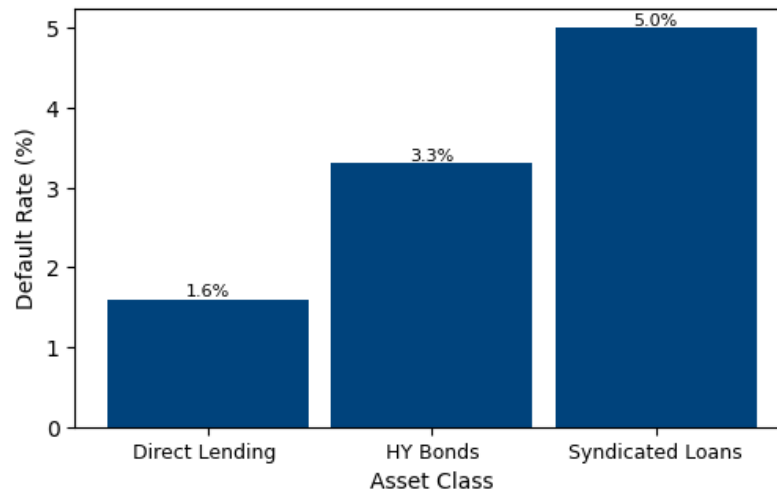
Source: KBRA DLD

[Accessible version](#)

Default Rate

Nevertheless, year-to-date default rates have generally been low, compared to the broadly syndicated loan market or HY bond market, particularly in direct lending (Figure 13). Low default rates can be attributed to (i) low interest rates for most of the past 10 years and (ii) periodic monitoring of borrowers through loan covenants, as well as the ability to renegotiate flexibly with a relatively small group of creditors when borrowers are in distress.¹⁴ However, industry commentary suggest recent deals are devoid of financial maintenance covenants as private credit managers look to compete with banks in the large corporate market segment.¹⁵ Moreover, a recent study by S&P Global finds that repeat-defaults were marginally more likely in private credit funded borrowers, and the average time span between repeat-defaults is shorter among borrowers with private credit compared to those without.¹⁶ It is important to note that the industry has yet to go through a prolonged recession.

Figure 13. Year-to-Date Default Rate (As of Oct, 2023)



Note: This chart plots year-to-date default rates across various asset classes in 2023 as reported by KBRA DLD.

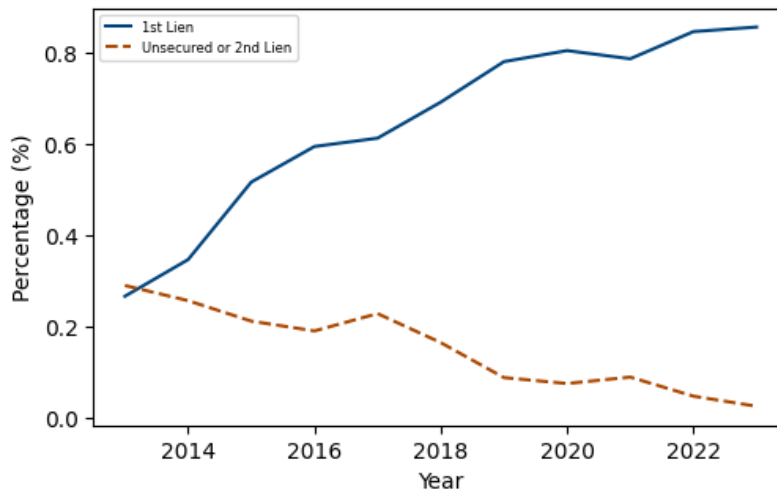
Source: KBRA DLD

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Loss Given Default

An important trend related to loss given default is that the share of private credit loans with 1st liens on the borrower's assets has increased significantly over time (Figure 14). Despite this seniority in debt structure, private credit loans have relatively low recovery rate upon default (or equivalently, exhibit high loss given default) compared to syndicated loans or HY bonds, as shown in Figure 15. Post-default value of a direct loan is around 33 percent, while those in syndicated loans and HY bonds are 52 and 39 percent respectively.

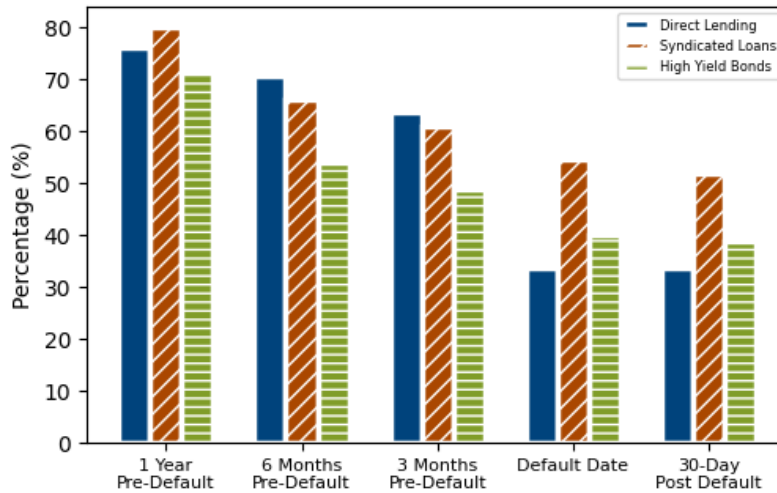
Figure 14. Share of Loans with 1st Liens



Note: This chart reports the share of loans with a 1st lien for a given private credit loan facility as reported in Pitchbook in the navy blue line. The orange line reports the share of unsecured or 2nd lien loans. For a small share of loans, Pitchbook only reports if the loan is secured or not, thus the total of the two line will not necessarily add to 100 percent.

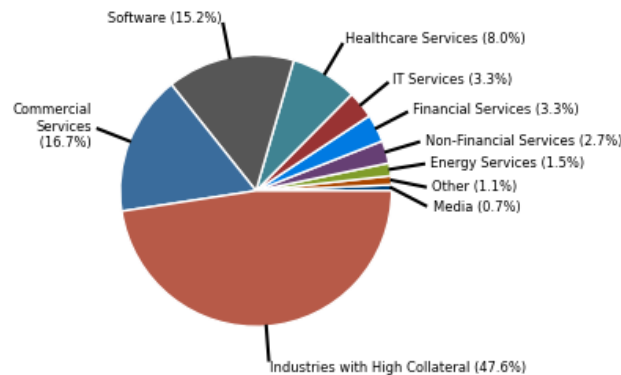
Source: Pitchbook and authors' calculations
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Figure 15. Recovery Rate



The key reason for the low recovery rate upon default is that more than half of all value-weighted private credit is provided to borrowers in sectors with relatively low collateralizable or tangible assets such as software, financial services or healthcare services (Figure 16), and thus have lower recovery rate for every dollar of defaulted loans. Higher loss given default increases the likelihood of fund-level impairment and thus ultimately hurts investor returns.

Figure 16. Share of Lower Collateral Sectors



Note: Pitchbook reports one primary sector for a given borrower. Staff made conservative assumption when identifying sectors that likely have relatively lower tangible assets, and grouped all others into a category called 'Industry with High Collateral'. Thus, for sectors where asset tangibility is not fully clear, staff categorized it as a 'high collateral sector'.

Source: Pitchbook and authors' calculations

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Financial Stability Implications of Private Credit

The May 2023 FSR pointed out that redemption and fire sale risks posed by private credit seems to be low, largely due to its long lock-up periods (as high as 10 years) and low leverage or derivative exposures. However, there are other financial stability implications worth to monitor for this relatively opaque sector as its footprint in nonbank lending continues to grow.

Illiquidity

Private credit loans are illiquid due to the lack of a secondary market. There is limited market discovery, and investors acquiring these loans should expect to hold them to maturity or face steep losses in need of an emergency exit.

Rise in corporate leverage and default

Given relatively low collateralizable assets and high leverage, it is likely that a significant share of borrowers would not be able to obtain adequate financing in the absence of private credit. This view is consistent with persistently higher spreads in private credit relative to syndicated loan borrowers in Figure 6. Therefore, an important implication is that private credit raises overall corporate leverage, potentially making the corporate sector more vulnerable to financial shocks. In the environment of inflation and rising interest rates, higher interest payments on floating-rate debt could stress borrowers' balance sheets, leading to a significant increase in defaults in an economic downturn.

Dry Powder and deterioration in credit quality

Excessive growth in dry powder and continued competition with banks could compromise underwriting standards. Dry powder has grown tremendously in private credit, particularly in direct lending. For example, relative to 2014, dry powder has nearly quadrupled. Since private credit managers have a mandate to deliver high returns to LPs within a fixed timeframe, fund managers might choose riskier deals, offer more covenant-lite loans, or more generally reduce underwriting standards as opportunities dry up when the economy slows down. Combined with high concentration of dry powder within a few funds, fund managers run the risk of structuring deals poorly going forward in order to boost internal rate of return. Deterioration in deal quality can raise future defaults, hurting fund performance and investors' returns, given relatively low recovery.

Potential spillover to other nonbank institutions

Given that fund managers have the contractual right to obtain committed capital at any point in time, investors such as insurance companies or pension funds run the risk of needing to honor capital calls when credit conditions worsen, even when their own liquidity conditions are under stress. For example, property & casualty (P&C) insurers can face a surge in short-term claims stemming from exogenous liquidity shocks such as natural disasters. Since P&C insurers are obligated to pay out short-term claims, exposure to private debt can exacerbate liquidity problems if fund managers make capital calls at the same time.

Interconnections with banks

While bank lending to private credit funds appears moderate, there are growing interconnections between these two types of lenders. First, banks are increasingly partnering with private credit funds to fund new deals.¹⁷ Second, banks are progressively selling complex debt instruments to private fund managers in so-called "synthetic risk transfers" in order to reduce regulatory capital charges on the loans they make.¹⁸ Such instruments have limited transparency and pose hidden risks to the financial system, especially as the industry has yet to endure a prolonged recession. Relatedly, there is growing concern that tighter regulations such as Basel III endgame could intensify migration of credit from banks to private credit lenders. Considering borrower risk profiles, such substitution is less likely to occur to bank-held loans, and more so with syndicated

leveraged loans. In such cases, banks stand to lose underwriting fees to private credit funds. These developments suggest that private credit will become increasingly important to credit market functioning.

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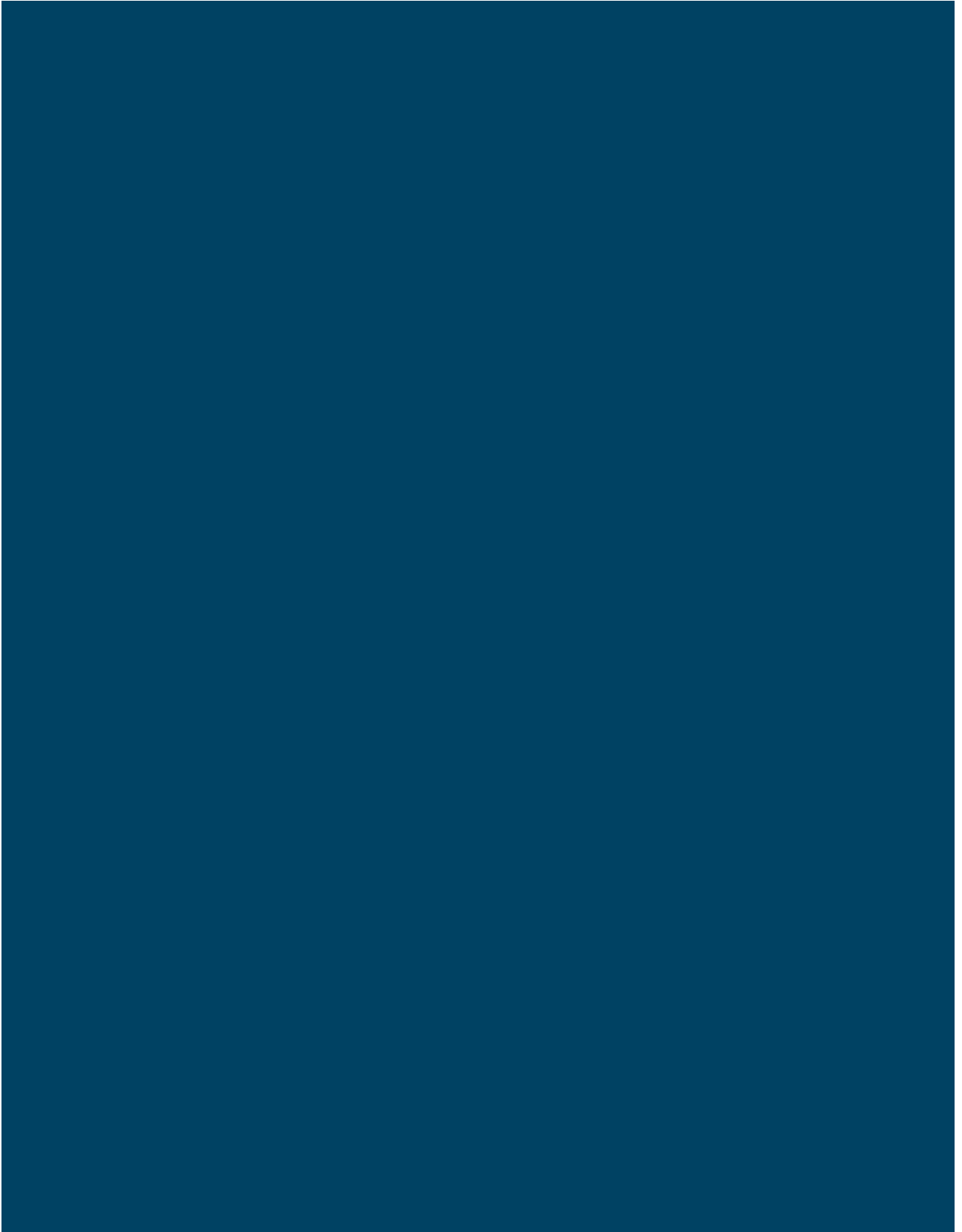
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Proskauer» The Private Credit Group



Trends in Private Credit

The Industry Speaks



Contents

Executive Summary

4

Demographics of Respondents

6

Current State of Play

10

Detailed Results

12

Investment Conditions and Considerations

16

Market Predictions

66

Hot Topics

94

Conclusion

100

Proskauer Trends in Private Credit

Executive Summary

Across the world, the private credit market finds itself in somewhat familiar waters. Like in previous years, a large majority of lenders are raising debt funds and planning to fundraise. More than half said the check size their firm is willing to write hasn't changed in the past 12 months, and almost one-third said they are willing to underwrite large deals, those worth \$250 million or more.

Further, fears—of inflation, recession and general geopolitical strife—so prevalent in our previous year's survey are still a part of this year's to be sure. For instance, many lenders said they expect to see lower deal pricing and more defaults going forward than they saw in the previous 12 months. However, it's as if these fears have been *normalized*, or at least, lenders may not be in the *catastrophic* mode that a sober look at some adverse economic indicators evident in the wider economy might warrant.

And some of these numbers are sobering. For example, the total amount of capital deployed in credit strategies by lenders over the past 12 months was approximately \$258.9 billion, *significantly down* from the \$338.5 billion deployed just a year ago.

Also notable was a shift to smaller deployment levels of capital this year. In fact, almost half of lenders surveyed (47%) said they deployed less than \$1 billion of capital into credit strategies in the past 12 months, compared to the previous year when a similar percentage of respondents (49%) said their firm deployed between \$1 billion and \$5 billion during the previous year's 12-month cycle.

The Proskauer Private Credit Survey 2024, which gathered responses from private credit firms in the United States, the United Kingdom and Mainland Europe, showed that overall, almost all respondents (especially those in the UK and EU market) are looking for new lending opportunities, vigorously fundraising and deploying capital, albeit at lower levels compared to past years.

In fact, just like 2021 showed a surge of pent-up lender optimism and activity expectations that the pandemic had held at bay, so too has 2024 seen that heightened level of optimism, with a stunning 80% of lenders saying they expect more deal activity in the coming year than they saw in the last 12 months.

This year's survey also explores the most critical drivers of deal flow in the market, as well as what major challenges lenders are facing. The report also explains what our survey respondents see as the hot topics in the years ahead and the key five-year trends that may impact dealmaking and the private credit market in 2024.

And while it may be important to consider which direction major economic indicators are pointing in the year ahead, some of what were top concerns—such as recession fears—have notably waned, although not receded completely. Indeed, the largest portion of respondents (38%) said they expect a recession in the next 6 to 12 months, while last year, the largest portion of respondents (41%) said a recession was less than six months away, while another sizable portion (33%) said we were *already* in a recession. Still, it doesn't take more than a few ill economic winds to blow recession and inflation fears back into the marketplace where they can take a heavy toll.

As in previous years, the report offered valuable insight into the minds of private lenders in areas such as deal volume, pricing, borrower EBITDA, deal covenants and perhaps more importantly, why they think borrowers chose private credit lending options.

Many lenders see a still robust dealmaking environment

- A large majority (70%) of firms made less than 50 new credit investments last year, while 36% made between 25 and 100 investments. Most respondents deployed less than \$1 billion of capital into credit strategies this year, which is down from last year when most deployed between \$1 billion and \$5 billion. Almost one-third (32%) of lenders said they are willing to underwrite deals worth \$250 million or more.
- More than half of lenders say that the check size their firm is willing to write has not changed in the past 12 months, and the average EBITDA of companies in their portfolios is mostly between \$25 million and \$49.9 million. As to deal covenants, most lenders say they permit 20% to 24.9% of EBITDA add-backs in loan agreements. Uncapped EBITDA add-backs increased to 4% this year (from 3% last year) but remain well below the 10% in 2022. The majority of lenders (58%) said they do not do deals without a covenant.
- Lenders in the United States identified the US, UK and Canada as the top jurisdictions for growth opportunities for their business, while UK and EU lenders saw the DACH region — Germany, Austria and Switzerland — as its top potential growth area with the US much further down the list (behind the UK and France).
- A majority of lenders said they have less than 2.5% of their portfolio in default, but most predict more defaults than they saw in the previous 12 months.
- Still, a large majority of lenders also said they are actively raising debt funds and planning to fundraise.
- More than two-thirds of lenders said they have fund-level leverage facilities, with most employing less than 1.5-times leverage.

Challenges for the Year Ahead

- More than one-third of dealmakers cited *Inflation/macroeconomic risks* as their largest concern over the next 12 months, with this category of concern getting more votes (ranked 1st, 2nd or 3rd) than any other.
- Two other factors — *Lack of alignment on purchase price between buyers and sellers* and *Lack of quality assets in the market* — also were ranked as key challenges for the coming year while *Access to financing*, which was the second-most cited challenge last year, dropped to fifth place as a top challenge this year.

Proskauer Trends in Private Credit

Demographics of Respondents

The *Proskauer Private Credit Survey 2024* gathered responses from 178 private credit firms, an 18% increase in the number of respondents compared to last year's survey. Of these respondents, 70% were in the United States and 30% were in the United Kingdom & Europe. Sixty percent of respondents were either Managing Directors or Partners at their firms and 72% of respondents were senior-level executives. (See full breakdown in the chart below.)

In terms of assets under management (AUM), 55% of this year's survey respondents came from firms with \$10 billion or more AUM, and another 32% came from firms with between \$1 billion and \$9.99 billion AUM. And the remaining percentage (13%) came from firms with less than \$1 billion AUM.

Overall, the total amount of capital deployed in credit strategies by respondents over the past 12 months was approximately \$258.9 billion, significantly down (by 23%) from \$338.5 billion cited in last year's survey. Further, you can see this downturn in deployed assets among individual firms too: Last year, almost half of respondents (49%) deployed between \$1 billion and \$5 billion of capital into credit strategies over the past 12 months. This year, almost the same percentage of respondents (47%) deployed less than \$1 billion into credit strategies over the past 12 months.

Managing Director	38%
Partner	22%
Director	8%
Executive Director	4%
Principal	10%
Vice President	8%
Internal Counsel	3%
Associate	3%
Other	3%
Senior Associate	2%



178 Respondents
in total

70%



United States

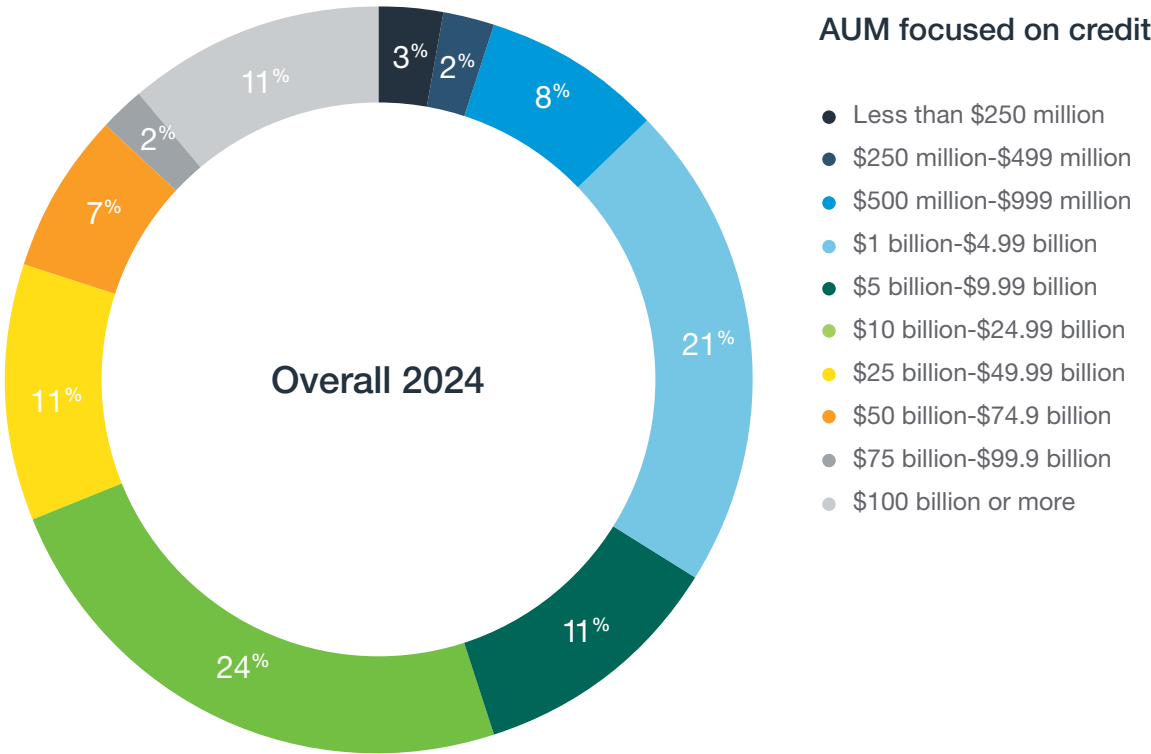
30%



United Kingdom & Europe

Demographics of Respondents

Total amount of capital by respondents into private credit strategies over the past 12 months was approximately \$258.9 billion



Headquarters 2024



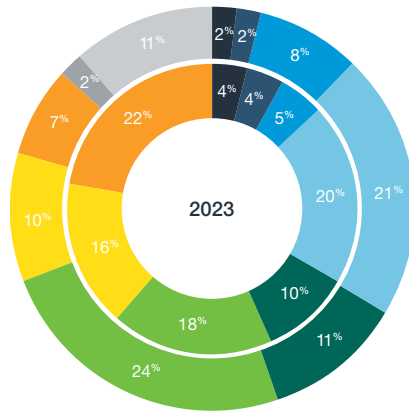
UK/EU Respondents



US Respondents

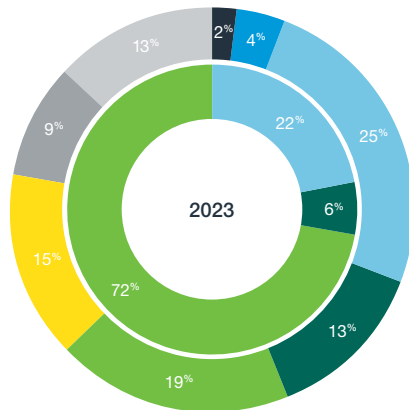
● US ● UK ● Other Europe ● France ● Canada ● Other ● Asia

87% of respondents manage \$1 billion in assets or more. Median AUM of respondents is \$1 billion



US 2024

- Less than \$250 million
- \$250 million-\$499 million
- \$500 million-\$999 million
- \$1 billion-\$4.99 billion
- \$5 billion-\$9.99 billion
- \$10 billion-\$24.99 billion
- \$25 billion-\$49.99 billion
- \$50 billion-\$74.9 billion
- \$75 billion-\$99.9 billion
- \$100 billion or more



UK/EU 2024

- Less than €250 million
- €250 million-€499 million
- €500 million-€999 million
- €1 billion-€4.99 billion
- €5 billion-€9.99 billion
- €10 billion-€24.99 billion
- €25 billion-€49.9 billion
- €50 billion-€74.9 billion
- €75 billion-€99.9 billion
- €100 billion or more

Current State of Play

Our survey results are in line with other forecasts and studies showing that private credit is not slowing down, albeit predictions for North America, which still dominates the private credit market, are more positive than they are for Europe.

Even after the banking crisis earlier in 2023 following the demise of Silicon Valley Bank and Signature Bank, borrowers continue to look to private credit. Indeed, in the wake of the crisis, a consortium of funds set an industry record when they provided fintech firm Finastra Group Holdings Ltd. with a €4.8 billion loan.

Overview of key economic and market statistics:

- Bank of England base rate is 5.25% after five rate increases in 2023, which in total raised the base rate 1.75 percentage points.
- 10-Year Treasury Rate was 3.88% at the close of 2023, up from 3.46% at the close of last year.
- S&P 500 Index was up 24.4% in 2023.
- S&P U.S. Treasury Bond Index is recovering, and the yield on the 10-Year Government Bond is expected to be 6.087% by the end of March 2024.
- Preqin forecasts an overall average growth in AUM of 17.4% between now and 2026.
- However, Preqin predicts the compound annual growth rate (CAGR) for Europe-focused AUM to fall to 10.9% between 2021 and 2027.
- PwC predicts that by 2025, already largely fund-driven private credit in Europe will be completely fund-driven, rather than bank-driven. Along with this, direct lending is predicted to expand and compete with syndicated bank facilities.
- The Global Private Capital Association (GPCA), states 2022 was a record year,¹ reporting US\$10.8 billion of new inflow, an 89% increase from last year.

What forecasters are saying:

In its *2024 Global Credit Outlook* (which they subtitled, *Back in the saddle*), Goldman Sachs explained that its view for 2024 centered on three ingredients: *i)* modestly tighter spreads and modestly lower yields that translate into lower excess returns, but higher *total* returns compared to 2023; *ii)* a balanced supply/demand technical backdrop; and *iii)* rising financial distress in the low end of the quality spectrum that is to some degree already priced in.²

“In some ways, we expect 2024 will be a mirror image of 2023, given the tighter starting level of spreads, higher starting level for yields, and the end of the

1. See “Private credit investments surged 89% in 2022 – report”, Chiara Elisei, Reuters; February 22, 2023; available at <https://www.reuters.com/business/private-credit-investments-surged-89-2022-report-2023-02-22>.

2. *2024 Global Credit Outlook: Back in the saddle*, Goldman Sachs Credit Strategy Research; November 13, 2023.

hiking cycles in the US and Euro area,” the Goldman report noted.

BlackRock’s *Global Credit Outlook* for the first quarter of 2024 saw a widening divide for the coming year in “various areas of the investing landscape” that reflects “heightened dispersion amidst a higher cost of capital environment” that also underscores the “importance of selectivity.”³

BlackRock noted that while “the consumer the engine of the US economy has been resilient overall... the transition to a higher cost-of-capital is not yet complete.” As a result, BlackRock said it expects “a continued (albeit moderate) march higher in default rates and credit losses (in both public and private debt) through mid-2024 even absent a recession.”

Finally, the *Global Credit Outlook 2024: New Risks, New Playbook* from S&P Global Ratings indicated change may be afoot. “Looking ahead at 2024 and after, it’s clear that the events since the COVID-19 pandemic have brought on a profound transformation for the global economy and financial markets,” the report noted.⁴

S&P Global said it expects additional credit deterioration in 2024 and cited several factors that could make the situation worse, such as tightening financing conditions, continued inflation, a sharp slowdown in global growth, high energy prices that squeeze corporate profits and rising geopolitical tensions, among others. S&P also noted that several factors—including heightened geopolitical risks, the need to accelerate the de-carbonization of the economy and the technology revolution—“will increasingly shape the future of credit.”

3. *Global Credit Outlook 1Q2024: A widening divide*, BlackRock; December 2023.

4. *Global Credit Outlook 2024: New Risks, New Playbook*, S&P Global Ratings; December 4, 2023.

Detailed Results

What our survey respondents are saying

The respondents to our latest survey offered their critical insight and perspective into the state of the private credit market, including:

The majority of respondents said they use Private funds and Managed Accounts as their primary lending vehicles.

Direct lending is the top private debt strategy pursued overall, followed by mezzanine, special situations and hybrid. Asset-backed lending (ABL), specialty assets and venture debt were notably less used in the UK/EU markets than in the US market.

70% of respondents said their firm made *less than* 50 new credit investments last year, up slightly from last year. Further, 36% made between 25 and 100 new credit investments last year; and overall, 13% of respondents stated they made more than 100 new investments last year.

Notably, there was a shift to smaller deployment levels of capital. This year, almost half of respondents (47%) deployed less than \$1 billion of capital into credit strategies in the past 12 months, compared to last year when a similar percentage of respondents (49%) said their firm deployed between \$1 billion and \$5 billion during last year's 12-month cycle.

The maximum loan size is evenly spread across groups, with 32% of respondents saying the maximum size deal their firm is willing to underwrite is \$250 million or more.

Somewhat surprisingly, a majority (52%) of respondents overall say the check size their firm is willing to write has *not changed* in the past 12 months. Interestingly, that same percentage (52%) of last year's respondents said the check size their firm is willing to write had *decreased* over the previous year.

The maximum total leverage US respondents who said they would underwrite is most likely to be in the 5.5-times to 5.99-times range, while respondents in the UK/EU market see a more even spread across ranges from 6.0-times to 6.49-times. Interestingly, last year most UK/EU respondents said the maximum total leverage they would underwrite was in the 5.5-times to 5.99-times range.

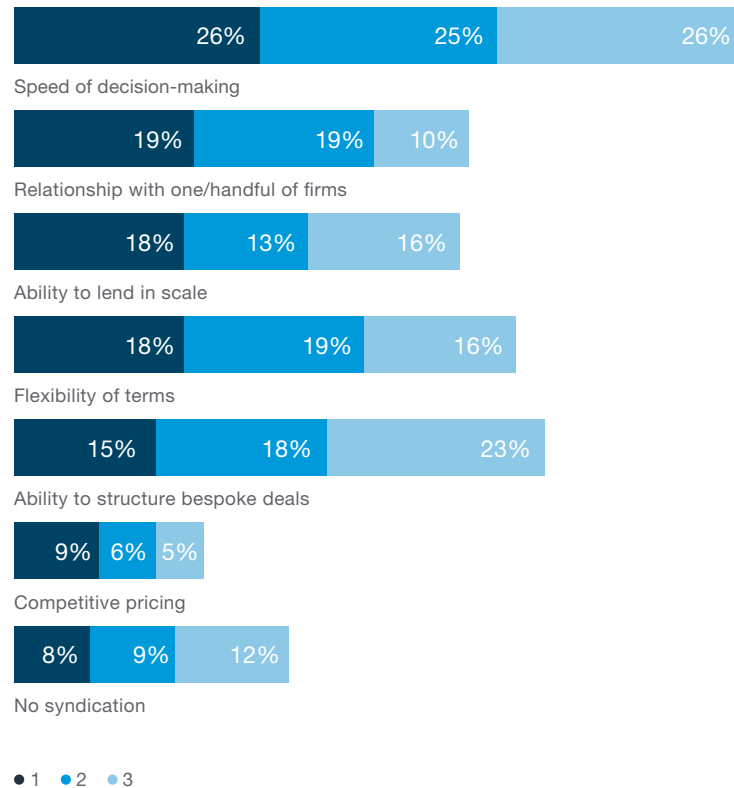
When respondents were asked to select up to five reasons why they believe borrowers value private credit, like last year, they named *speed of decision-making* as the top reason.

Lenders' Insight

There are various reasons that respondents give as to why they think their borrowers value private credit lending, and all of these offered a keen perspective into what lenders may be thinking, especially about the mindset of their borrowers. Respondents were asked to select up to five reasons why they believe borrowers value private credit and rank them in order of importance. Not all respondents chose five reasons, but almost all selected at least three.

Similar to last year, speed of decision-making was most often placed in the top three and was most often listed first. Further, flexibility was most frequently ranked fifth, and competitive pricing and no syndication were the reasons most often left out completely.

Why do borrowers value private credit?



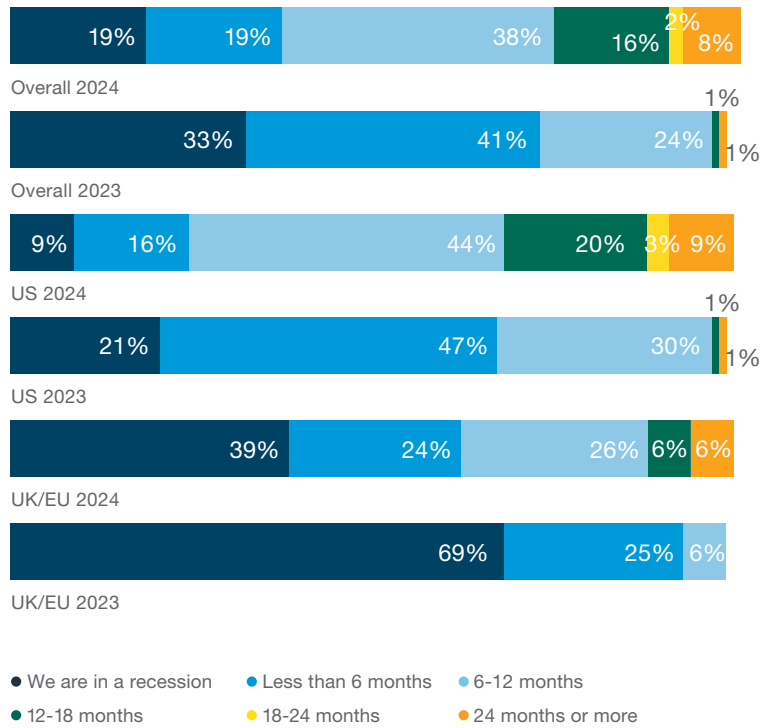
Detailed Results

Recession Expectations

This is a key insight because fears of immediate recession color so much in the private credit and overall lending market. As our survey shows, however, last year's fears of a more immediate recession may have abated. This year, more than one-third of respondents (38%) said they expect a recession in the next 6 to 12 months. Last year, the largest portion of respondents (41%) said a recession was less than six months away, while another sizable portion (33%) said we were *already* in a recession.

This demonstrates a relatively strong shift toward fears of a much less immediate recession, indicating perhaps an easing of this overall concern for lenders.

When do you expect the next recession to begin?



Investment Conditions and Considerations

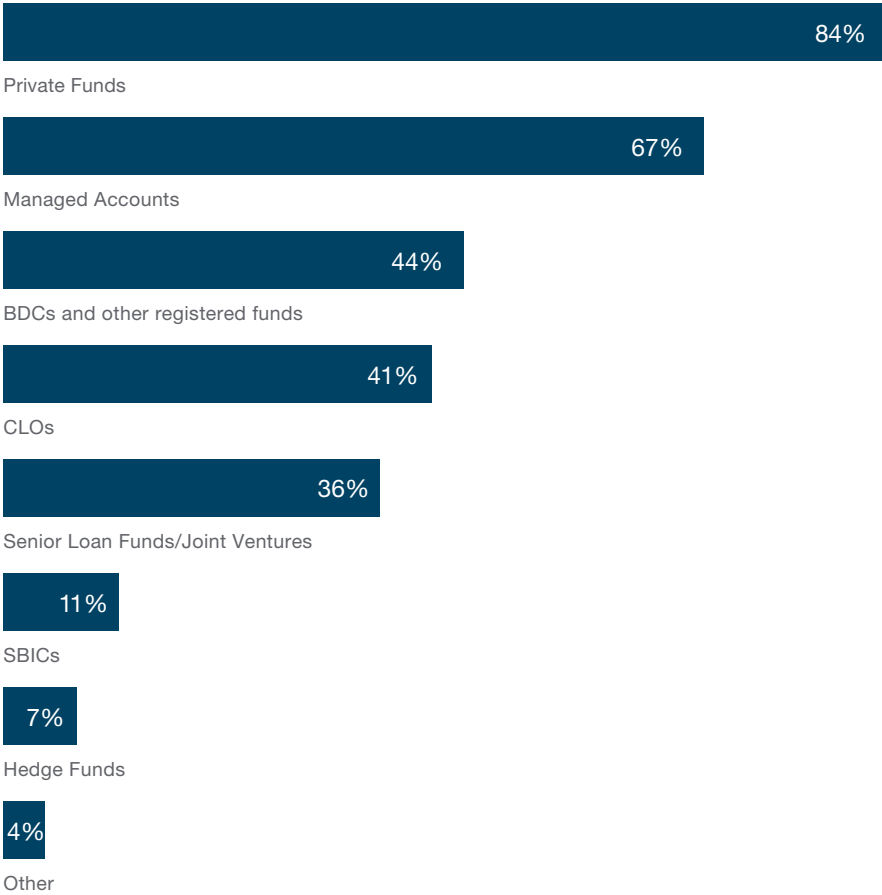
Lending Vehicles

There continued to be a large majority (84%) of respondents saying they use private funds as their preferred lending vehicle, with those in the UK and EU markets utilizing these vehicles more (90%), compared to the US market (82%). Interestingly, all these percentages were down slightly from last year when 87% of respondents cited private funds as their lending vehicle of choice, and 94% of the UK/EU markets and 84% of the US market cited their use.

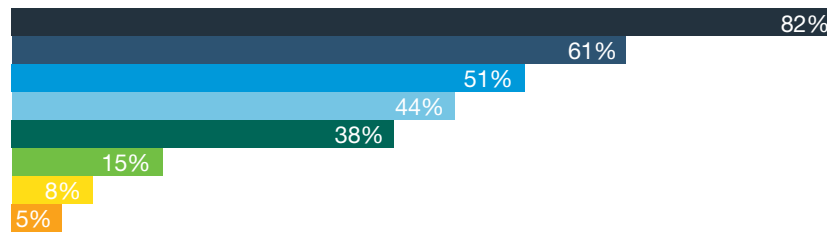
Not surprisingly, other lending vehicles—managed accounts, business development companies and collateralized loan obligations (CLOs)—all saw their use tick up slightly, indicating in a small way that lenders may be diversifying their lending vehicles in today’s market.

By region, the UK/EU markets are more likely than the US market to use Private Funds and Managed Accounts and less likely to use BDCs, with limited usage of SBIC and Hedge Funds as well.

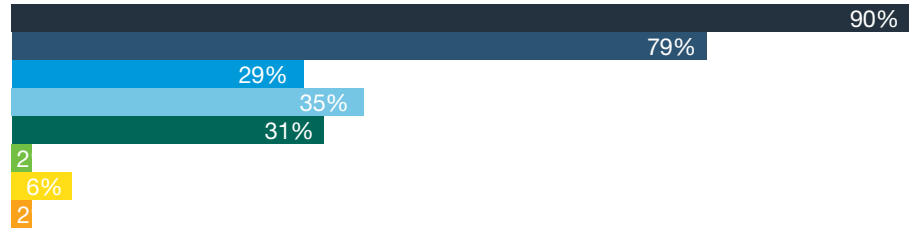
What vehicles do you utilize for your lending activities?



What vehicles do you utilize for your lending activities?



US



UK/EU

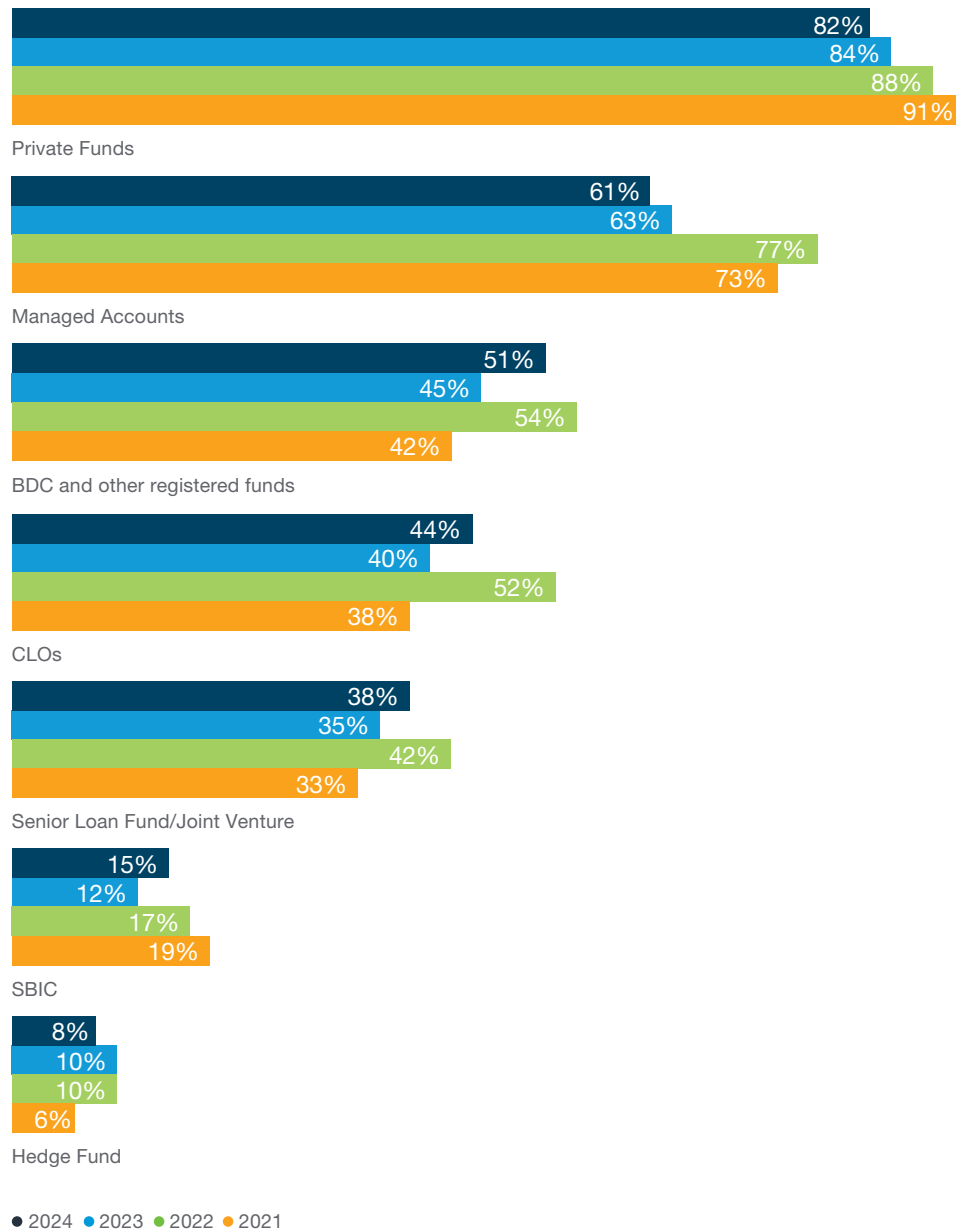
● Private Funds ● Managed Accounts ● BDC ● CLOs ● Senior Loan Funds/Joint Ventures ● SBIC ● Hedge Funds ● Other

Investment Conditions and Considerations

In breaking the numbers out over the course of the last several years, we see some of these vehicles, such as managed accounts in the UK/EU, have picked up over the years. Of course, the use of several vehicles, notably private funds, has slowly declined as compared to previous years, while others remained somewhat consistent.

What vehicles do you utilize for your lending activities?

US 2024/2023/2022/2021



What vehicles do you utilize for your lending activities?

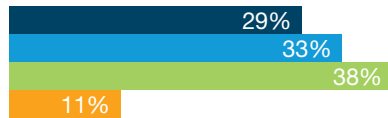
UK/EU 2024/2023/2022/2021



Private Funds



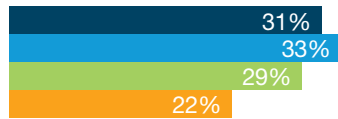
Managed Accounts



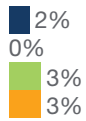
BDC and other registered funds



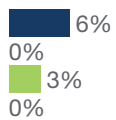
CLOs



Senior Loan Fund/Joint Venture



SBIC



Hedge Fund

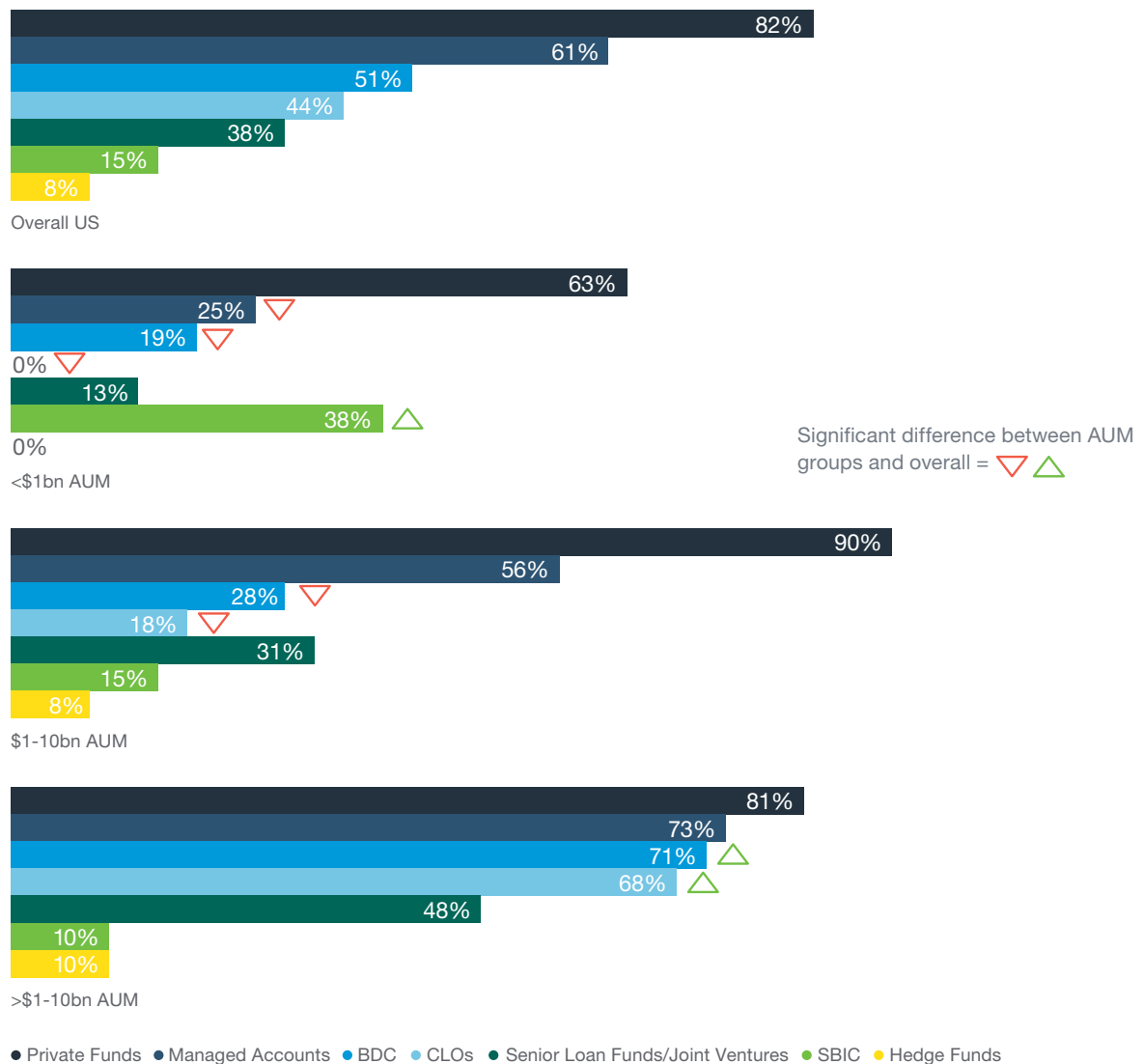
● 2024 ● 2023 ● 2022 ● 2021

Investment Conditions and Considerations

Also not surprisingly, those respondents from firms with the largest AUM said they are more likely to use multiple lending vehicles, while smaller AUM firms use fewer. These findings also are in line with the results from 2023.

What vehicles do you utilize for your lending activities?

By US AUM: Increased usage seen by higher AUM groups



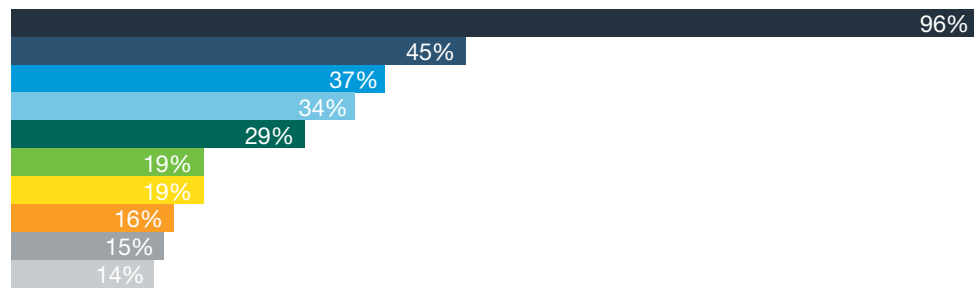
ABL, specialty asset as well as venture debt notably less common in UK/EU

Private Debt Strategies

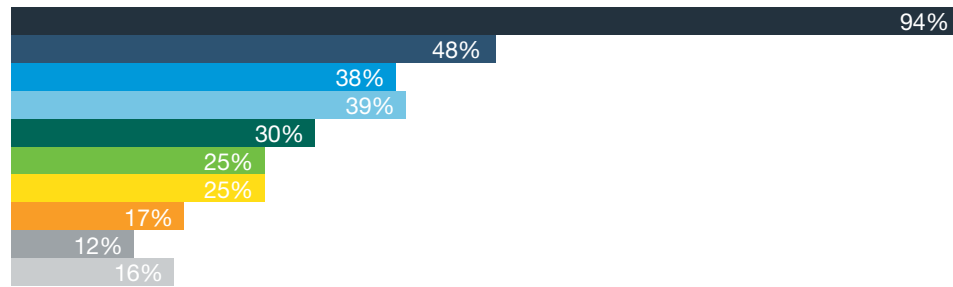
Direct lending continues to be the top private debt strategy in all regions by a wide margin and is even slightly higher in the UK and EU markets. Venture debt and ABL structures, meanwhile, are much more common in the US market.

What private debt strategies does your firm pursue?

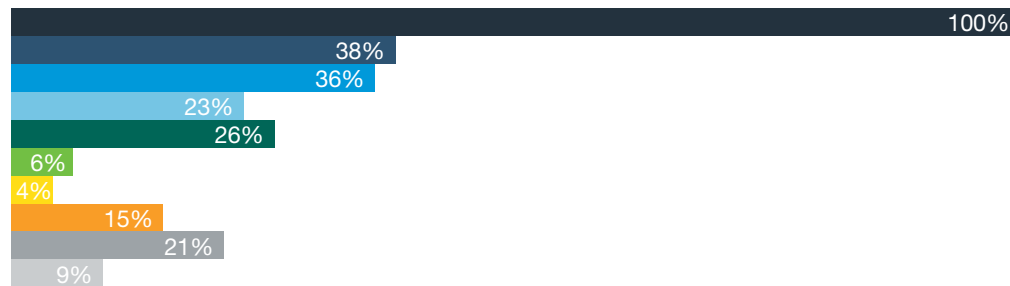
By region: Direct lending is the top private debt strategy in both regions, slightly higher in UK/EU



Overall



US



UK/EU

- Direct lending ● Mezzanine ● Special situations ● Hybrid debt/equity solutions ● Real estate ● ABL
- Specialty asset or industry finance ● Lender or fund finance ● Infrastructure ● Venture debt

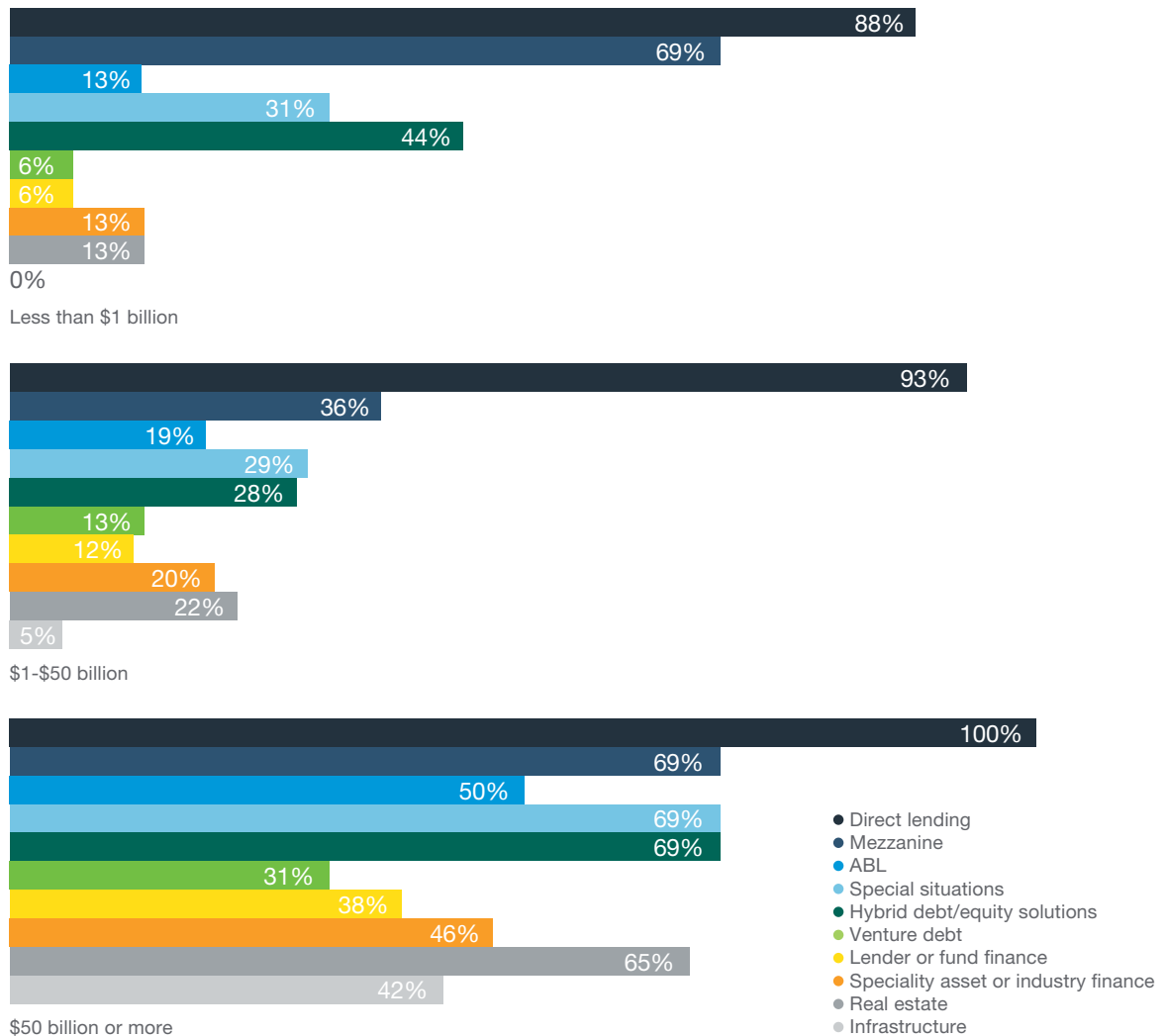
Investment Conditions and Considerations

When broken out by AUM in the US market, we see that two new categories, Infrastructure and Real Estate—which were introduced in this year’s survey—were extremely popular with larger AUM firms. Firms with \$50 billion or more of AUM invested in Infrastructure and Real Estate at high rates, with almost half (42%) and two-thirds (65%) of these firms, respectively, pursuing these strategies. Smaller firms, those with less than \$1B AUM were more likely to invest in mezzanine (65%) and hybrid debt/equity solutions (44%) than larger firms.

And when comparing strategy choices to last year’s survey, the results are in line with last year, showing no major changes except for a decline in respondents choosing Special Situations.

What private debt strategies does your firm pursue?

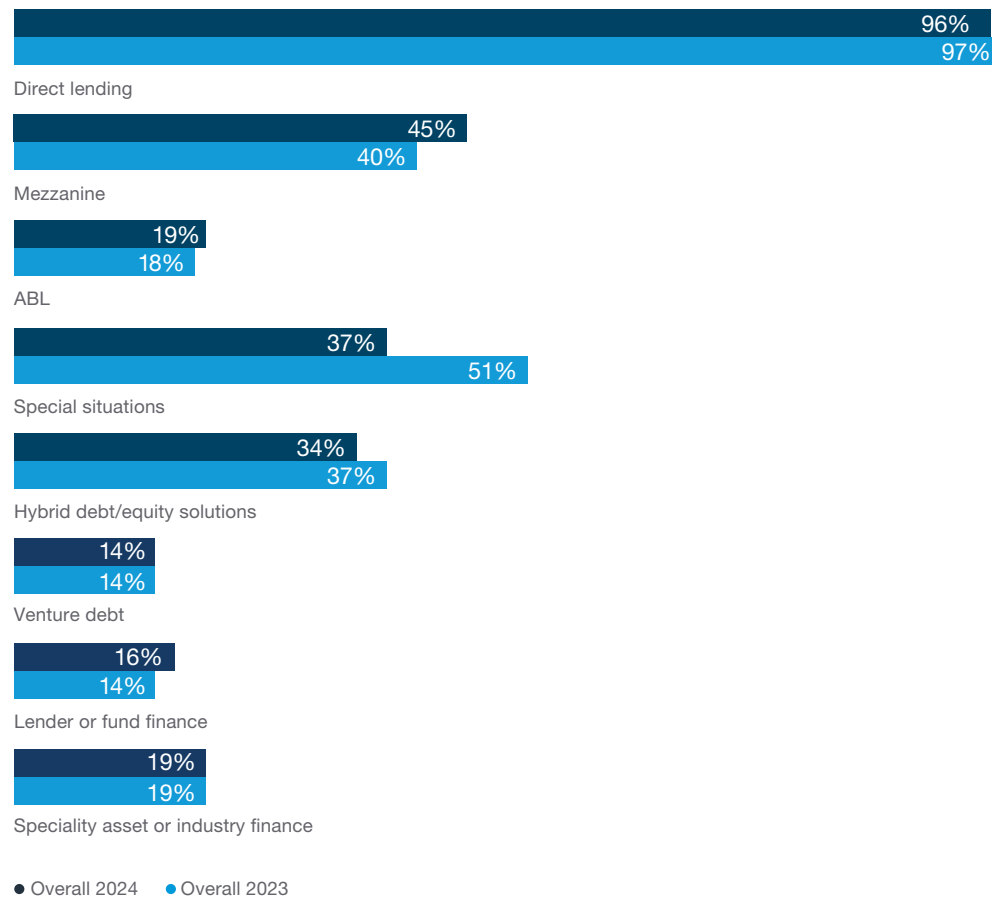
US by AUM



Results are in line with last year, showing no major changes except for a decline in respondents choosing Special Situations.

What private debt strategies does your firm pursue?

2023 vs 2024

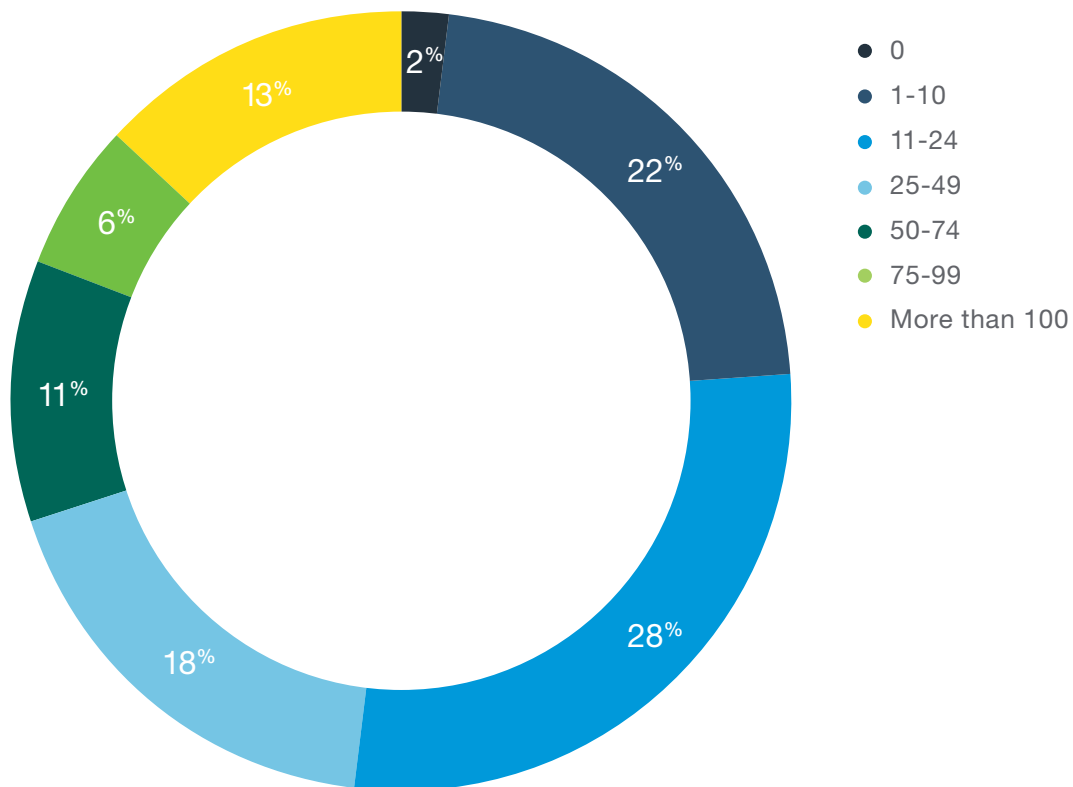


Investment Conditions and Considerations

New Credit Investment

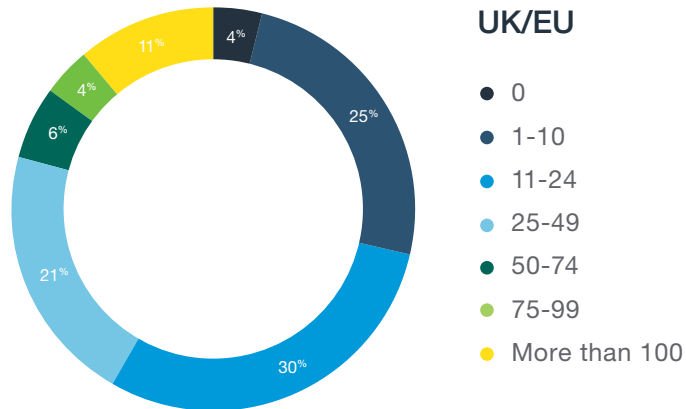
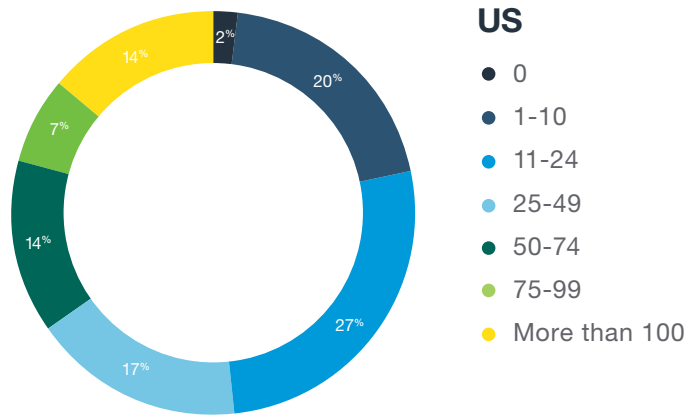
Overall, 70% of survey respondents said their firm made less than 50 new credit investments last year, up from last year when 66% of respondents said that. Further, more than one-third of respondents (36%) said their firm made between 25 and 100 new investments, and 13% stated their firm made more than 100 new investments last year. Only 2% said their firm made no new credit investments last year.

How many new credit investments did your firm make last year?



In the US, more than half of firms (52%) reported making 25 or more new credit investments, while in the EU/UK market, 42% made 25 or more new credit investments. Both of these percentages were down compared to last year, indicating a slowing pace of new credit investments.

How many new credit investments did your firm make last year?



Investment Conditions and Considerations

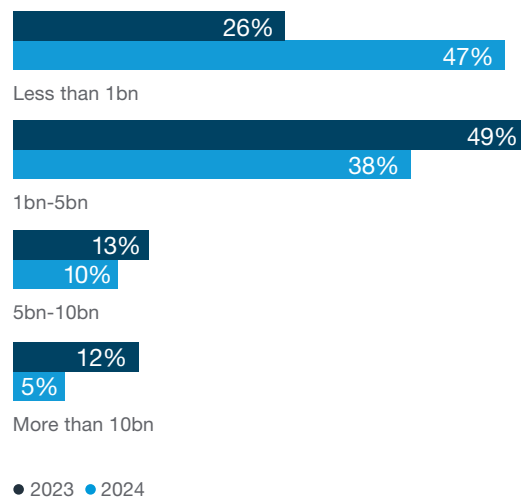
Deploying Capital

This year showed a sharp pullback in the larger amounts of capital deployed as the percentage of firms deploying between \$1 billion and \$5 billion in credit strategies in the past 12 months fell this year by 11 percentage points, to 38%, compared to last year when almost half (49%) were deploying that much capital into credit strategies in the previous 12 months.

In a related development, there was a significant rise in the percentage of firms saying they were deploying less than \$1 billion into credit strategies in the past 12 months, with 47% of firms saying this, compared to just 26% saying it last year.

How much capital has your firm deployed into credit strategies in the past 12 months?

2023 vs. 2024

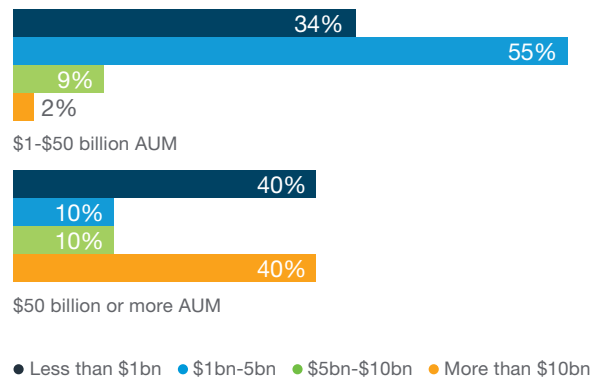


AMERICAN BANKRUPTCY INSTITUTE

More than half of US respondents (55%) with up to \$50 billion in AUM have deployed capital of between \$1 billion and \$5 billion into credit strategies over the past 12 months, while 40% of those with \$50 billion or more in AUM have deployed less than \$1 billion, perhaps indicating a pullback from some of the largest US firms.

How much capital has your firm deployed into credit strategies in the past 12 months?

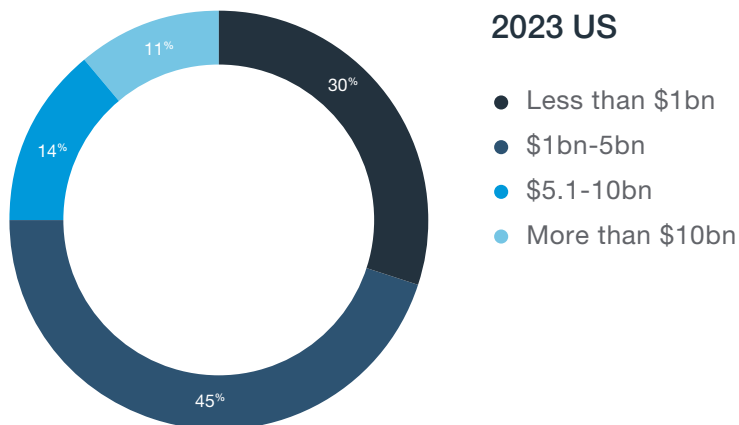
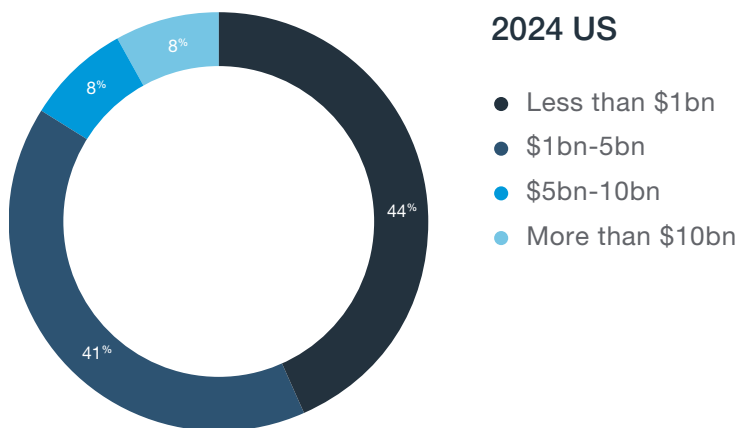
US by AUM

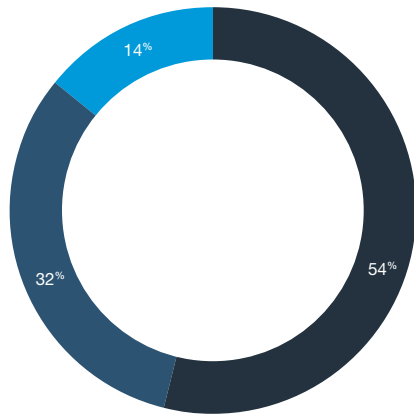


Investment Conditions and Considerations

Broken down by region and compared by year, respondents from the UK/EU region reflected a sharp drop in their willingness to invest between \$1 and 5 billion into credit strategies over the past 12 months compared to last year. Indeed, no UK/EU respondents said they deployed more than \$10 billion this year, compared to 17% last year, further indicating a wider pullback from larger investment totals.

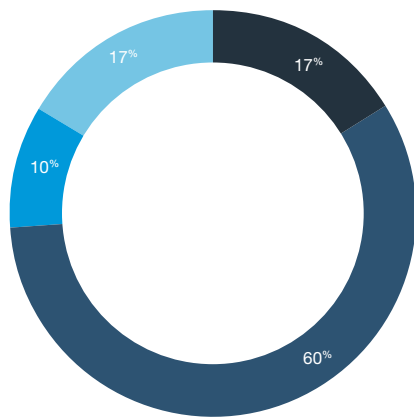
How much capital has your firm deployed into credit strategies in the past 12 months?





2024 UK/EU

- Less than €1bn
- €1bn-5bn
- €5bn-10bn
- More than €10bn



2023 UK/EU

- Less than €1bn
- €1bn-5bn
- €5.1-10bn
- More than €10bn

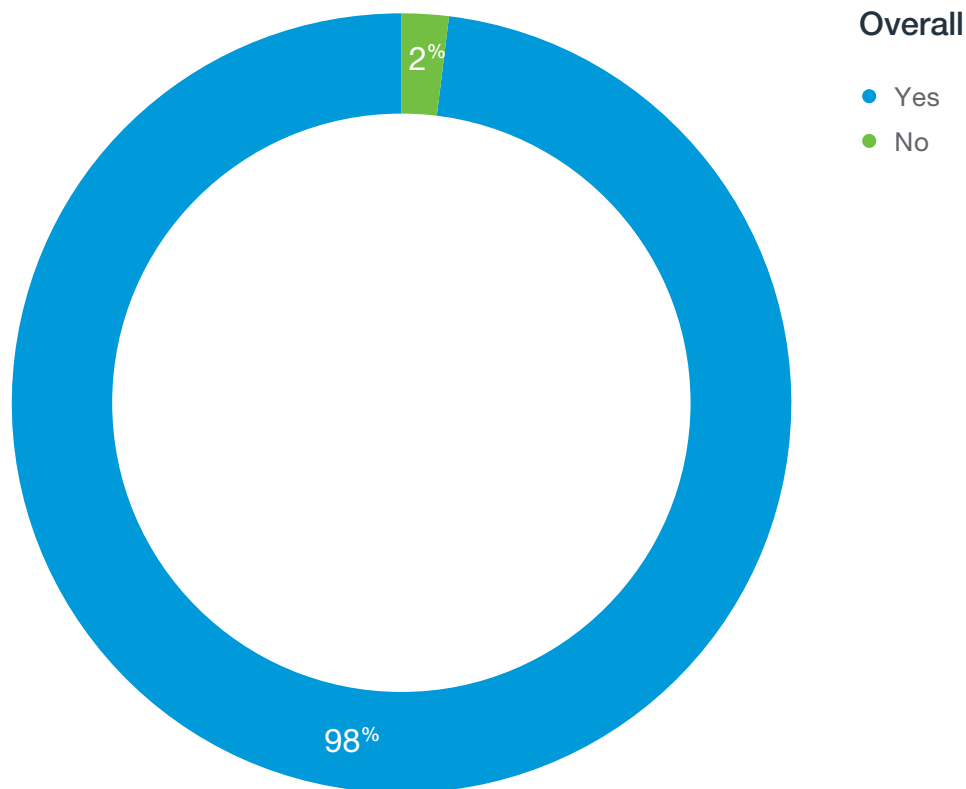
Investment Conditions and Considerations

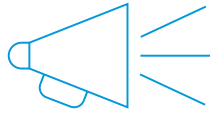
New Lending Opportunities

Even considering the pullback in some areas of investment levels, almost all respondents (98%) said they are actively looking for new lending opportunities, indicating — perhaps counterintuitively — that lenders are willing to lend even amid somewhat trepidatious totals from last year.

Is your firm looking for new lending opportunities today?

By region: Almost all are looking for new lending opportunities, 100% in UK/EU

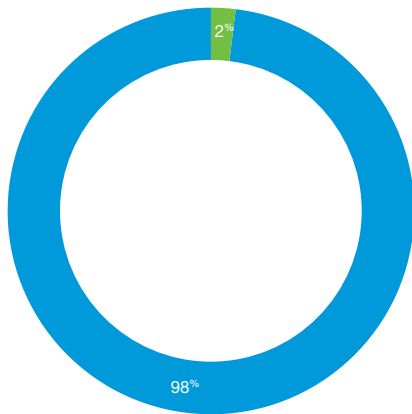




What some respondents told us about looking for new lending opportunities:

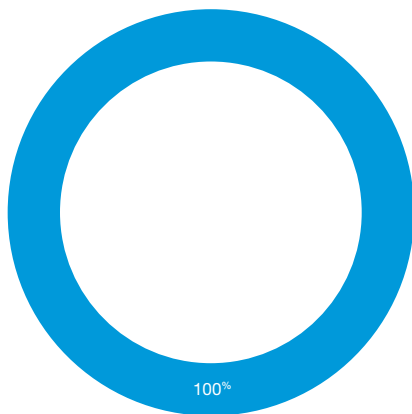
“We are open for business with plenty of dry powder to deploy.”

“We are always looking for new opportunities — both because we recycle capital in our funds, and because we are actively fundraising.”



US

- Yes
- No



UK/EU

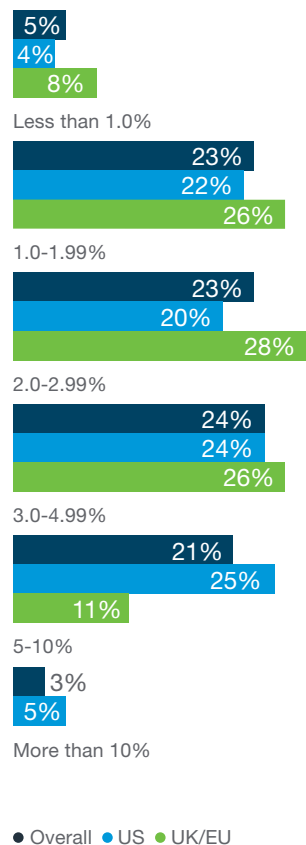
- Yes
- No

Investment Conditions and Considerations

Deal Closure

There is a higher closure rate among US respondents, 30% of whom said they close 5% or more of the deals they screen, compared to just 11% of UK/EU respondents who said the same thing. And almost one-quarter (24%) of respondents overall said they close 5% or more of the deals they screen, while another 47% close between 2% and 4.9% of the deals they screen.

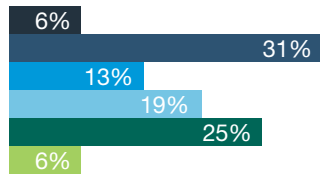
What percentage of deals do you close in relation to the number of deals you screen?



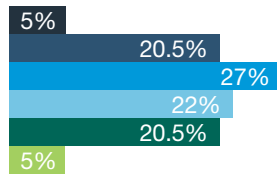
Broken out by AUM among US respondents, those with \$50 billion or more in AUM saw much higher rates of deal closure than those with AUM of less than \$50 billion.

What percentage of deals do you close in relation to the number of deals you screen?

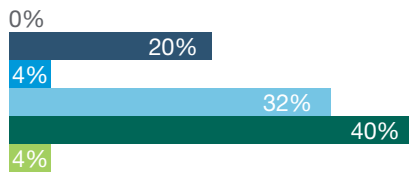
US by AUM



Less than \$1 billion



\$1-\$50 billion



\$50 billion or more

● Less than 1.0% ● 1.0-1.99% ● 2.0-2.99% ● 3.0-4.99% ● 5-10% ● More than 10%

Investment Conditions and Considerations

Maximum Leverage

The maximum leverage that private credit lenders were willing to incur centered mostly on the 5.5-times to 5.9-times range, which saw 23% of overall respondents saying this was the maximum leverage level at which they would underwrite. This level was the same as last year.

In the US, respondents said their firms were most likely (24%) to be in the 5.5-times to 5.9-times range, while UK/EU respondents saw a more even spread across ranges between 5-times to 6.49-times. Interestingly, this was the reverse of last year, when more UK/EU firms were more likely to be the 5.5-times to 5.9-times range category while US firms saw a more even spread across ranges.

Overall:

What's the maximum total leverage that you will underwrite today?

US most likely to be in 5.5x – 5.99x category while UK market sees a more even spread across ranges 5.0x to 6.49x



Overall



US



UK/EU

By Overall AUM

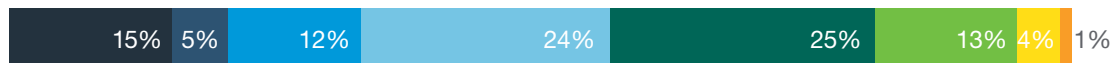
Higher AUM groupings more focused on maximum total leverage above 5.99x



<\$1bn



\$1-10bn



>\$10bn

● ≥7.50x ● 7.0x - 7.49x ● 6.5x - 6.99x ● 6.0x - 6.49x ● 5.5x - 5.99x ● 5.0x - 5.49x ● 4.5x - 4.99x ● ≤ 4.49x

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The more than 7.50-times category is low in all regions and overall, but the lowest category for all is 7.0-times to 7.49-times, which only saw 4% of respondents saying this was their firms' acceptable level of maximum leverage.

By US AUM

Maximum leverage <\$1bn AUM grouping has higher proportion in ≤4.49x category



US overall



<\$1bn



\$1-10bn



>\$10bn

● ≥7.50x ● 7.0x - 7.49x ● 6.5x - 6.99x ● 6.0x - 6.49x ● 5.5x - 5.99x ● 5.0x - 5.49x ● 4.5x - 4.99x ● ≤4.49x

By UK/EU AUM

Maximum leverage between 5.0x – 5.99x is most common for both €1-10bn and >€10bn AUM groups



UK/EU overall



€1-10bn



>€10bn

● ≥7.50x ● 7.0x - 7.49x ● 6.5x - 6.99x ● 6.0x - 6.49x ● 5.5x - 5.99x ● 5.0x - 5.49x ● 4.5x - 4.99x ● ≤4.49x

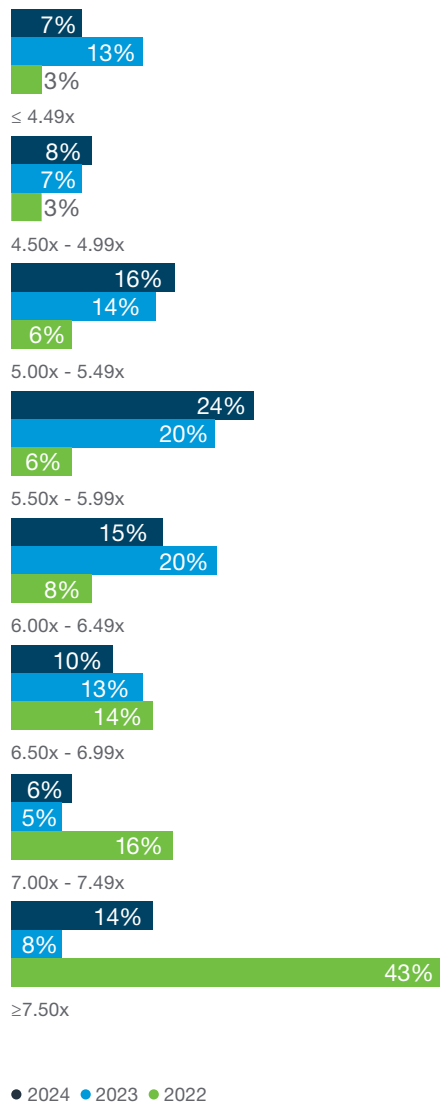
Investment Conditions and Considerations

Maximum Total Leverage

The percentages of respondents who said they were comfortable underwriting with higher levels of leverage continued to fall this year, again underscoring much of the caution that the private credit market may still be feeling.

What's the maximum total leverage that you will underwrite today?

US



Continued decrease in 6.50x-6.99x category; increases in 4.50x-5.99x categories

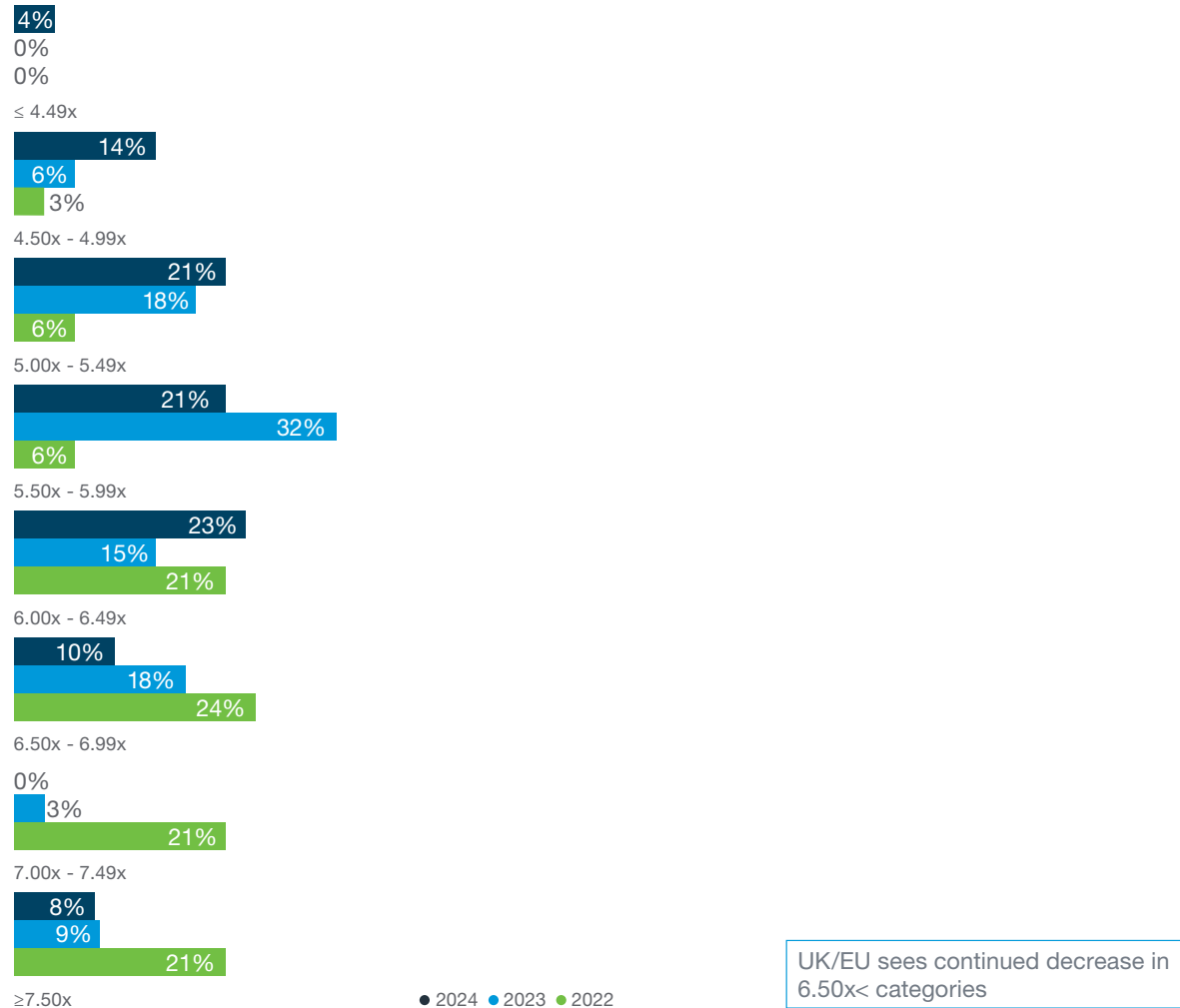
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In the US, just 14% of respondents said the maximum total leverage their firm would underwrite today is 7.5-times or more, compared to 43% of US respondents who said that in 2022, representing a dramatic decrease in willingness to underwrite at that level of leverage. There were also continued decreases over the past two years in the 6.50-times to 6.99-times and the 7.0-times to 7.49-times categories. Conversely, lower leverage categories climbed up during the same time frame, with increases in the three categories between 4.50-times and 5.99-times maximum leverage.

UK/EU respondents saw similar continued drops at the higher leverage ends (anything above 6.5-times), but saw continued increases in 4.5-times to 5.49-times categories.

What's the maximum total leverage that you will underwrite today?

UK/EU



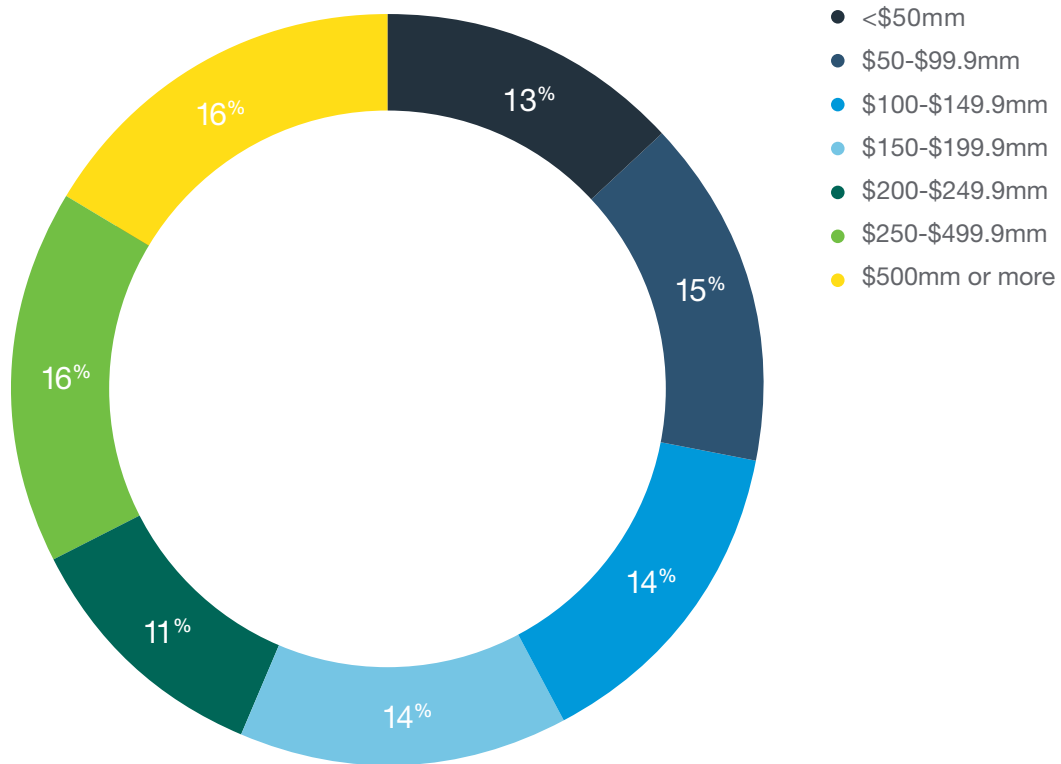
Investment Conditions and Considerations

Maximum Deal Size

Like last year, the levels of maximum deal size were quite evenly spread across categories of deal size groupings, with almost one-third (32%) of respondents saying the maximum size deal their firm is willing to underwrite is \$250 million-plus. This represents a slight growth in this category from last year when just 26% said that the maximum size deal their firm is willing to underwrite is \$250 million-plus.

The percentage of respondents saying that the maximum size deal their firm will underwrite is less than \$50 million grew to 13% this year, compared to 10% last year, again, perhaps indicating higher levels of caution around deal-making.

What is the maximum size deal your firm will underwrite today?



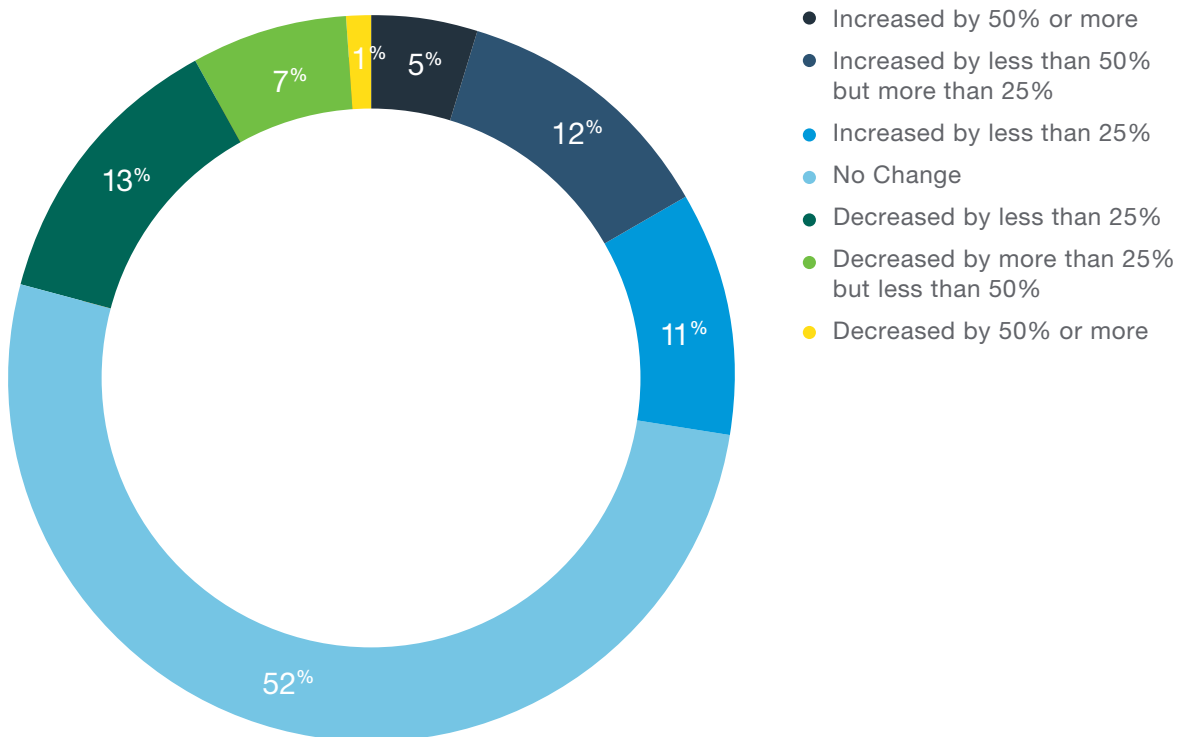
Investment Conditions and Considerations

Check Size

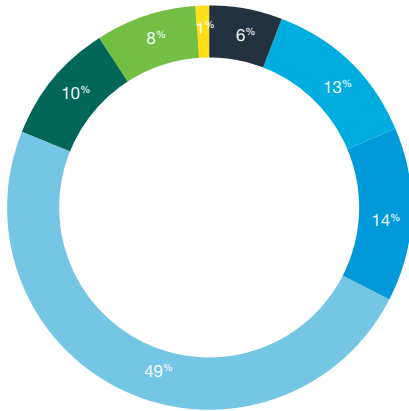
The majority of respondents (52%) overall said the check size their firm is willing to write has not changed in the past 12 months. Interestingly, this was the same percentage who, last year, said the check their firm is willing to write has *decreased* in that previous 12-month period, representing a stabilizing of concerns somewhat, at least in regard to check size. Last year, just about one-third of respondents (35%) said the check size their firm is willing to write has not changed in the past 12 months.

This year, 28% of respondents overall said their firms' check size increased, and 21% said their firms' check size had decreased.

Has the size of the check your firm is willing to write changed over the past 12 months?

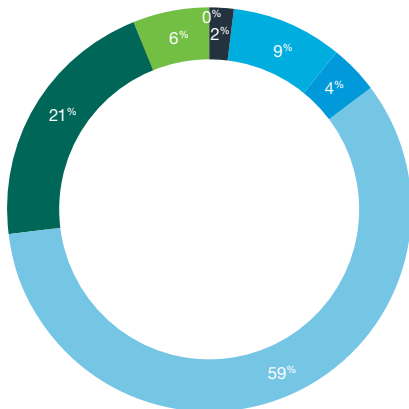


By region, UK/EU respondents were twice as likely to say that decreases were less than 25% compared to US respondents.



US respondents more likely to select increase

- Increased by 50% or more
- Increased by less than 50% but more than 25%
- Increased by less than 25%
- No Change
- Decreased by less than 25%
- Decreased by more than 25% but less than 50%
- Decreased by 50% or more



UK/EU respondents more likely to select decrease

- Increased by 50% or more
- Increased by less than 50% but more than 25%
- Increased by less than 25%
- No Change
- Decreased by less than 25%
- Decreased by more than 25% but less than 50%
- Decreased by 50% or more

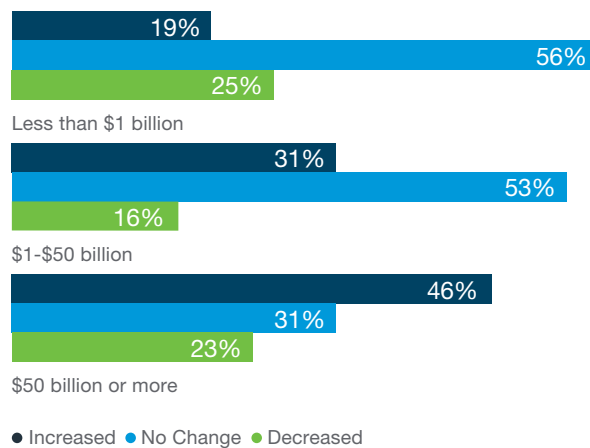
Investment Conditions and Considerations

By AUM, a majority of respondents with less than \$50B AUM said there was no change in their check size, and almost half (46%) of those with more than \$50B AUM said their check size had increased over the past twelve months.

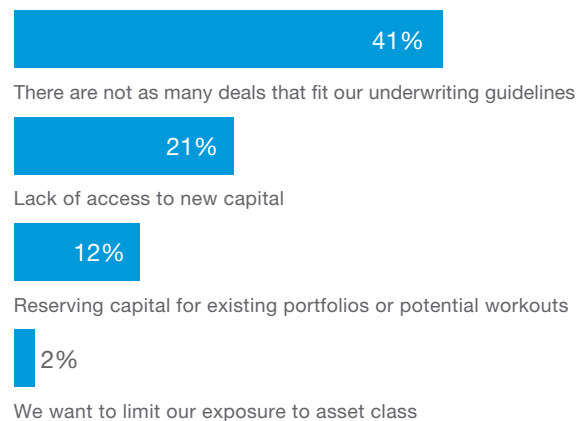
When asked for the reasons behind their answers about their check size, 41% of respondents said, “there are not as many deals that fit our underwriting guidelines,” while another 21% said it was “lack of access to new capital” that led to their answer.

Has the size of the check your firm is willing to write changed over the past 12 months?

US by AUM



Why has it increased/decreased or remained the same?



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Further, several respondents offered more detailed answers, depending on the movement of their check size:

Increased

"Access to new capital."

"Increase our influence with sponsors. Limit number of loans in the portfolio to concentrate on best opportunity."

"More access to capital from successful fundraising."

"Increased as we've raised incremental capital."

"Fewer high-quality opportunities and increasing comfort with economic outlook (interest rates and cost inflation plateauing)."

"Increased because we have raised new investment vehicles."

Decreased

"Fewer refinancings create less recycled capital."

"Increase diversity."

"We are seeking more diversification going forward."

"Finding more opportunities doing smaller originations."

"Increasing diversification."

No Change

"Appetite to invest... hasn't changed, credit parameters around investment situations have become more rigorous."

"Balance of quality vs capital inflow."

"No change in strategy, we continue to deploy as we have done so for the last 3-5 years."

"Relatively liquid balance sheet - no change in credit profile."

"Strategic decision to continue to focus on deals of a certain size."

"We increased deal size. At the same time, we reduced committed lines remaining undrawn."

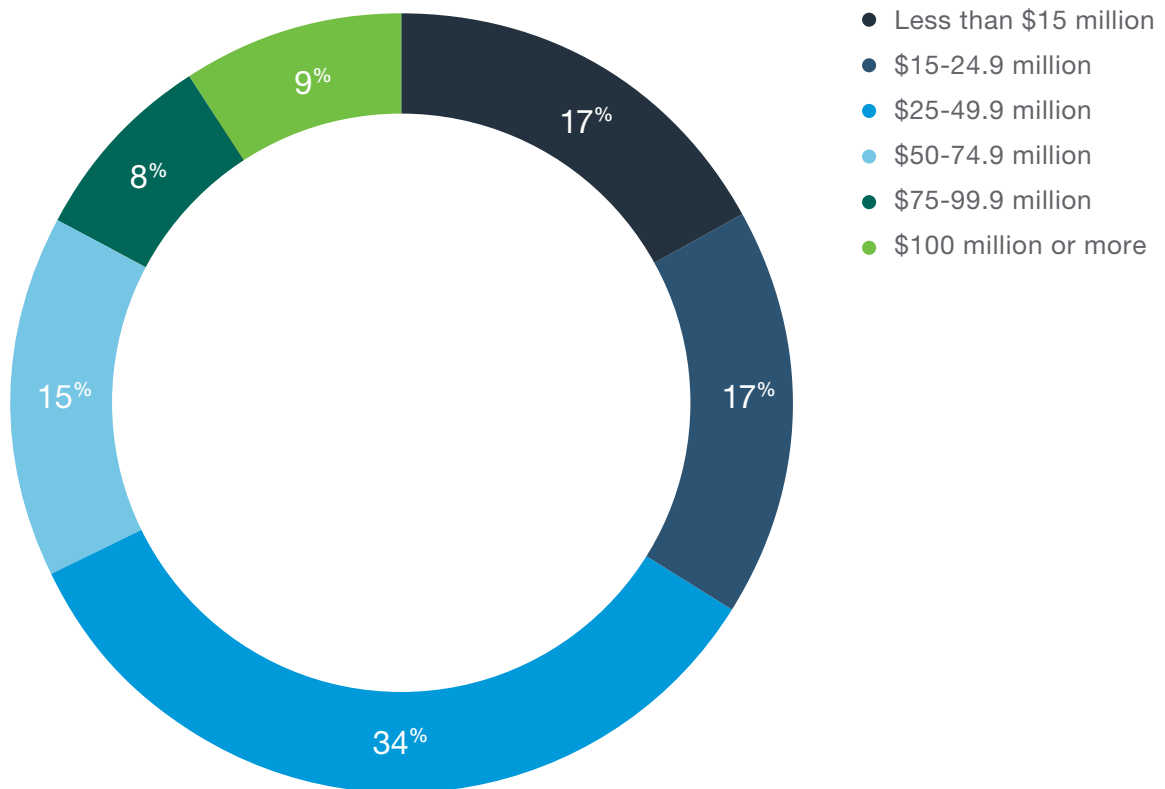
Investment Conditions and Considerations

EBITDA Profile of Borrowers

Overall, the most common average EBITDA of companies in respondents' portfolios was between \$25 million and \$50 million, with just more than one-third (34%) of lenders saying this is the average range for their investments. While still the most common EBITDA range, this was down slightly from last year when 38% of respondents cited this range.

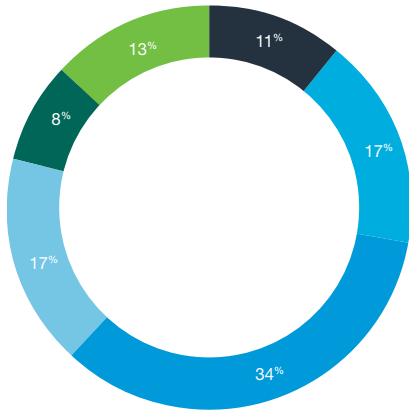
Almost as many (32%) said that the average EBITDA of companies in their portfolios was more than \$50 million this year, with 9% saying it was more than \$100 million.

What is the average EBITDA of companies in your portfolio?



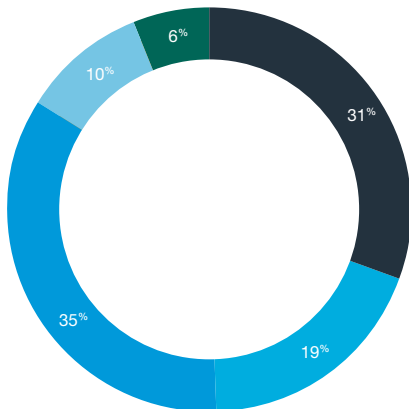
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By region, 28% of US respondents said the average EBITDA of the companies in their portfolio was less than \$25 million, 50% of UK/EU respondents said their portfolio companies' average EBITDA was less than €25 million.



US

- Less than \$15 million
- \$15-24.9 million
- \$25-49.9 million
- \$50-74.9 million
- \$75-99.9 million
- \$100 million or more



UK/EU

- Less than €15 million
- €15-24.9 million
- €25-49.9 million
- €50-74.9 million
- €75-99.9 million
- €100 million or more

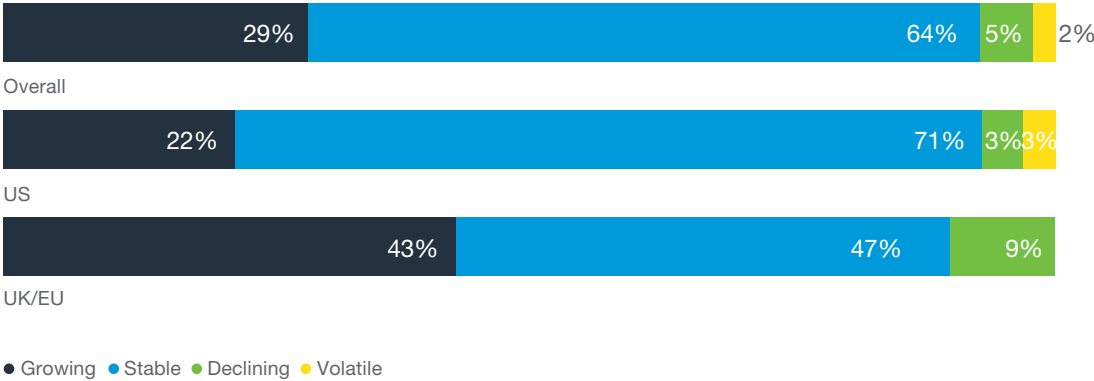
Investment Conditions and Considerations

Further, nearly two-thirds of overall respondents (64%) described EBITDA of their portfolio companies as *stable*; that description was much more prevalent among US respondents (71%) than among UK/EU respondents (47%). Overall, 29% of respondents described the EBITDA of their portfolio companies as *growing*.

Fully 93% of respondents overall said the EBITDA of their portfolio companies was either stable or growing, representing a slight elevation of the positive mood compared to last year, when 87% of respondents said this.

From the following options, how would you describe the EBITDA of your borrowers?

Majority describe their EBITDA as stable, but more from US than UK/EU



A number of respondents offered more detailed descriptions of their answers, whether they described the EBITDA of their portfolio companies as *stable* or *growing*:

Growing

"Average growth in EBITDA is around 12% on a year over year basis, including the impact of M&A strategies deployed by our portfolio."

"Resilient business in growing sectors."

"We are generally investing in larger borrowers than our historical norm."

"On a macro level, slowly growing, but underneath that, performance is more mixed by company, industry, sector."

"EBITDA continues to grow. EBITDA % has slightly compressed over the LTM period but appears to have stabilized."

Stable:

"There is a big mix."

"On average - stable and performing."

"Overall, our portfolio is stable, with little in the way of economic headwinds. At the same time, we are being cautious in this environment."

"Not hitting original projections, but not declining."

"There is more volatility in EBITDA but the average is still stable."

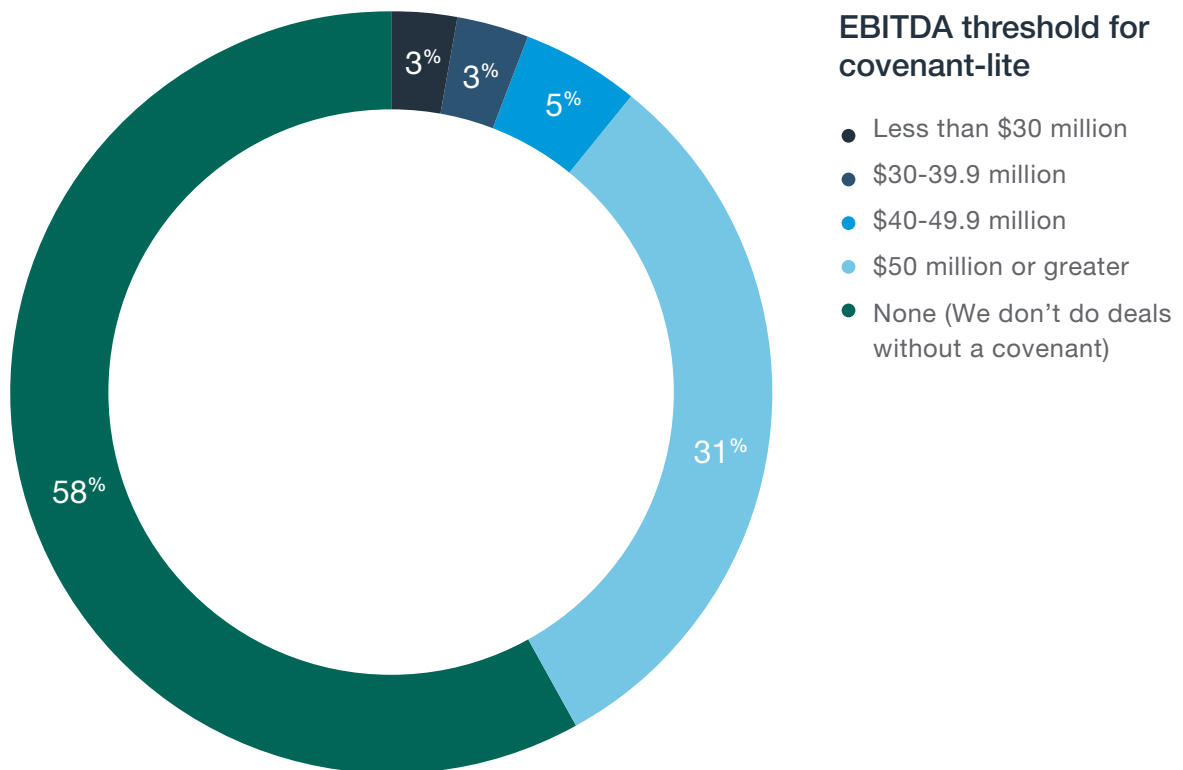
Investment Conditions and Considerations

Covenant-lite Transactions

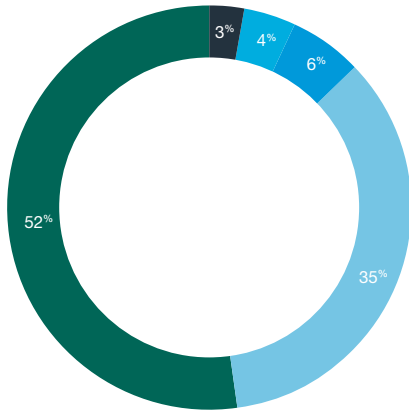
When asked at what EBITDA level lenders would consider a covenant-lite transaction, well more than half (58%) said they do not do deals without a covenant. This was up a bit from last year when 53% of lenders said the same thing.

For those lenders that would consider doing deals without a covenant, 31% said they would need the target company's EBITDA level to be more than \$50 million to make the deal happen.

At what EBITDA level would you consider a covenant-lite transaction?

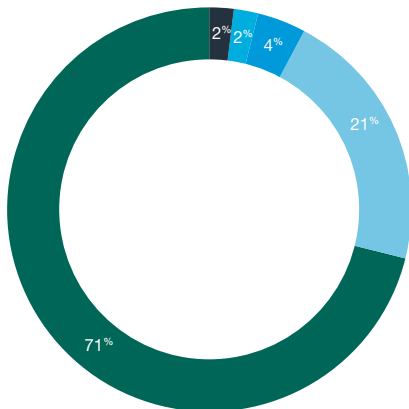


By region, lenders in the UK/EU region had a much higher portion (71%) of those that were unwilling to do deals without a covenant. However, in both regions, for those willing to consider doing deals without a covenant, both regions said they would need the target company's EBITDA level to be more than \$50 million or €50 million to make the deal happen.



EBITDA threshold for covenant-lite - US

- Less than \$30 million
- \$30-39.9 million
- \$40-49.9 million
- \$50 million or greater
- None (We don't do deals without a covenant)



EBITDA threshold for covenant-lite - UK/EU

- Less than €30 million
- €30-39.9 million
- €40-49.9 million
- €50 million or greater
- None (We don't do deals without a covenant)

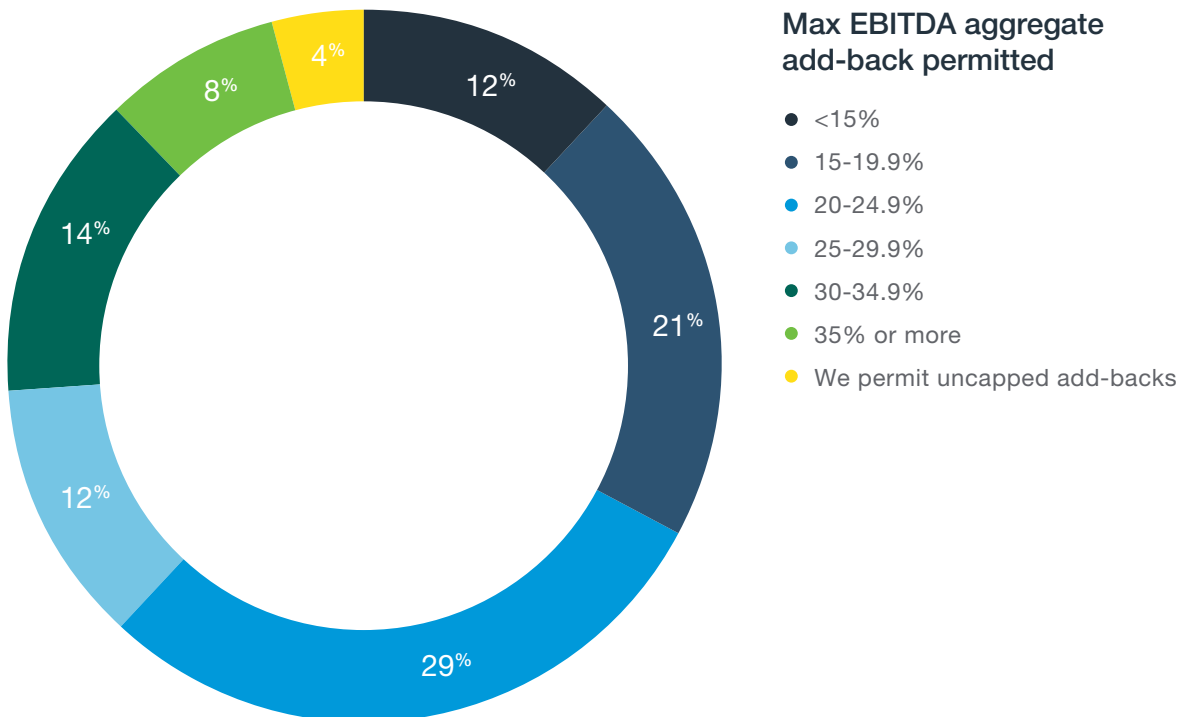
Investment Conditions and Considerations

EBITDA Add-Backs

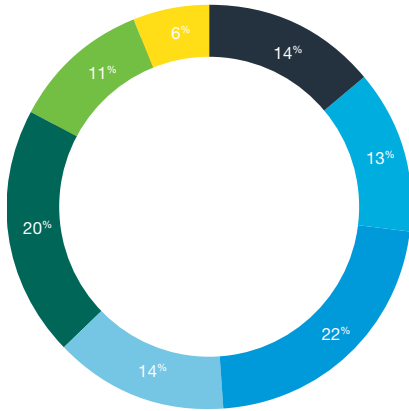
The percentage of lenders who said they would permit uncapped EBITDA add-backs remained relatively unchanged this year at 4%, compared to 3% in last year's report. However, this was still far below the 10% cited by respondents in 2022.

The most common maximum aggregate amount of EBITDA add-backs permitted by lenders was 20% to 24.9%, with 29% of lenders overall citing that category.

What is the maximum aggregate amount of EBITDA add-backs you will permit for your transactions?

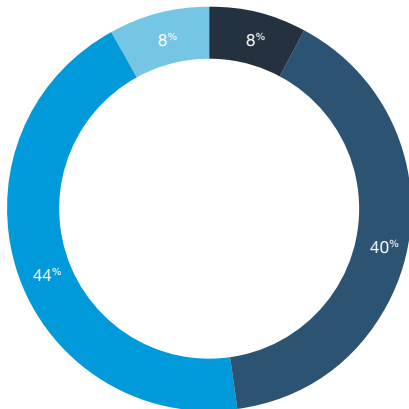


By region, the US showed a much higher risk tolerance with ranges as high as 35% or more, and 6% of US lenders saying they would permit uncapped add-backs. The UK/EU region, on the other hand, had no respondents willing to accept ranges higher than 29.9% or any uncapped add-backs.



Max EBITDA aggregate add-back permitted US

- <15%
- 15 - 19.9%
- 20 - 24.9%
- 25 - 29.9%
- 30 - 34.9%
- 35% or more
- We permit uncapped add-backs



Max EBITDA aggregate add-back permitted UK/EU

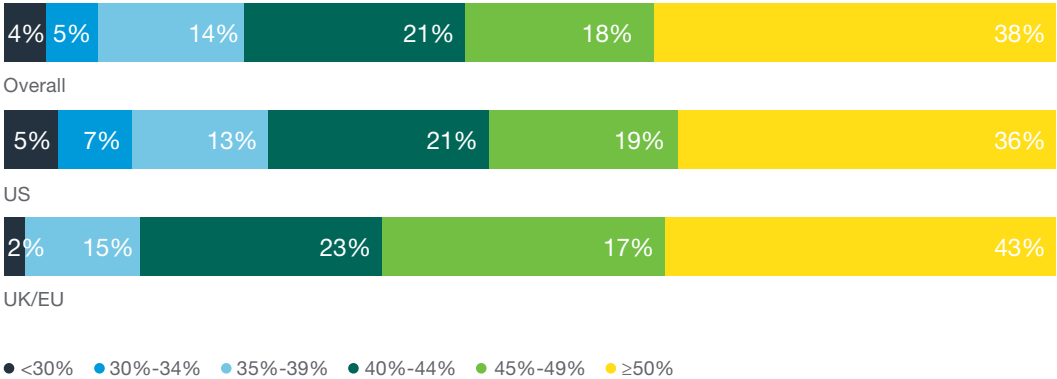
- <15%
- 15-19.9%
- 20-24.9%
- 25-29.9%

Investment Conditions and Considerations

Equity Contributions

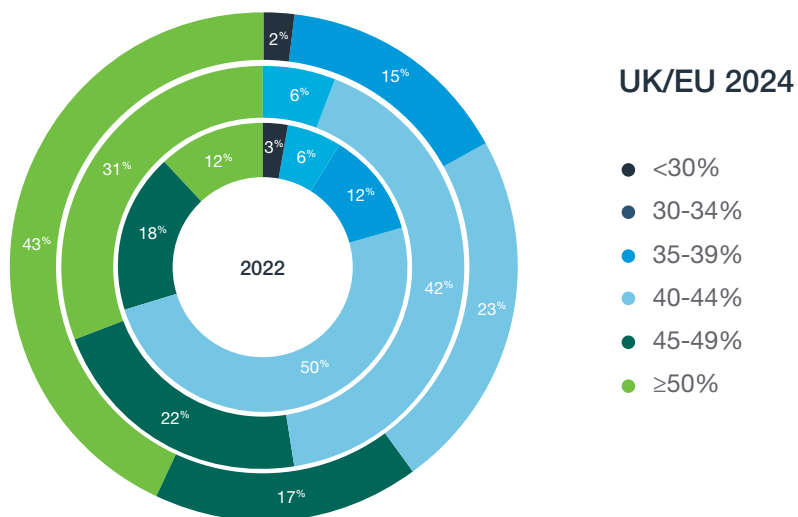
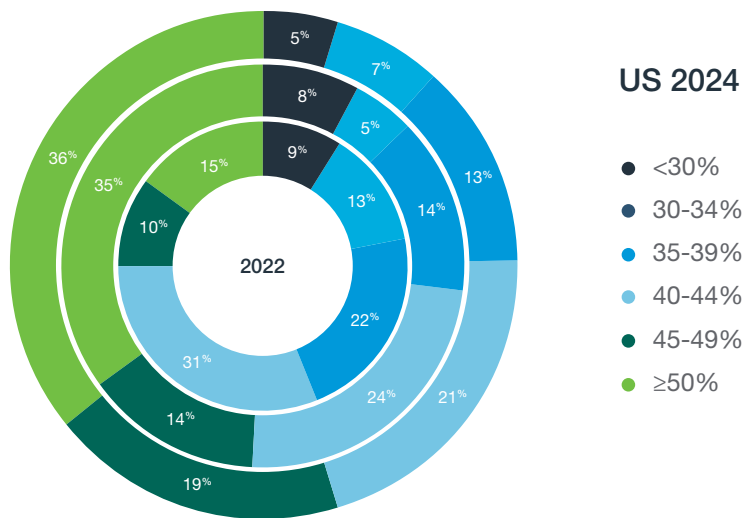
As for the percentage of equity required for a deal, overall and in both regions, the level most cited was more than 50%, with almost a large portion (43%) of UK/EU lenders requiring this level. While there was more harmony across US and UK/EU respondents than in previous years, one difference was that no UK/EU respondent selected the 30% to 34% range.

How much equity (on a % basis) does your organization typically require in your transactions?



US: ≥50%
and 45-49%
categories
increase; others
see slight
decreases

Looking over the past few years, we see that the percentage of respondents saying their organization typically requires 50% or more of equity has risen dramatically in both regions. Among US respondents, the portion grew to more than one-third (36%) this year, more than doubling the level of 15% in 2022. In the UK/EU region, it was even more pronounced with 43% saying their organization typically requires 50% or more of equity this year, compared to just 12% who said that in 2022.



UK/EU: Nothing
for 30%–34%
categories, but
large increase in
≥50% category,
compared to
previous year

Investment Conditions and Considerations

Geographic Investment

Overall, respondents ranked the UK among the top three jurisdictions in which both US and UK/EU firms expect to see the biggest growth opportunities in the coming 12 months. Respondents from both regions also expected to see growth opportunities in the US, but UK/EU respondents ranked that much lower than did their US counterparts.

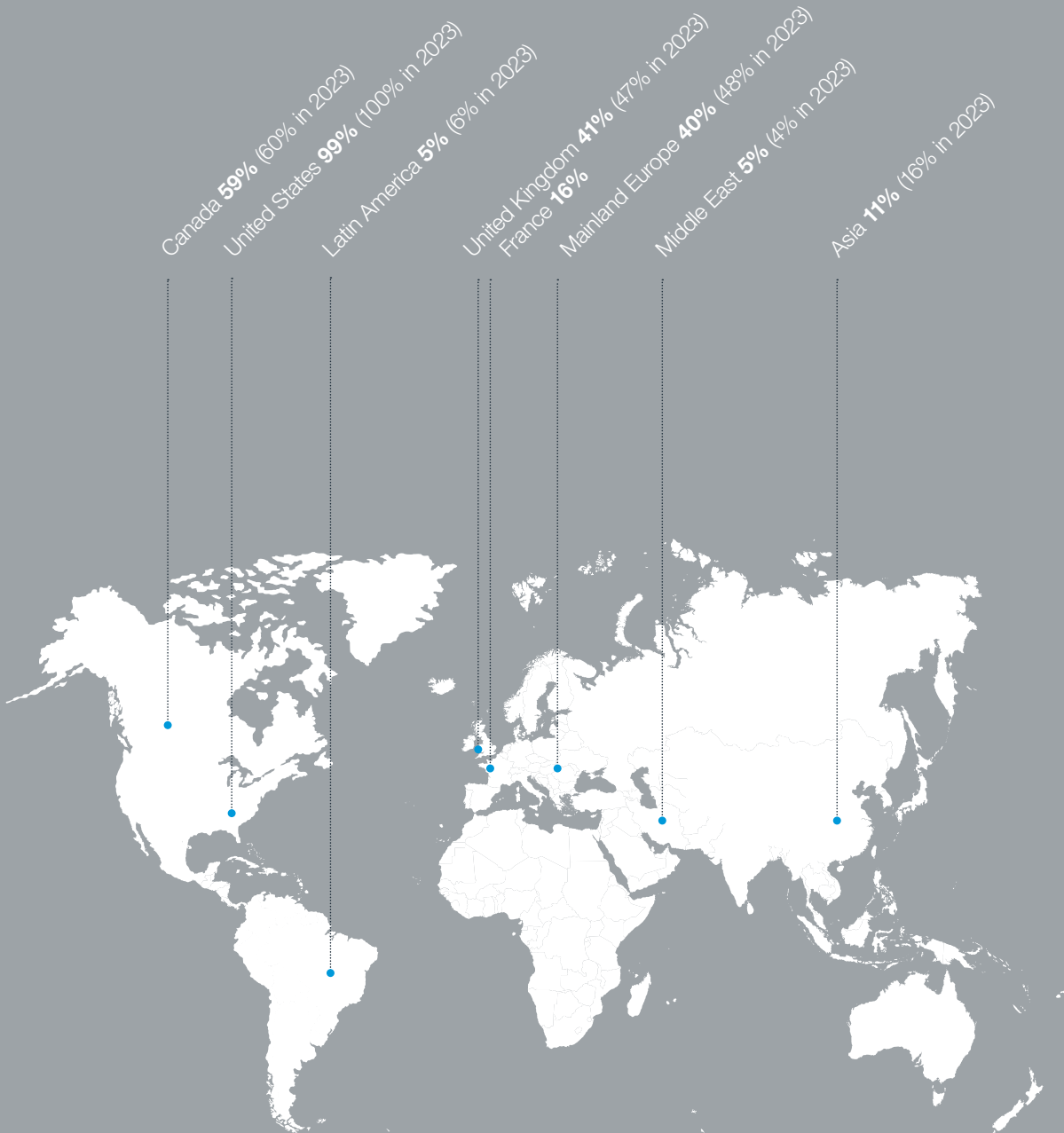
Geographic Investment-US

US firms expect to see their biggest growth opportunities domestically, in the UK and in Canada. Almost all US respondents (99%) said their organization is considering investing in the US in the coming year, although percentages were lower across the globe in all regions except the Middle East.

Biggest growth opportunities for your firm over the next 12 months

US	97%	Middle East	4%
UK	35%	France	3%
Canada	34%	DACH	3%
Asia	11%	Latin America	2%
Southern Europe	9%	Eastern Europe	1%
Other Europe	5%	Other	1%

Which locations are your organization considering investing in over the next 12 months?



Investment Conditions and Considerations

Geographic Investment-UK/EU

Respondents from firms in the UK/EU region expect to see their biggest growth opportunities domestically, in the DACH (Germany, Austria and Switzerland) region, and to a lesser extent in France⁵ and the US. Like with US firms, the percentages of those UK/EU firms considering investing in certain regions were lower across the globe in all regions except the Middle East and Latin America.

5. This was the first time France was included as a category, so there is no year-to-year comparison.

Biggest growth opportunities for your firm over the next 12 months

DACH	62%	Eastern Europe	10%
UK	62%	Asia	10%
France	46%	Middle East	0%
US	40%	Latin America	0%
Southern Europe	27%	Canada	0%
Other Europe	17%	Other	0%

Which locations are your organization considering investing in over the next 12 months?



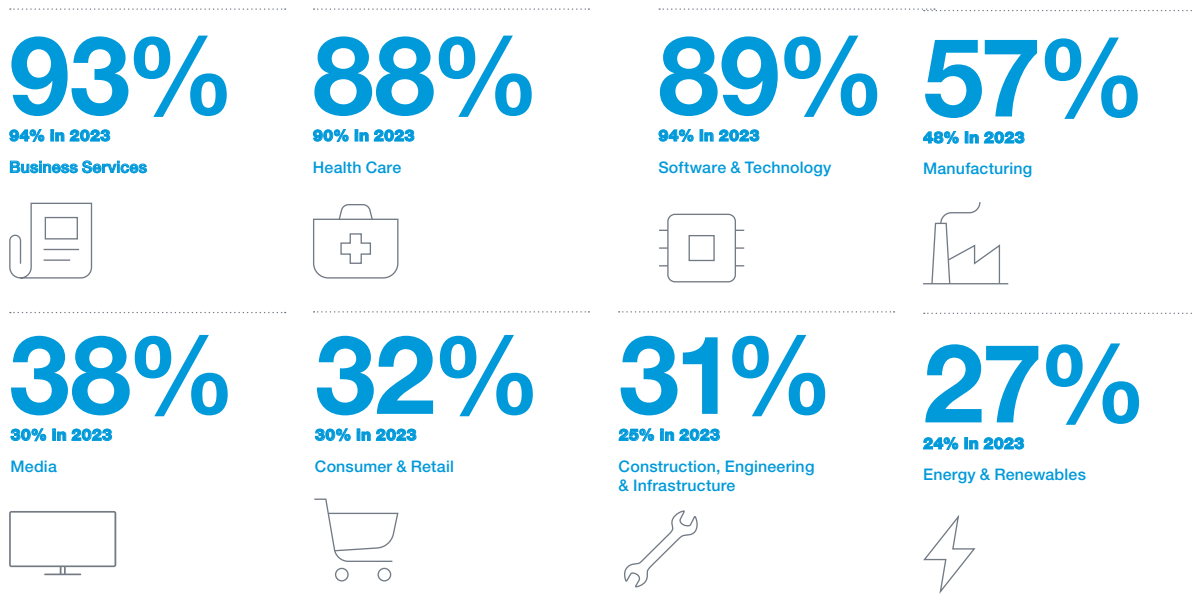
Investment Conditions and Considerations

Industry Investment

Interest or consideration to invest in most industries (8 out of 14) has fallen compared to last year. In fact, the only industries that saw interest or consideration to invest increase compared to last year were Manufacturing, Media, Consumer/Retail, Construction, Energy and Other, with Manufacturing and Media showing the largest increases.

By region, respondents in the UK/EU are significantly more likely to be considering investing in Healthcare and Education compared to their US counterparts, but are significantly less likely to show interest or consideration for investment in the Consumer/Retail, Construction, Real Estate and Transportation industries.

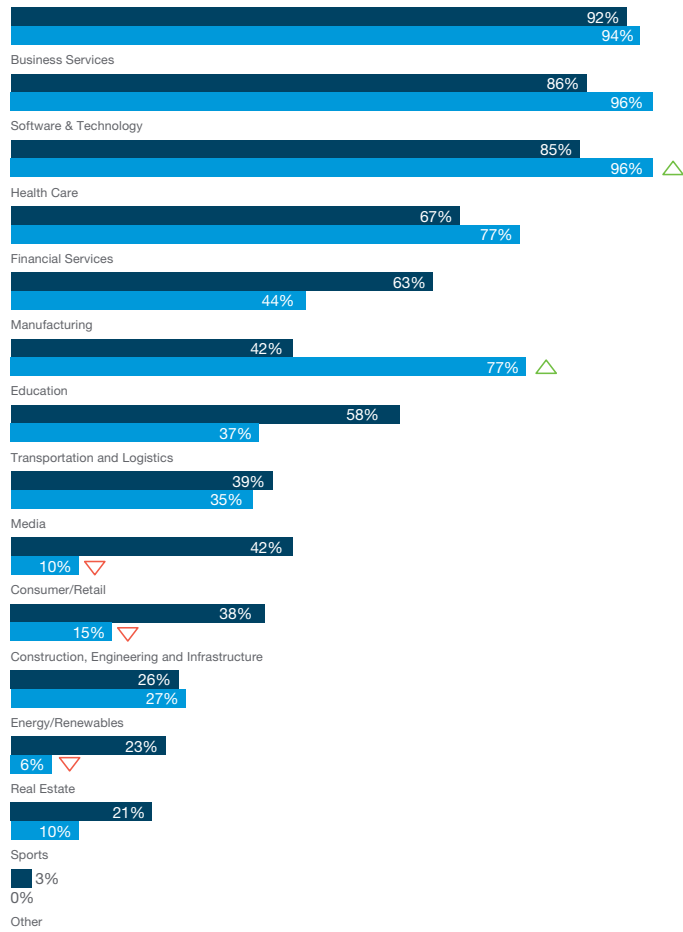
In which industries is your organization interested in/considering investing in over the next 12 months?



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In which industries is your organization interested in/considering investing in over the next 12 months?

Significant difference between AUM groups and overall = ▽ ▲



● US ● UK/EU

Significant difference between regions = ▽ ▲

51%

52% In 2023

Transport & Logistics



53%

59% In 2023

Education



70%

71% In 2023

Financial Services



18%

19% In 2023

Real Estate



18%

21% In 2023

Sports



2%

1% In 2023

Other

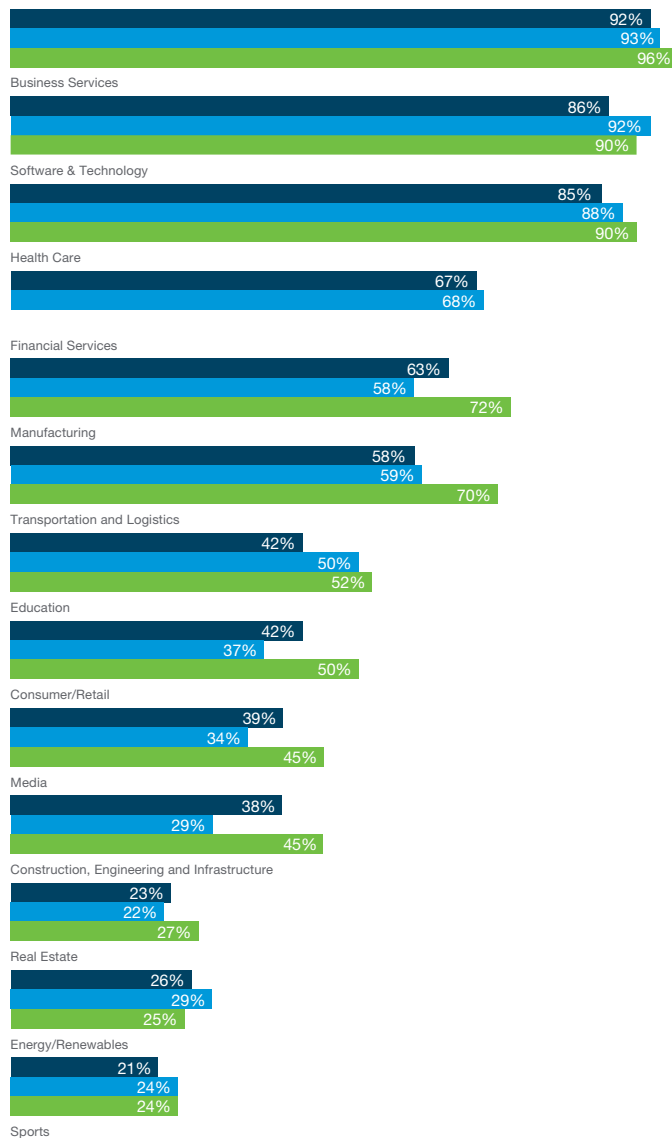


Investment Conditions and Considerations

Year-to-year, interest or consideration for investment by US firms decreased in more than half of the industries, compared to last year. Interest or consideration for investment only increased in the Consumer/Retail, Media, Construction, Engineering & Infrastructure, Real Estate and Manufacturing industries.

In which industries is your organization interested in/considering investing in over the next 12 months?

US 2024 v 2023 v 2022

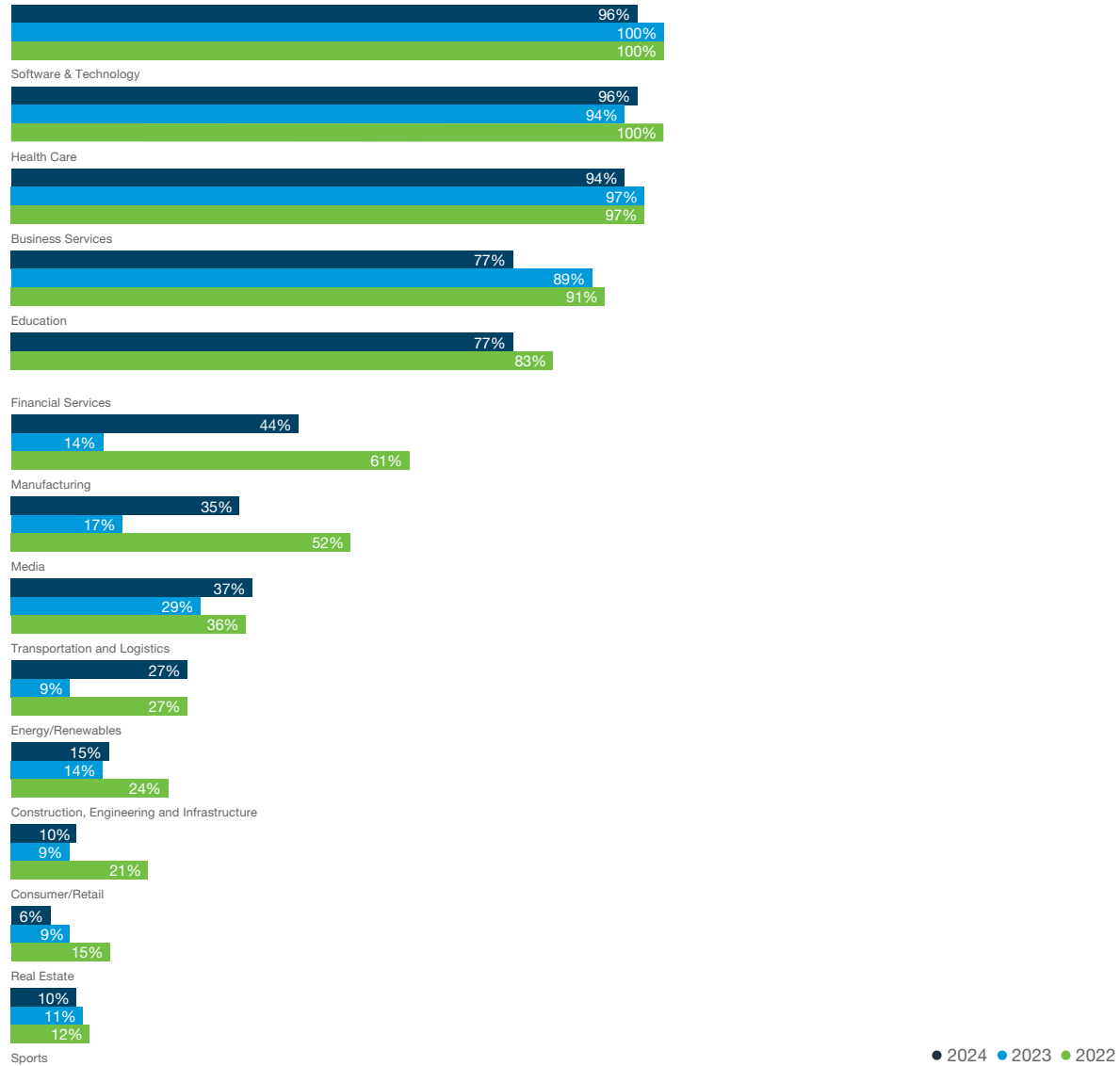


● 2024 ● 2023 ● 2022

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Among UK/EU firms, year to year, there were large increases in interest or consideration for investment compared to last year in industries such as Manufacturing, Media and Energy/Renewables, while Construction, Healthcare and Consumer/Retail also had slight increases in interest or consideration for investment.

UK/EU 2024 v 2023 v 2022



Investment Conditions and Considerations

Fundraising

In our survey, nearly all respondents (91%) said their firms were engaged in fundraising plans for 2024, and 84% said they were currently raising a debt fund. Both of these figures are up slightly from last year. In fact, interest in raising a debt fund continued a multi-year rise since 2021, and interest in fundraising generally showed that over the past five years, more than 90% of respondents have had plans to fundraise.

Both of these data points indicate that a return of more confident activity continues to grow, albeit slowly, in the post-pandemic era.

Is your organization currently raising a debt fund?

Investment Plans



Does your firm have plans to fundraise
in the next 12 months?

Investment Plans



Fundraising

● Yes ● No

Investment Conditions and Considerations

By region, consideration among US firms to raise debt funds and fundraise generally has increased slightly compared to last year, while consideration among UK/EU firms to raise debt funds and fundraising has slightly fallen.

Investment Plans

US 2024 v 2023

2024



Currently raising a debt fund?



Plans to fundraise?

2023



Currently raising a debt fund?



Plans to fundraise?

● Yes ● No

Investment Plans

UK/EU 2024 v 2023

2024



Currently raising a debt fund?



Plans to fundraise?

2023



Currently raising a debt fund?



Plans to fundraise?

● Yes ● No

Market Predictions

Looking Forward

Respondents also shared their predictions for the private credit market and the overall global economic outlook, underscoring again this year a slightly cautious—though not calamitous—viewpoint of the coming year and beyond.

Key insights included:

- Loan documentation expectations are mixed between more favorable, less favorable and about the same.
- Respondents expected positive deal activity on balance, as 80% said they expect deal activity to be more active than last year.
- Economic outlook/market conditions were the top factor behind increased and decreased deal activity, but interest rates are the main factor behind remaining the same.
- Sponsors seeking realizations ranked first as the most important challenge for lenders, and it also had the most overall rankings.
- Lack of alignment on purchase price between buyers and sellers was ranked as the biggest challenge for dealmakers in the US, but lack of quality assets in the market is the biggest challenge for UK/EU respondents.
- Almost all US firms consider investing in the US, and almost all UK/EU consider investing in Europe. Consideration to invest in the Middle East has increased compared to last year.
- US, UK and Canada are the top three jurisdictions in which respondents foresee the biggest growth opportunities, but DACH is the top jurisdiction for UK/EU respondents.
- Interest/consideration to invest in most industries (8 out of 14) has fallen slightly compared to last year.
- Lower pricing and more defaults are expected than in the previous 12 months.
- Majority report that less than 2.5% of their portfolio is in default, but 2.5% to 4.9% category has seen an increase this year in the UK/EU.
- More than two-thirds have less than 1% of their loan portfolio on non-accrual.
- Allowance of add backs to EBITDA is considered the greatest risk to lenders.
- Large majority are raising debt funds and have plans to fundraise.
- More than two-thirds (67%) have fund-level leverage facilities, and 85% of them employ less than 1.5-times leverage.

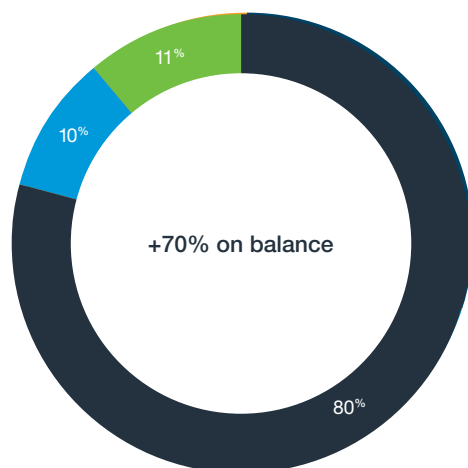
Indeed, in several areas, lenders dialed back their concerns that were exhibited so prominently last year. For example, a large percentage of respondents (80%) said they expect to see deal activity increase in the market over the next 12 months, compared to 10% that say they expect decreased deal activity. This makes for a +70-net-percentage favorability leaning toward *increased* deal activity, compared to a -27-net-percentage favorability noted last year, with 55% saying they expect decreased deal activity and 28% saying they expect increased activity.

Clearly, this illustrates a massive pendulum swing toward more positive perspective on deal making in the coming year.

What are your expectations for deal activity in the market over the next 12 months?

Why do you think deal activity will increase/decrease or remain the same?

Increased activity	%
Economic outlook/ market conditions	23%
Availability/amount of capital	20%
M&A activity	19%
Dry powder levels	13%



Remain the same	%
Interest rates	40%
Economic outlook/ market conditions	20%
M&A activity	13%
Buyer & seller gap	13%
Lack of quality deals	13%

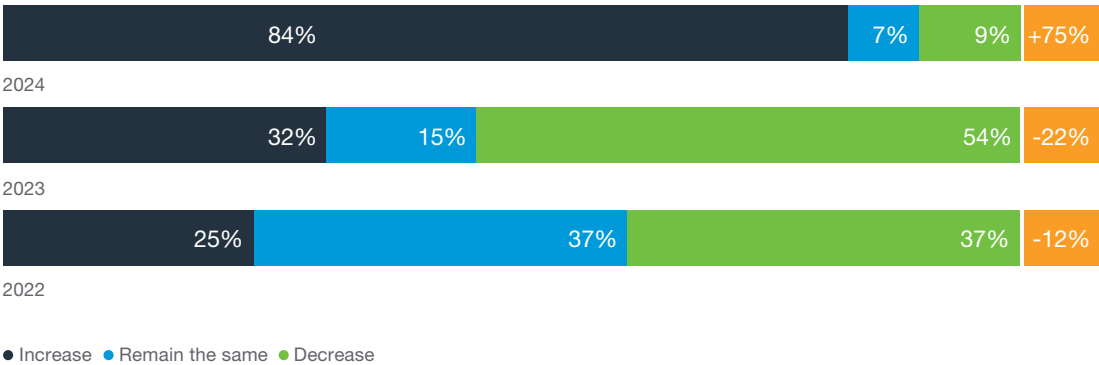
Decreased activity	%
Economic outlook / market conditions	60%
Stage of economic cycle	20%

Predictions of deal activity have swung dramatically to expectations of increased activity this year compared to previous years

Market Predictions

What are your expectations for deal activity in the market over the next 12 months?

US 2024 v 2023 v 2022



Increased activity	%
Economic outlook/ market conditions	24%
Availability/amount of capital	21%
M&A activity	20%
Dry powder levels	13%

Remain the same	%
Interest rates	38%

Decreased activity	%
Economic outlook/ market conditions	40%
Stage of economic cycle	20%
Deal activity	20%
M&A activity	20%

Among US respondents, this more positive outlook was also reflected.

Increased deal activity

"Better sentiment on the economy will drive more deal flow."

"People realizing this is the new interest rate environment for the foreseeable future and sellers realizing that leverage multiples have also come down for the foreseeable future."

"Significant capital has been raised and that money has to be invested. Also, sellers will begin to decrease valuation expectations."

"Increased confidence in relation to the macroeconomic outlook, combined with increased pressure on PE firms to deploy funds."

"More visibility on economic cycle. Stable interest rate environment."

"Pent up demand that was put on hold by a rising rate environment; even a stable high-rate environment should begin to produce more new issues."

"Private Equity firms are going to need to realize their investments at some point for their LPs. Similarly, private credit shops are going to need to pick up on capital deployments to meet goals set for their own LPs."

"Pressures to deploy capital and recalibration of purchase price multiple expectations."

"As markets begin to stabilize following the volatility in the broader economy over the last 12-18 months."

"Sponsor capitulation to market dynamics. Maturity windows approaching. Increased restructuring/workout activity."

"Been suppressed for past 12 months and believe it will normalize in next 12 months."

"Dry powder sitting on the sidelines, more certainty about the economy (though still uncertain, more known than 6-12 months ago)."

"Valuation gap normalizing, pent-up M&A demand."

"Last 12 months have been fairly slow and we are seeing an uptick in new opportunities recently. That coupled with a lot of capital seeking deals."

"Capital raised in PE and LP pressure for returns."

"Economic activity and impact of a soft landing from rising interest rates."

"Maturities combined with rising costs of capital and higher costs to grow."

"i) 2017-2018 wave of refis begins. ii) broken capital structures iii) need for capex and/or M&A capital."

"Rates will come down and there will be more lending."

"Exit environment will pick back up."

"High dry powder and pressure to exit for PEs will force price expectations to align and transactions to go ahead."

"i) Banks are hungry for deal making. ii) High interest rates are stabilizing hence making valuations easier and reducing gap between buyers and sellers and iii) Sponsors needing to return money to LPs will need to realize some value."

Proskauer Trends in Private Credit

Those who said they expect decreased deal activity (10) or expected no change in deal activity (15) offered their reasons. And although no consensus was reached, many mentioned interest rate increase concerns as a prime reason for their viewpoint.

Decreased deal activity

"Reduced pressure on GPs and increased sensitivity to macro risks."

"The consumer has not borne the brunt of higher rates (e.g., auto insurance continues to increase given lags in car price increases from years ago) and volatile fuel prices; as they burn through excess savings, expect continued softness in multiple consumer categories and then B2B categories (e.g., continued car discounting), which compounded with continued high rates, could create a vacuum of muted activity."

"Sponsors holding assets for longer, less PE sales processes and increasing number of troubled situations."

"Poor/uncertain macro environment; high cost of debt; sellers still want full PPM's."

"Deal volume decline - more stress on assets. Still an EV gap from sellers/buyers."

"Worsening market conditions and increasing defaults as impact of higher interest rates is absorbed."

"Valuation bridge still wide."

"Lower M&A activity."

"Less assets coming to the market; limited dry powder; portfolio management."

"Risk of recession and bid-ask spread."

No change

"Current pipeline ."

"Buyer and seller expectation gap has yet to narrow and there is nothing to suggests this will do so quickly."

"Not enough attractive, underwritable deals in the market."

"Demand and supply factors have not changed materially at the end of the market that we play in."

"We have a plan."

"Base rates and economy are depressing deal volumes."

"Interest rates high, macro-outlook uncertain."

"No impetus for interest rates (i.e., cost of capital) to decline."

"Rates stabilization."

"Macro and valuation pressures."

"Similar climate where banks continue not to lend like they used to."

"High rates and stagnant M&A markets."

"Bid/ask spread between buyers and sellers."

"No changes to the rate policies and M&A volumes (low multiples and FY23 declined in current trading)."

"General economy and difficult fundraising environment."

Market Predictions

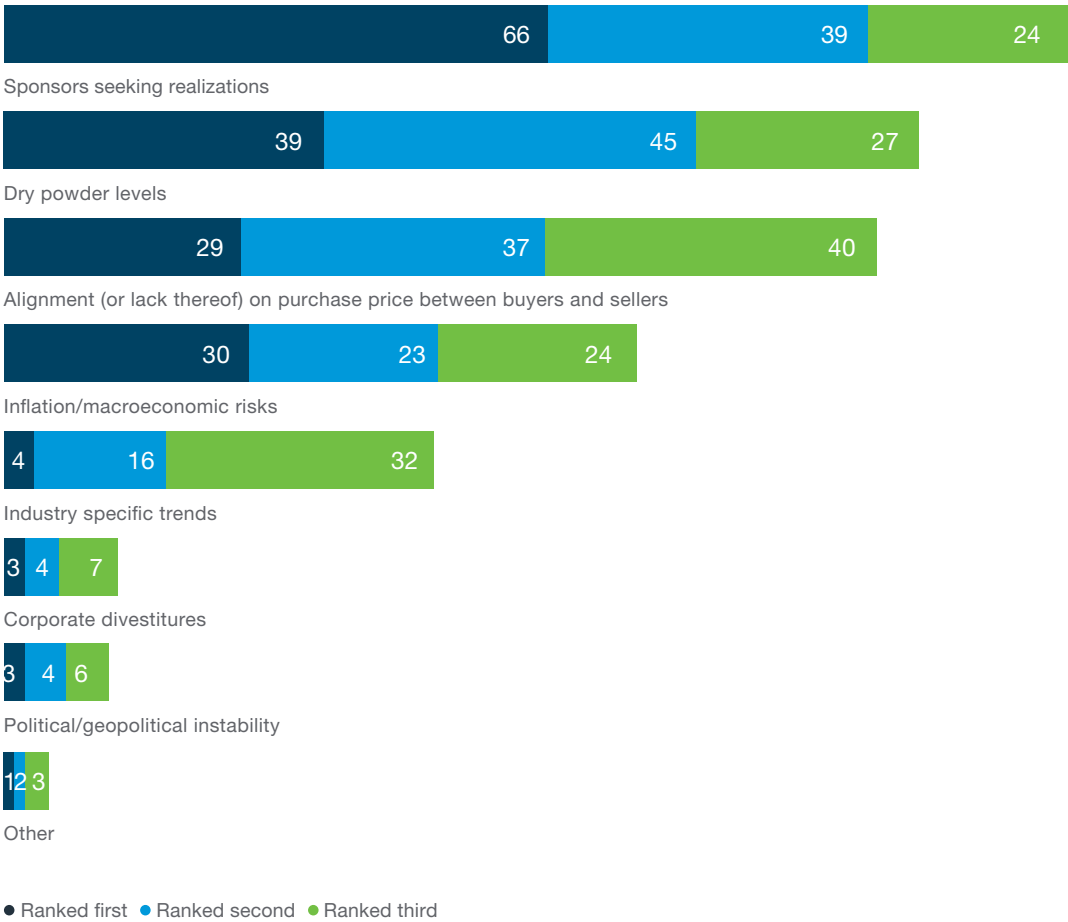
Drivers of Deal Flow

We asked respondents to select from a list the three most important drivers of deal flow over the next 12 months and then to rank the drivers in order of importance. Respondents most commonly ranked *Sponsors seeking realizations* as the most important, with 66% of respondent ranking that category first. *Sponsors seeking realizations* also had the most overall rankings. Also, *Dry powder levels* had the second-most overall rankings as a driver of deal flow and also was second-ranked (39%) as the most important driver of deal flow.

Last year, however, respondents had a much more dour outlook, ranking *Inflation/macroeconomic risks* as the most important driver of deal flow with more than two-thirds of respondents (67%) saying that. This year, that category ranked fourth.

What do you expect to be the most important driver of deal flow in the next 12 months?

Overall – Sorted by overall rankings



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Regionally, both the US and UK/EU views generally reflected the overall assessment of what factors were driving deal flow.

US respondents cite sponsors seeking realizations as most important

US respondents – sorted by overall rankings



Sponsors seeking realizations



Dry powder levels



Alignment (or lack thereof) on purchase price between buyers and sellers



Inflation/macroeconomic risks



Industry specific trends



Corporate divestitures



Political/geopolitical instability



Other



UK/EU respondents rank sponsors seeking realizations as most important and most overall rankings

UK/EU respondents – sorted by overall rankings



Sponsors seeking realizations



Dry powder levels



Alignment (or lack thereof) on purchase price between buyers and sellers



Inflation/macroeconomic risks



Industry specific trends



Political/geopolitical instability



Corporate divestitures

- Ranked first
- Ranked second
- Ranked third

Market Predictions

Challenges For Dealmakers

When asked what challenges they see as their largest concern over the next 12 months, more than one-third of dealmakers cited *Inflation/macroeconomic risks* as one of their top challenges. That category also got more votes (ranked 1st, 2nd or 3rd) than any other challenge, although just barely.

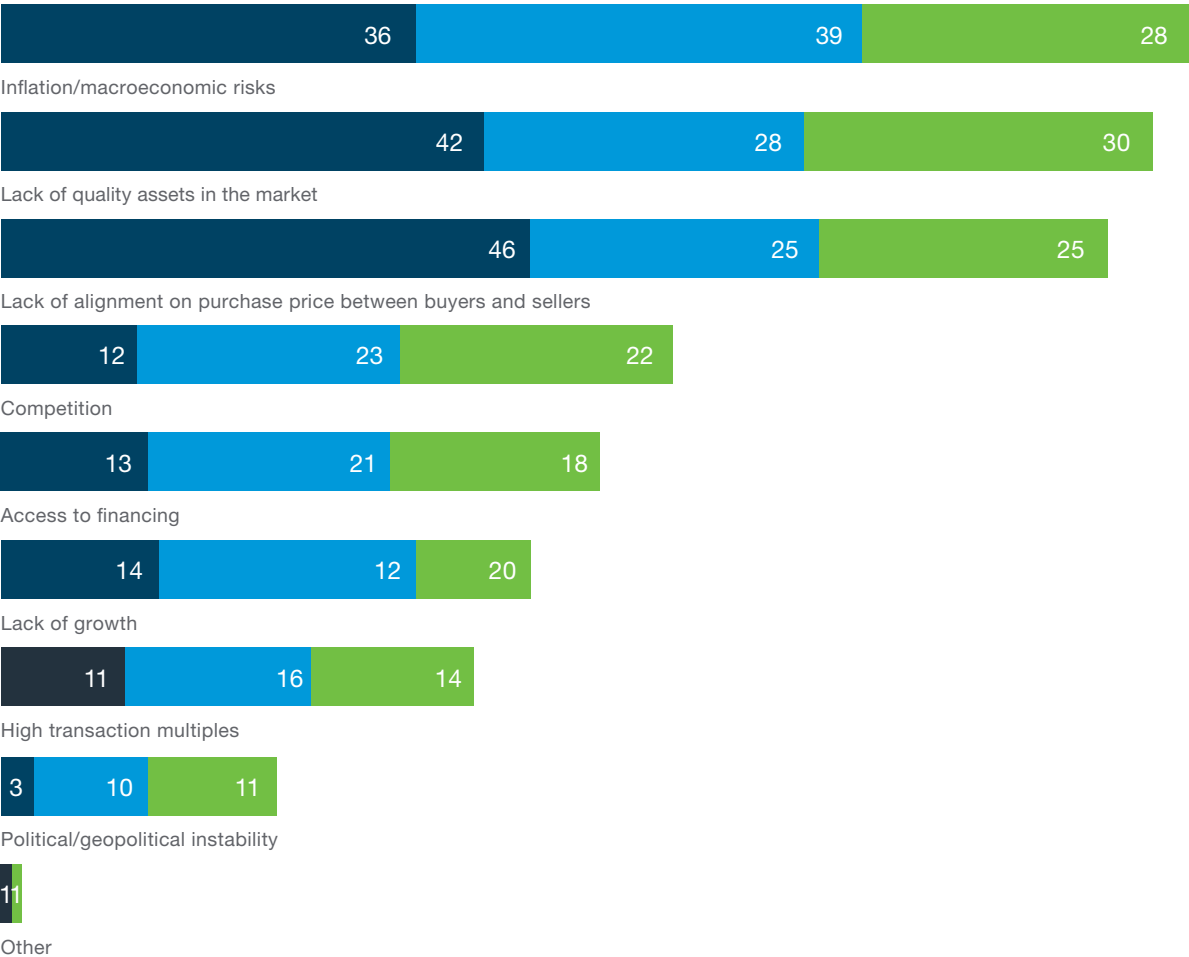
Yet, two other factors—*Lack of alignment on purchase price between buyers and sellers* and *Lack of quality assets in the market*—were more frequently ranked most important by 46% and 42% of respondents, respectively.

Interestingly, *Access to financing* was the second category cited as the biggest challenge last year, with more than one-third of respondents (34%) ranking it first. This year, that category dropped to fifth place, with just 13% of respondents ranking it as the top challenge.

What do you anticipate to be the biggest challenge for dealmakers in the next 12 months?

Overall - Sorted by overall rankings

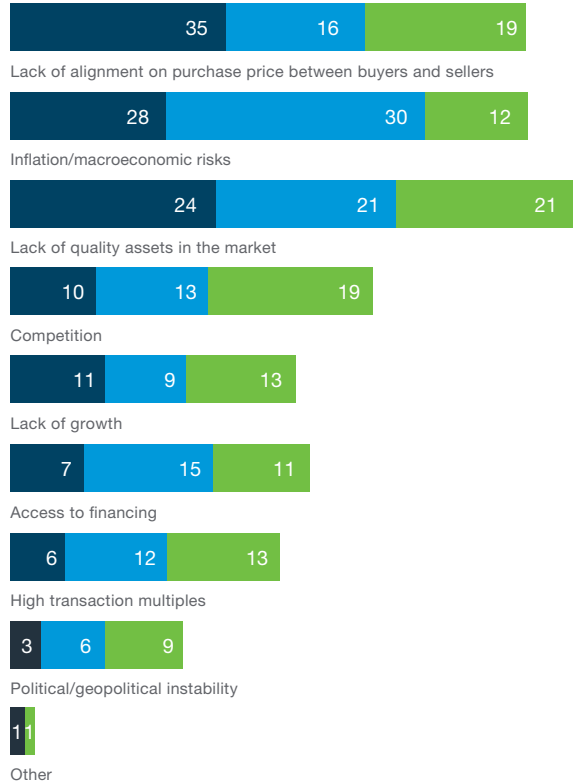
Inflation/macroeconomic risks most ranked overall



Regionally, there was some shuffling of the top three categories. US respondents cited *Lack of alignment on purchase price between buyers and sellers* as their biggest challenge, and UK/EU respondents cited *Lack of quality assets* as their biggest challenge.

What do you anticipate to be the biggest challenge for dealmakers in the next 12 months?

US respondents



UK/EU respondents



● Ranked first ● Ranked second ● Ranked third

US respondents
leaned slightly
toward
documentation
becoming more
favorable to
borrowers

Market Predictions

Document Favorability

Overall, respondents said they believe documentation will become mixed over the next 12 months, with almost the same percentage saying it will become *more* favorable to borrowers as those who said it will stay the same.

This marks an improvement from last year, when almost two-thirds (63%) said documentation would become *less* favorable to borrowers. Just 28% said that this year.

Do you expect loan documentation to become more or less borrower-favorable over the next 12 months?

Overall



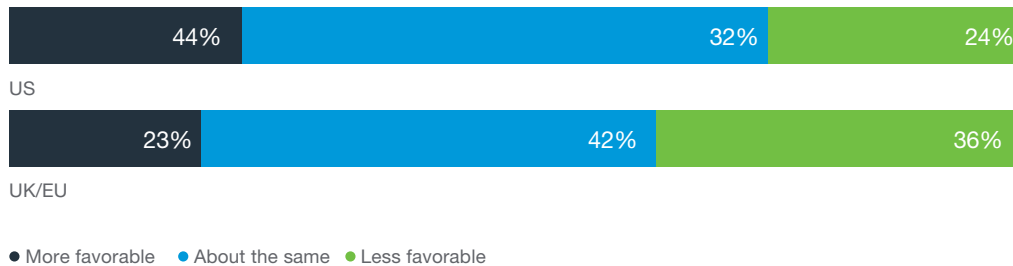
Documentation favorability

● More favorable ● About the same ● Less favorable

Regionally, US respondents leaned slightly toward documentation becoming more favorable to borrowers (44%), while the largest portion of UK/EU respondents (42%) saw documentation staying about the same.

Has loan documentation become more or less favorable?

US v UK/EU



Market Predictions

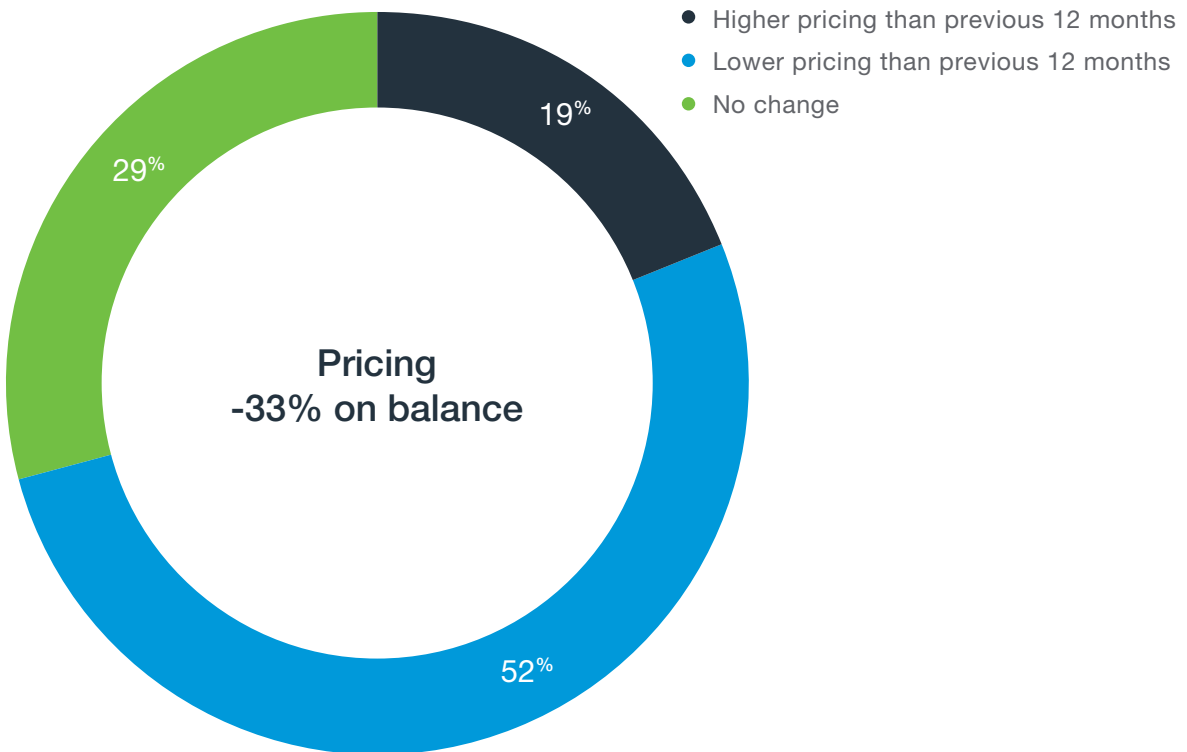
Pricing Predictions

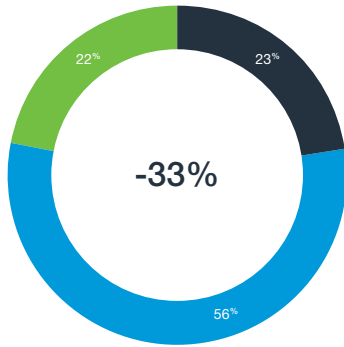
More than half of respondents (52%) overall said they expect lower pricing than in the past 12 months, which means on balance, about one-third of respondents (33%) are expecting lower pricing.

That's a big shift from last year, when more than three-quarters (77%) of respondents said they expect *higher* pricing, and on balance, more than half of all respondents indicated they were expecting higher pricing.

Interestingly, this shift may mean that many respondents think the immediate threats of recession are lifting.

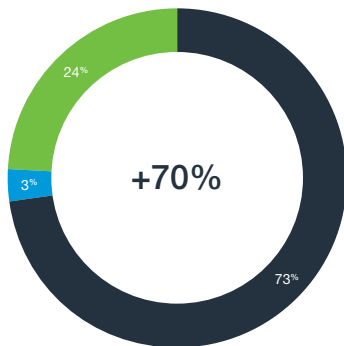
What are your expectations for pricing over the next 12 months?





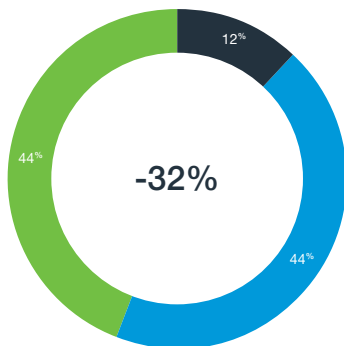
2024 US Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change



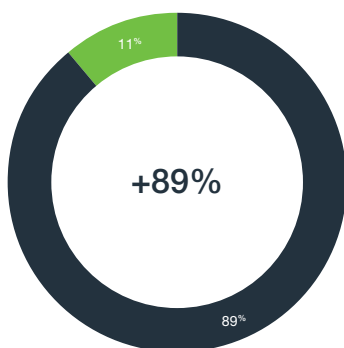
2023 US Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change



2024 UK/EU Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change



2023 UK/EU Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change

Market Predictions

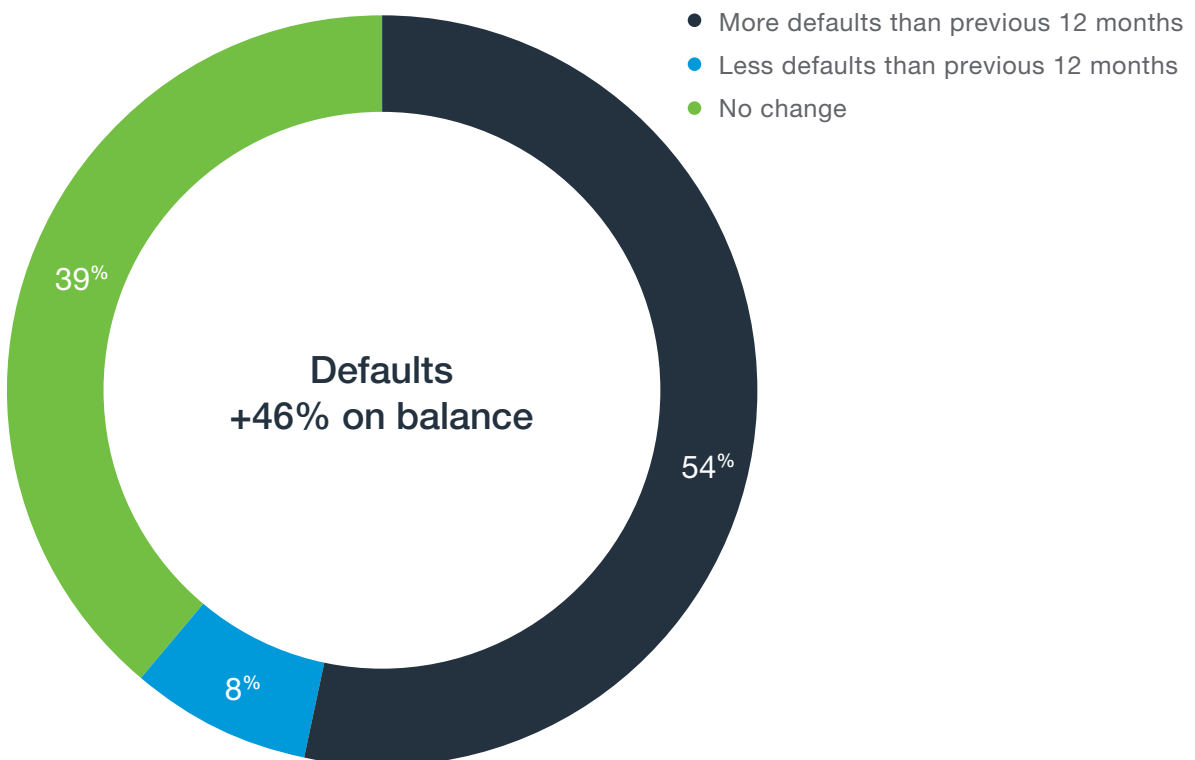
Default Expectations

More than half of all respondents (54%) said they expected more defaults over the next 12 months. Only 8% said they expected fewer defaults, meaning that on balance, almost half of respondents (46%) indicated they expect more defaults over the next 12 months.

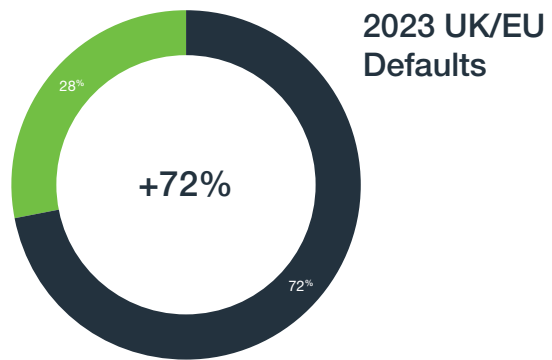
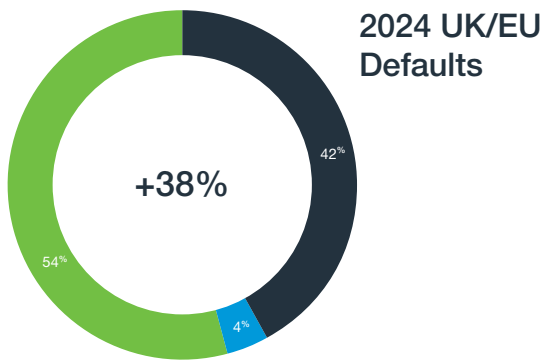
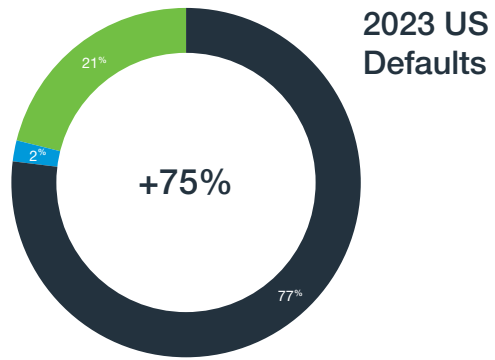
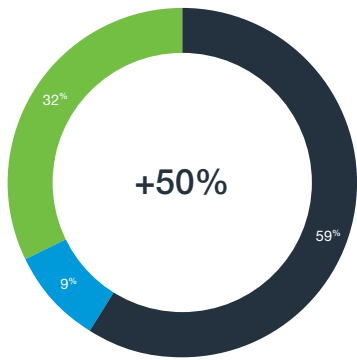
This again may represent an easing of concerns compared to last year, as then more than 75% of respondents said they expect more defaults in their portfolio over the ensuing 12 months.

The overall default rate of the 1,002 loans included in the Proskauer Private Credit Default Index was 1.6% in the fourth quarter of 2023, an increase from 1.41% in the third quarter of 2023.

What are your expectations for your portfolio over the next 12 months?



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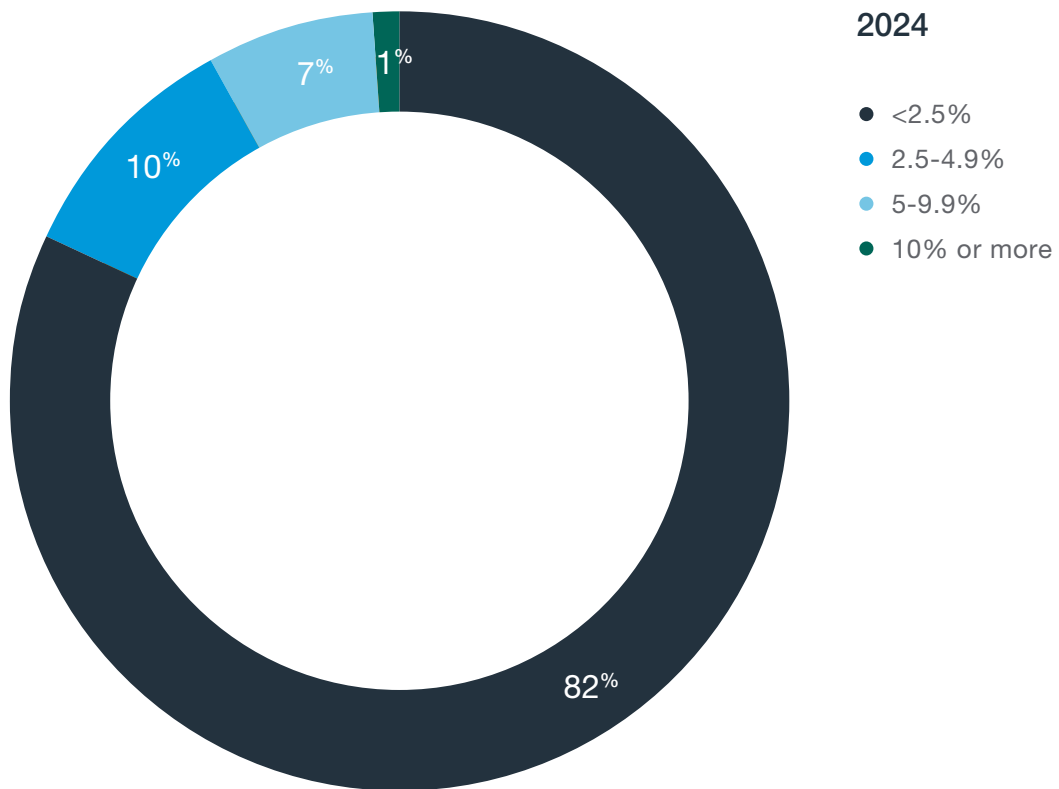
- More defaults than previous 12 months
- Less defaults than previous 12 months
- No change

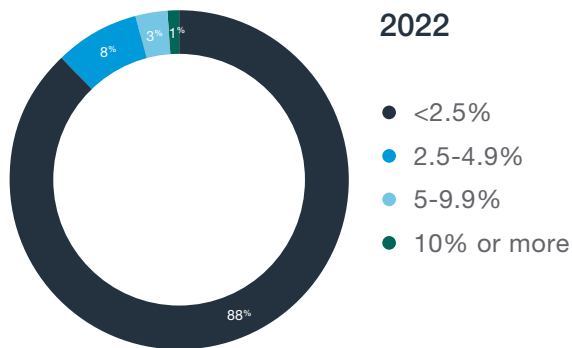
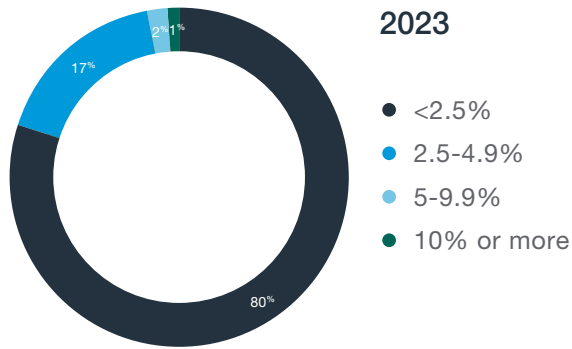
Market Predictions

And like last year, a portion of respondents this year (18%) said that 2.5% or more of their portfolio already is in default. This percentage was down slightly from last year but was well above the percentage of respondents seeing default in 2022.

What percentage of your portfolio is in default?

US only





Market Predictions

Lender Risks

When all respondents were asked to rank which concessions by lenders they believe presents their greatest risk, most ranked the following: *i)* allowance of addbacks to EBITDA; *ii)* flexibility to incur additional indebtedness; *iii)* covenant-lite or springing covenants; and *iv)* collateral leakage as the greatest risks.

Interestingly, this was the exact same ranking as last year, except covenant-lite or springing covenants and collateral leakage swapped places.

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

Overall — sorted by overall rankings



Allowance of addbacks to EBITDA



Flexibility to incur additional indebtedness



Covenant-lite or springing covenants



Collateral leakage



Unrestricted subsidiaries



Limited sacred voting rights



Flexibility to pay dividends



Equity/auto cures

● 1 ● 2 ● 3 ● 4 ● 5 ● 6 ● 7 ● 8

Indeed, no matter how the data was sorted, by ranking or by region, those four risks were ranked by lenders as the top four in every iteration of the data, except one—UK/EU sorted by overall rankings. That iteration brought in unrestricted subsidiaries as a top four risk.

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

Overall — sorted by 1st rankings



Allowance of addbacks to EBITDA



Collateral leakage



Covenant-lite or springing covenants



Flexibility to incur additional indebtedness



Limited sacred voting rights



Unrestricted subsidiaries



Flexibility to pay dividends



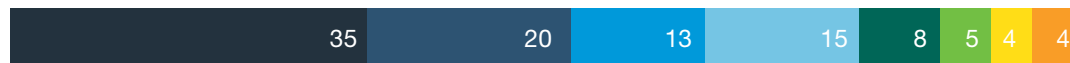
Equity/auto cures

● 1 ● 2 ● 3 ● 4 ● 5 ● 6 ● 7 ● 8

Market Predictions

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

US – sorted by overall rankings



Allowance of addbacks to EBITDA



Collateral leakage



Flexibility to incur additional indebtedness



Covenant-lite or springing covenants



Unrestricted subsidiaries



Limited sacred voting rights



Flexibility to pay dividends

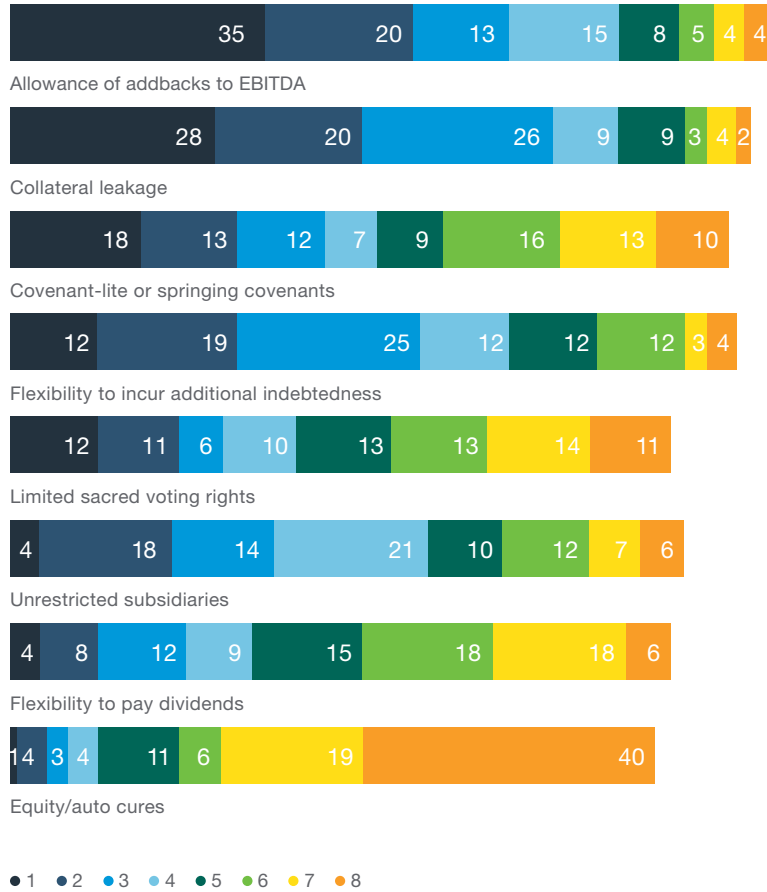


Equity/auto cures

● 1 ● 2 ● 3 ● 4 ● 5 ● 6 ● 7 ● 8

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

US – sorted by 1st rankings



Market Predictions

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

UK/EU – sorted by overall rankings



Allowance of add backs to EBITDA



Covenant-lite or springing covenants



Flexibility to incur additional indebtedness



Unrestricted subsidiaries



Collateral leakage



Flexibility to pay dividends



Limited sacred voting rights

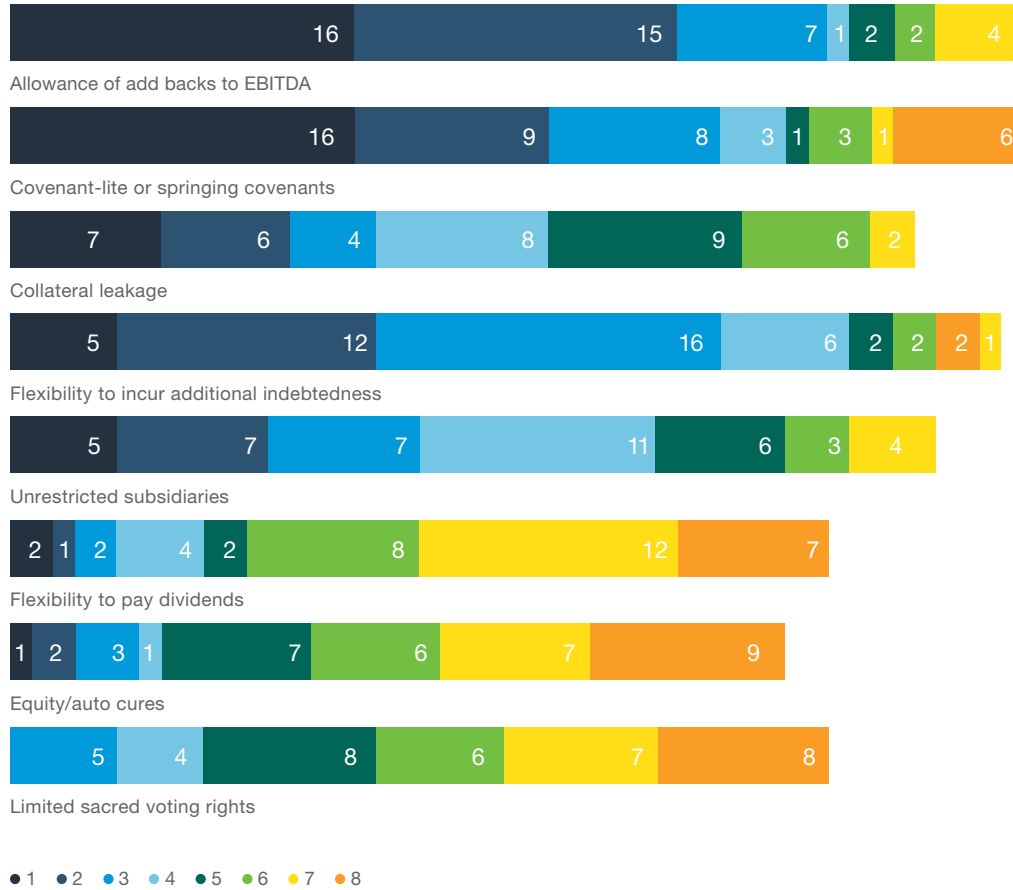


Equity/auto cures

● 1 ● 2 ● 3 ● 4 ● 5 ● 6 ● 7 ● 8

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

UK/EU – sorted by 1st rankings



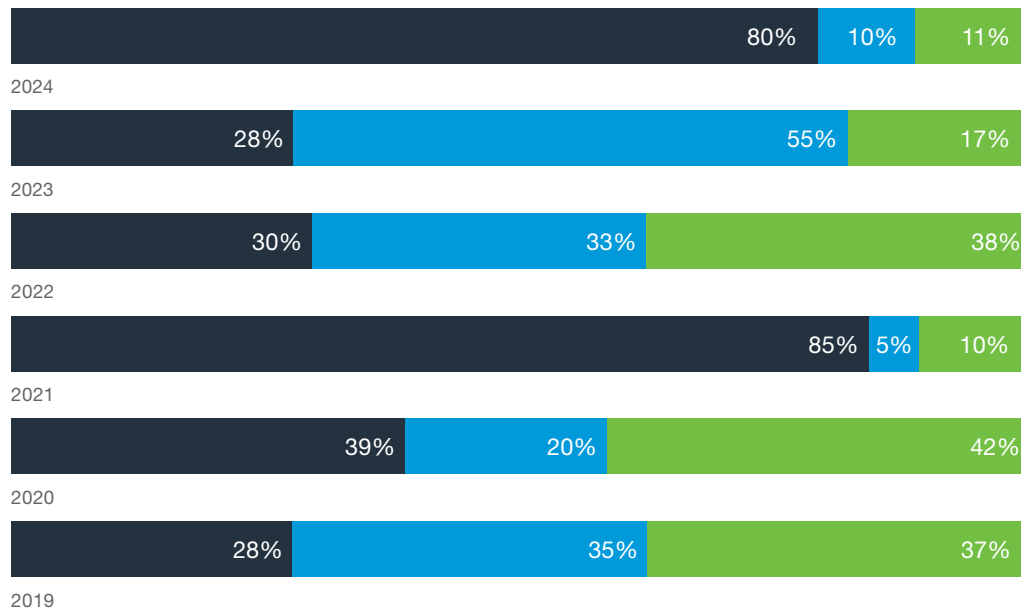
Five-Year Trends

We asked respondents for their predictions for deal activity, pricing and default levels for the coming year, as well as whether they were fundraising. We then compared their answers to the responses gathered in our past surveys since 2019 to observe any trends that have developed since the global pandemic.

Volume of Deal Activity

In the most recent survey, 80% of all respondents said they expect dealmaking to be more active than in the previous 12 months, a huge swing from last year in which a majority of respondents (55%) said they expect dealmaking to *decrease*. Indeed, the exuberance most respondents feel about deal activity going forward is eclipsed only by 2021 when 85% of respondents said they felt deal activity would increase the next year.

What are your expectations for deal activity in the market over the next 12 months



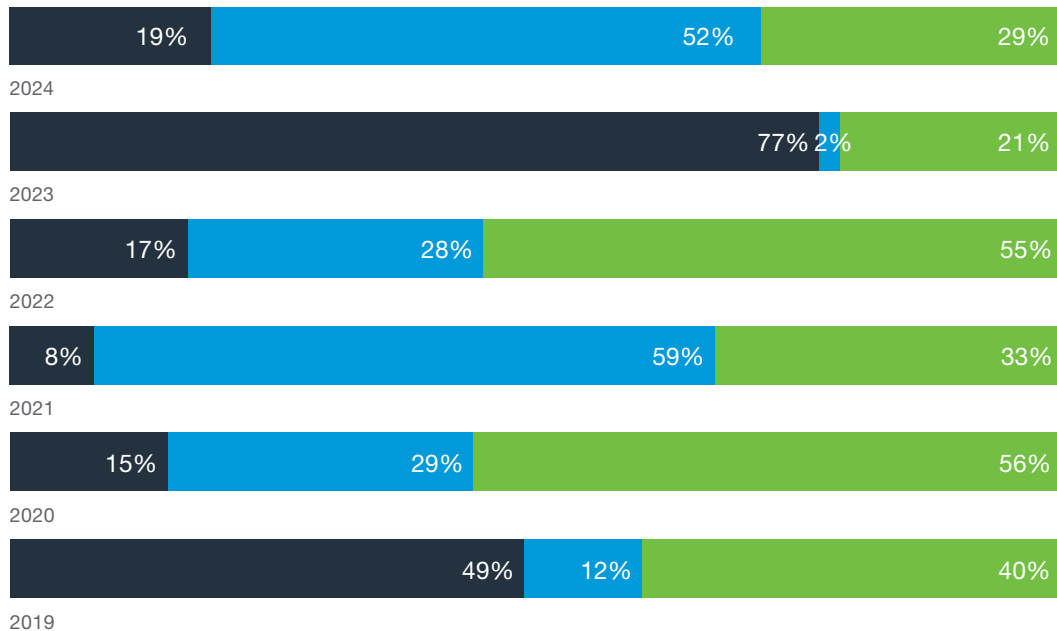
● More active than previous 12 months ● Less active than previous 12 months ● No change

Market Predictions

Pricing Predictions

A majority of respondents (52%) said they expect pricing to be lower than in the previous 12 months, a massive jump from last year when just 2% said they expected lower pricing but more in line with 2021, when 59% said that. Again, much like 2021, this may reflect an easing of concerns around the pandemic, the expectation of lower pricing now may reflect an easing — or at least a *normalization* — of fears of recession and global crises.

What are your expectations for pricing over the next 12 months?

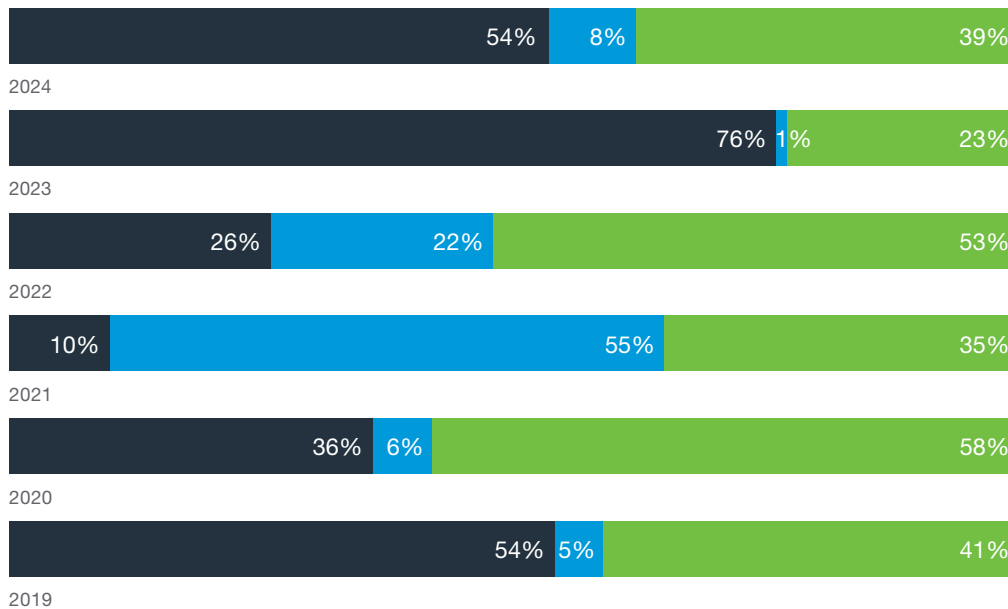


● Higher pricing than previous 12 months ● Lower pricing than previous 12 months ● No change

Default Expectations

Similarly, the easing of macro-economic fears may be what's behind the fall in default expectations as well. This year, a majority of respondents (54%) said they expect more defaults than in the past 12 months, which while high, is 22-percentage points *lower* than expectations for more defaults last year (76%). Still, these past two years have been the only ones since 2019 in which a *majority* of respondents said they expect more defaults than in the past 12 months.

What are your expectations for your portfolio over the next 12 months?



● More defaults than previous 12 months ● Less defaults than previous 12 months ● No change

Hot Topics

ESG Consideration

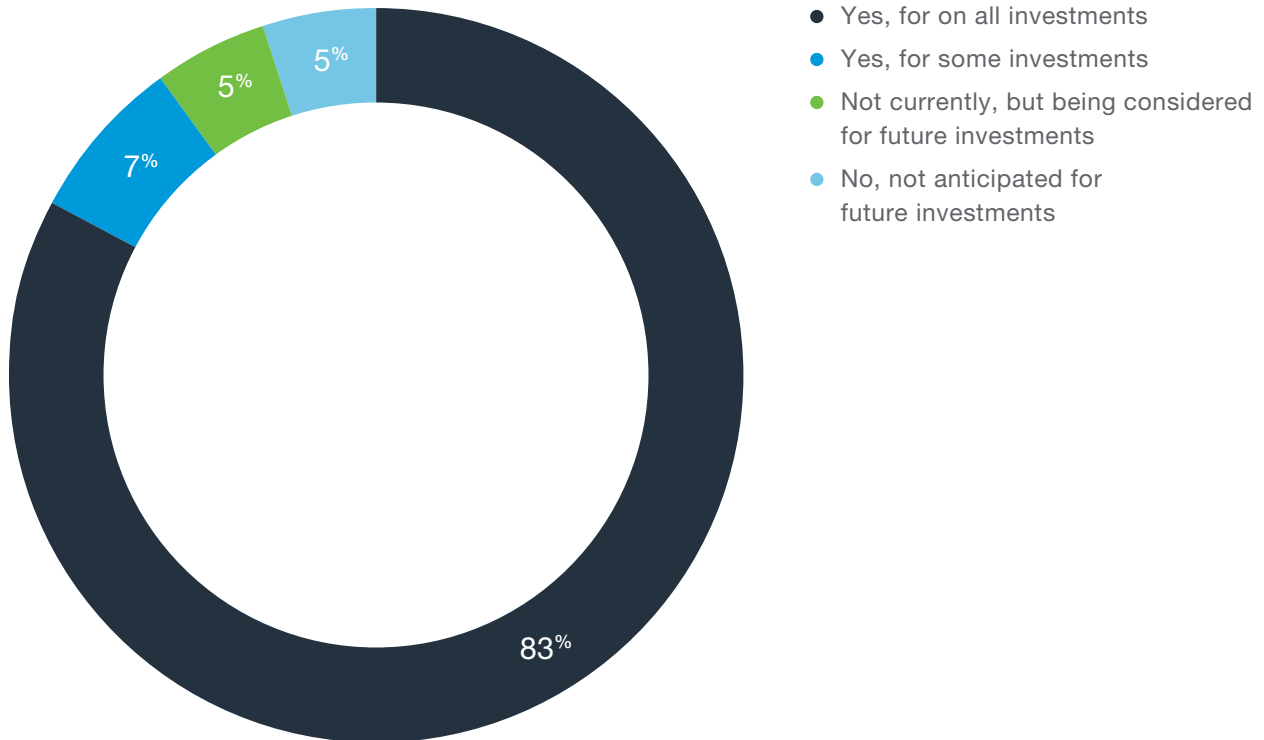
The private lending industry's continued focus on environmental, social & governance (ESG) factors continued to be an important topic, especially in consideration of certain investments.

This year, 80% of respondents said they consider ESG on all investments; however, it was not specified as to whether this is on a formal or informal level. Another 7% said they consider ESG factors on at least some investments. These levels are almost identical to last year's results, showing that ESG continues to be a strong consideration.

Over 80% consider ESG on all investments, however, it is not specified whether this is on a formal or informal level.

ESG Consideration

Overall



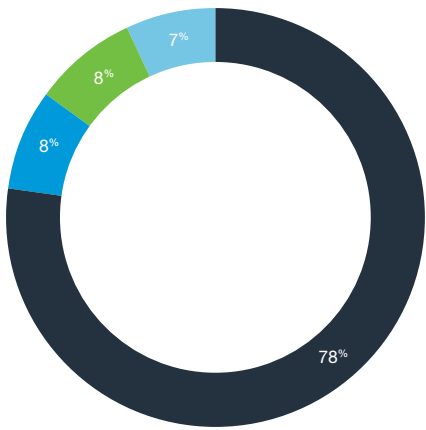
Hot Topics

Regionally, just more than three-quarters of US respondents (78%) said they consider ESG factors for all investments, down slightly from last year's 80%. And just more than two-thirds majority (67%) of US respondents said they were not offering interest rate ratchets to borrowers to meet ESG goals—while still high, this level was down a bit from last year's 73%.

In the UK/EU market, it was quite the reverse, with 98% of respondents saying they were offering interest rate ratchets to borrowers to meet ESG goals.

ESG considerations and interest rate ratchets to meet ESG targets

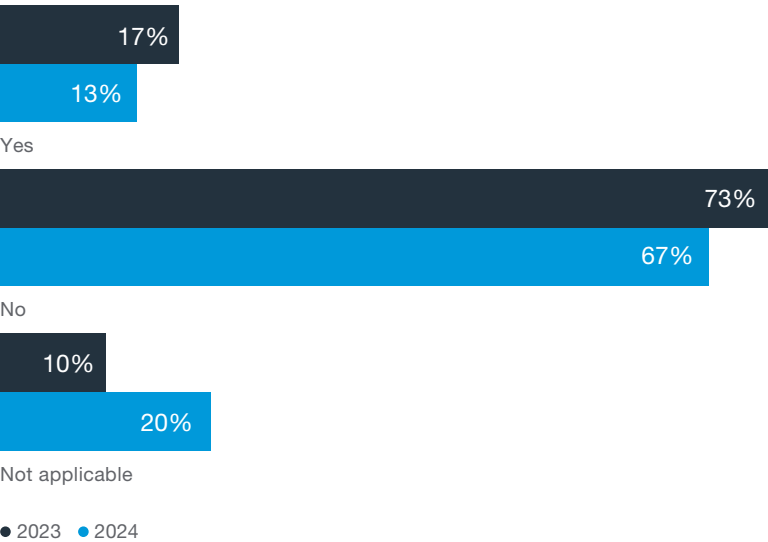
US only



ESG consideration

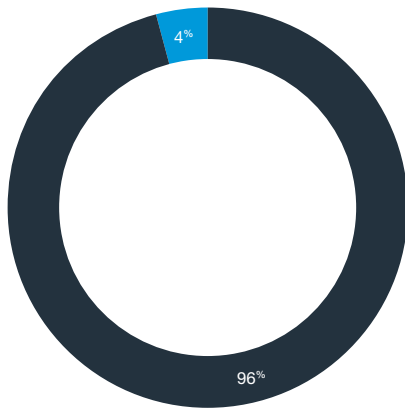
- Yes, for on all investments
- Yes, for some investments
- Not currently, but being considered for future investments
- No, not anticipated for future investments

Interest rate ratchets to meet ESG targets



ESG considerations and interest rate ratchets to meet ESG targets

UK/EU only



ESG consideration

- Yes, for all investments
- Yes, for some investments
- Not currently, but being considered for future investments
- No, not anticipated for future investments

Interest rate ratchets to meet ESG targets



Yes



0%

No

0%



Not applicable

● 2023 ● 2024

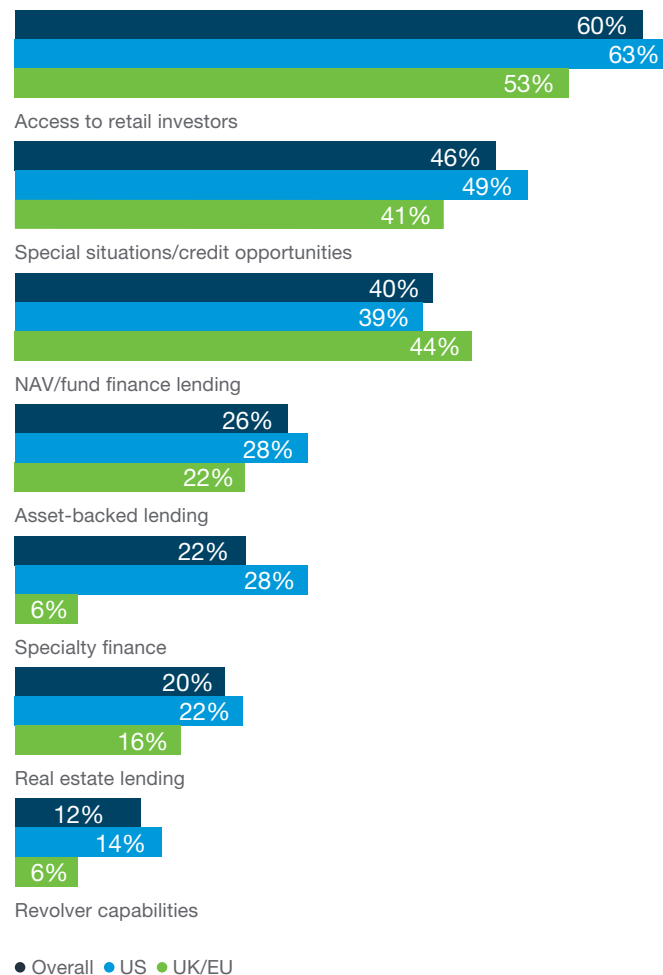
Hot Topics

Acquisition and Expansion

When we asked respondents if their firms were looking to acquire or expand any of their capabilities, they highlighted another Hot Topic. Overall, we saw that acquisition and expansion interests are in line across US and UK/EU respondents, with access to retail investors being cited the most, by 60% of respondents, as the capability they were seeking to enhance through acquisitions or expansion plans.

Regionally, the main difference between the two regions was a stronger appetite for specialty finance among US respondents.

Is your firm looking to acquire or expand any of the following capabilities (select all that apply)



Conclusion

Last year, we described the state of the private credit lending as being at a crossroads, with key metrics flashing warning lights and concerns over macroeconomic issues, deal volume, defaults and pricing dominating many lenders thinking, even as the overall private credit market remains resilient.

The analogy still holds—as if an entire industry paused at a crossroads for the past 12 months, uncertain as to which way to go.

Lenders' worries over inflation, recession and political strife around the world have ebbed, or at least receded from the top of their minds, even as some metrics continue to indicate a cautious approach as illustrated by capital deployment, which dropped overall 23% compared to the previous year.

Yet, as *The Proskauer Private Credit Survey 2024* shows, many lenders are still looking forward with a somewhat palpable dose of optimism toward a future that while still uncertain, could offer one of the best vintages of loans that the industry has ever seen.

The Private Credit Group

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Proskauer Trends in Private Credit



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Proskauer's Private Credit Default Index Reveals Rate of 1.6% for Fourth Quarter of 2023

January 18, 2024

Private Credit Defaults Increase from 1.41% in Q3

NEW YORK, January 18, 2024 – Proskauer, a leading international law firm, today announced the results of its quarterly Private Credit Default Index (the “Index”) for Q4 2023, revealing an overall default rate of 1.6%. The rate is a slight increase from Q3’s default rate of 1.41%, though still lower than Q1 and Q2, which were 2.15% and 1.64%, respectively.

The default rate for companies with greater than \$50 million of EBITDA increased from 1.2% in Q3 to 2.3% in Q4. Core middle market companies, those with EBITDA between \$25-\$49.9 million, had a default rate of 2.2% in Q4, a modest decrease from the prior quarter’s rate of 2.5%. Companies with EBITDA under \$25 million remained steady between Q3 and Q4, with default rates at 0.7% in each quarter. For the third consecutive quarter, the default rate for all EBITDA bands was below the default rate reported by Fitch Ratings.

The Firm’s Private Credit Default Index tracks senior-secured and unitranche loans in the United States and breaks down default rates by EBITDA and industry as well as default type (payment, bankruptcy, financial covenant, other material default, etc.). The Q4 2023 Private Credit Default Index included more than 1,000 active loans, representing \$148.9 billion in original principal amount.

The full report is available only to the Firm’s direct lending clients and contains a comparison to the default rates published by the rating agencies, historical trends by industry and EBITDA bands, defaults by default type, defaults in cov-lite loans and defaults by year of origination.

About Proskauer

We are 800+ lawyers serving clients from 12 offices located in the leading financial and business centers in the Americas, Europe and Asia. Since 1875, Proskauer has been devoted to our clients’ successes. Our lawyers are known for their unusually high accessibility, responsiveness and attentiveness. We go the extra mile to understand a client’s business — and think like savvy businesspeople in the process.

Working at the intersection of private capital and the sectors in which market players invest, we advise cutting-edge clients as they navigate complex challenges and seek to capitalize on market opportunities. Proskauer offers an

integrated platform that navigates clients through the full lifecycle of their business.

The Firm's Private Credit Group is made up of cross-disciplinary finance and restructuring experts exclusively dedicated to private credit investors. It includes over 110 finance and restructuring lawyers focused on representing credit funds, business development companies, and other direct lending funds in the restructuring of "clubbed" and syndicated credits, preferred equity, special situations and alternative investments. Over the past five years, Proskauer has been involved in over 1,200 deals for more than 100 private credit clients across the U.S. and Europe with an aggregate transaction value exceeding \$350 billion.

Trends in Private Credit Restructuring: Out of Court “Change of Control” Transactions

December 4, 2023

Restructurings defy a one-size fits all approach because every deal is unique and different tools are required to solve different problems. At one end of the restructuring continuum is the so-called “amend and extend,” where the credit agreement is amended to provide incremental liquidity, extend near-term maturities, modify covenants or some combination of the foregoing. This approach is fast and cost-efficient, but limited in its impact. At the other end of the spectrum is a restructuring through chapter 11. Bankruptcy is expensive, time-consuming and introduces significant legal, financial and operational uncertainty. In the middle of these scenarios are debt for equity transactions that can be implemented out of court through different legal structures. A company facing declining revenue, increasing costs, liquidity constraints and significant debt service obligations may have a viable restructuring path by working with its lenders to raise additional capital to bridge its liquidity needs and to eliminate funded debt from its balance sheet. Such businesses — those suffering from a broken balance sheets but with a viable business model — may be a candidate for an out of court change of control transaction. While this type of transaction can fix a broken balance sheet more quickly and cost effectively than chapter 11, it will not fix a broken business.

There are at least seven factors that drive the success of an out of court change of control transaction involving a debt-for-equity swap between a distressed borrower and its first lien secured lenders.

1. **Consent.** Out of court change of control transactions are *generally* a consensual path between borrower and lender.^[1] Borrower consent and cooperation are critical features of an out of court change of control transaction. A borrower owned by a private equity sponsor might be willing to consent to change of control transaction when, for example, the borrower is facing a liquidity crisis and its existing equity sponsor is no longer willing to invest additional capital and sees no path to recover on account of its existing equity stake. In these circumstances, it is far easier to achieve consensus with a borrower that is majority owned by a private equity sponsor as compared to a public company with a widely held shareholder base. That said, recent amendments to Delaware law have made it easier to consummate change of control transactions without seeking shareholder approval. Lender consent is preferred because the conversion of debt to equity triggers a “sacred right” in nearly all loan agreements and requires the consent of every affected lender. It is far easier to achieve consensus in a private credit club deal where consensus is forged among a group of like-minded investors as compared to a more disparate group of lenders in a broadly syndicated facility. The consent of all lenders is “preferred,” but it is not required. In the absence of 100% consent, the “required

lenders” (usually 50.1%) can direct the collateral agent to exercise remedies to consummate an out of court change of control using the strict foreclosure remedy under Article 9 of the Uniform Commercial Code.

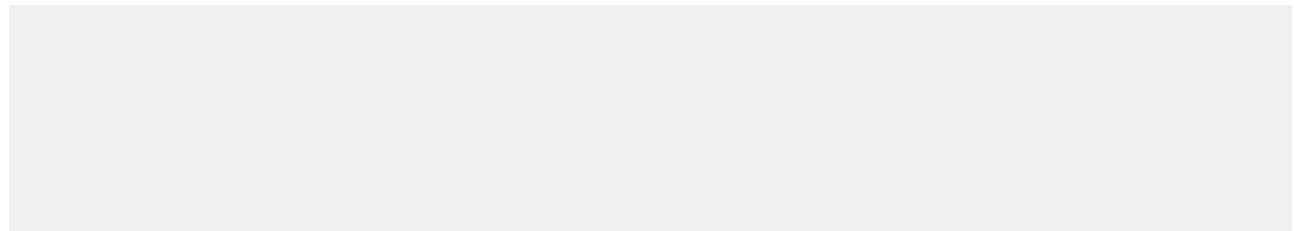
2. **Scope of Problem: Debt v. Operations.** A debt for equity change of control transaction can effectively de-lever a balance sheet, but it will not — without more — fix a company’s operational problems. For example, a debt for equity transaction will not help a “brick and mortar” business improve the operating performance of a retailer with a sprawling geographic footprint that needs to exit unprofitable store locations (e.g., WeWork). In that example, the business likely needs the “contract rejection power” in the bankruptcy toolbox to fix the operational problem. Thus, an out of court change of control transaction is best suited for fundamentally sound companies that have an excessive debt relative to earnings capacity.
3. **Existence of Legacy Liabilities.** A debt for equity transaction is equally ineffective at addressing the needs of companies suffering from so-called “legacy liabilities,” such as a significant money judgment, underfunded pension plans or arcane collective bargaining arrangements. Swapping first lien debt for equity will not address legacy liabilities, which can only be addressed with consent or in a chapter 11 bankruptcy with a “free and clear” sale under Section 363 or a discharge under a chapter 11 plan.
4. **Limited Change of Control Consequences.** An out of court change of control transaction must navigate change of control implications in key contracts or in highly regulated industries like healthcare, communications and gaming, where state or federal regulators have the right to approve a change of control of the business. Again, the change of control may still be possible, but execution is more challenging to manage.
5. **Managing Elevated Risk Profile.** Most debt-to-equity transactions result in a lender-owned acquisition vehicle that carries some amount of “take back” debt, i.e., term loans representing some portion of the amount formerly owed by the original borrower. As a result, the lenders will be the equity owners and primary lenders to the newly formed acquisition vehicle. Of course, the lenders will also control the appointment of a new board. There is no per se rule prohibiting lenders from acting in multiple capacities (e.g., shareholder, lender and even director), but this scenario creates an increased risk profile. If the underlying business fails to succeed, and the company subsequently files bankruptcy, the lender will be viewed as a statutory “insider.” As an insider, there will be (i) enhanced scrutiny for all insider transactions; (ii) a more lenient standard for equitable subordination (compared to a non-insider); and (iii) an extended avoidance period of one year for any payments received from the business. In addition, insider votes are excluded for determining class acceptance under a plan of reorganization. There are also other risks to consider, including claims for successor liability and fraudulent transfer. In most cases, these risks can be managed and are not an obstacle for consummating an out of court or in court restructuring, but they are factors to be aware of when formulating the initial change of control transaction.
6. **Aligning Employment Incentives.** The restructured company must be positioned in a manner to retain talented management teams (or attract new talent) to maximize value. Unfortunately, there may be very few incentives in place at the time of a negotiated restructuring to retain and motivate management. The

outstanding equity incentives may have little to no value and existing performance goals are unlikely to be met. Further, the transaction may trigger change in control payments and severance rights in existing management contracts that could encourage executive departures. Accordingly, lenders engaging in debt for equity transactions must negotiate with management to recalibrate and restructure equity awards, bonuses and change in control payments. These new incentives should be tailored to the company's particular financial circumstances and designed to balance the goals of encouraging profitability, avoiding liquidity drain and providing management with market compensation. The substitution, design and implementation of these incentives should be done with careful consideration of the tax, employment and securities law effects and limitations on the changes made to the company's previous incentive plans, if any.

- 7. Tax Efficient Structuring.** The success of an out of court transaction may depend on whether tax risks can be successfully neutralized in a tax efficient structure. In general, out of court change of control transactions are taxed like any other acquisition transaction — which is to say, the tax consequences will depend on (i) whether the change of control is structured as an equity or asset purchase and (ii) the amount of debt relieved, either directly or by use as “currency” to acquire assets or equity. The most common tax considerations in an out of court change of control transaction are (i) legacy tax liabilities of the borrower group and transfer taxes (which cannot be avoided outside a Section 363 or chapter 11 plan), (ii) cancellation of debt income (CODI) and other tax consequences to the borrower group and its legacy equityholders resulting from the transaction; (iii) timing of taxable gains or losses as a result of the change of control for all parties, (iv) taxation of the business going forward and (v) structuring the capital stack of the post-change of control borrower group. Note that in most out of court change of control transactions, the U.S. federal tax attributes of the borrower will either be eliminated or subject to significant limitations, and in rare circumstances, the value of those tax attributes will be so large and important to the business going forward that a so-called “G” reorganization (which can only be done pursuant to an in-court bankruptcy process) may need to be carefully considered.

In summary, out of court change of control transactions are an effective means to restructure a distressed company. That said, it's not the right tool for every situation and, in order to be effective, care must be taken to address the potential risks inherent in these transactions.

[1] There are paths for non-consensual change of control transactions where discussions between the lenders and borrower reach impasse. Those transactions, which often involve exercising the voting proxy in a stock pledge or foreclosure sales, involve a higher degree of complexity, costs and execution risk.



Private Credit Restructuring Trends: New Delaware Law Aids Secured Creditors in Getting Deals Done Out of Court

December 20, 2023

In our prior alert over the summer, we highlighted the Delaware Supreme Court's decision in *Stream TV Networks, Inc. v. SeeCubic, Inc.*, 279 A.3d 323, 329 (Del. 2022) ("**Stream TV**"), which held an insolvent corporation could not consensually "toss the keys" to its secured creditors in an out-of-court restructuring approved by the board of directors without the consent of the "out of the money" shareholders, because the transfer was a consensual sale of all or substantially all of the corporation's assets.[1] The decision was based on Section 271 of General Corporate Law of the State of Delaware ("**DGCL**"), requiring a shareholder vote for a sale of all or substantially all of a corporation's assets. *Stream TV* considered whether there was an "insolvency exception" from Section 271's shareholder approval requirement and held that "a common law insolvency exception, if one ever existed in Delaware, did not survive the enactment of Section 271," and that, accordingly, "there is no Delaware common law 'board only' insolvency exception under Section 271." The decision (which we disagreed with as a policy matter) had significant implications for secured creditors seeking to implement out-of-court restructurings by giving "out of the money" shareholders a veto right to use as leverage in negotiations. The *Stream TV* decision also impaired the ability of a secured creditor to use the voting proxy in its pledge agreement to implement a restructuring with a newly appointed independent board of directors. By frustrating the lenders' out-of-court playbook, *Stream TV* (we predicted) would needlessly increase the restructuring costs to be borne by secured lenders by forcing parties to use Chapter 11 as a means to effectuate a change of control transaction, where the very same transaction could be consummated more efficiently on an out of court basis.

The Delaware Legislature responded by enacting legislation to codify the "insolvency exception" that *Stream TV* found did not presently exist in the common law. Specifically, Section 272(b) of the DGCL was amended to add a new "safe harbor" provision for the sale, lease or exchange of collateral without shareholder consent. As explained below, the amendment provides material benefits for secured creditors, but (unfortunately) the statute also affords corporations a path to "opt out" of the safe harbor (thereby eliminating those newly-added benefits).

Here are four key takeaways from the new Delaware statute.

1. New Section 272(b)(1) provides that shareholder approval is **not** required for a non-consensual sale of collateral when the "secured party exercises its rights" under the law governing the security agreement or

mortgage or other applicable law, including Article 9 of a Uniform Commercial Code. This section would cover an Article 9 public or private foreclosure sale. This is not a material change in the law and shareholder approval was not required under Delaware law for an Article 9 public or private foreclosure, because it is a non-consensual secured creditor remedy and thus not considered a “sale” triggering shareholder consent rights under Section 271.[2]

2. In addition, new Section 272(b)(2) provides that shareholder approval is **not** required for a consensual sale of collateral by the corporation to the secured party or a third party that results in a full or partial debt forgiveness; provided that the collateral’s “value” is less than the amount of debt eliminated or reduced. This section covers an Article 9 strict foreclosure or a consensual transaction in lieu of a strict foreclosure. Section 272(b) does not require a specific method for valuing collateral. Moreover, Section 272(b)(2) provides that there is no presumption of solvency merely because the transaction involves consideration to the corporation (beyond debt forgiveness) or to existing equity. In other words, a deal structured with a “tip” to existing equity will not alone cause the transaction to fall outside the safe harbor.
3. Newly added Section 272(c) provides further protection by providing that, after a transaction is consummated, it cannot be unwound for failure to satisfy the “value” test in Section 272(b)(2) where the buyer provided value (including debt forgiveness) and acted in good faith. Section 272(c) will eliminate post-closing litigation where old equity threatens to or actually tries to challenge value using the benefit of hindsight.
4. Finally, under new Section 272(d), Delaware corporations can opt-out of the safe-harbor (and thus require shareholder consent for a sale of all or substantially all assets as required by Section 271) by express language in the certificate of incorporation added after August 1, 2023. Thus, corporations have the power to undue all of the benefits of the newly-enacted statute to the detriment of secured lenders. There are a number of options for secured lenders to consider to mitigate the impact of such a provision prior to closing a transaction.

The safe-harbor for the enforcement of secured creditor rights is a welcome development for secured creditors of insolvent[3] corporations. We believe that the trend for out-of-court restructurings will continue (particularly for stressed companies with a broken balance sheet as opposed to a broken business) and Section 272 will be a valuable tool to get deals done in the conference room instead of the courtroom. That said, the “opt out” right could provide an exception that swallows the safe-harbor entirely.[4]

[1] See our prior alert.

[2] UCC § 9-617, Comment 2 (“... a buyer at a foreclosure sale does not meet the definition of ‘purchaser’ in Section 1-201 (the transfer is not, vis-a-vis the debtor, ‘voluntary’).”)

[3] The amendments to Section 272 do not use the term “insolvent.” We use the term as a short-hand reference to a situation where the transferred collateral’s value is less than the amount of secured debt to be reduced or eliminated.

[4] When conducting diligence on the front end of a new loan, private credit lenders should take care to ensure that a prospective borrower or guarantor has not exercised its right to opt out of the safe harbor and that it may not do so while the loan remains outstanding.

The “**Board Flip**”: How Effective is the Pre-Petition Exercise of Proxy Rights in the Face of Bankruptcy?

August 3, 2023

1. Introduction

When debt restructuring discussions are at an impasse and the reservoir of goodwill between the parties has run dry, stakeholders face difficult choices. For a lender, one of the most powerful tools available is the exercise of rights under a voting proxy given by a parent holding company in connection with a pledge of a borrower’s stock or membership interests. Through the exercise of proxy rights, lenders may replace a borrower’s board of directors with a new board made up of independent directors. After a “board flip,” as it is commonly known, equityholders continue to own their interests in the borrower, but the economics associated with the interests are divorced from the voting rights associated with the interests, including the right to appoint directors or otherwise exercise control over the borrower.

Some have argued that a board flip should be unwound if the parent holding company promptly files for bankruptcy and makes a demand on the lender to relinquish voting control over the borrower, arguing that such voting control violates the automatic stay provisions of the Bankruptcy Code prohibiting creditors from controlling estate property or from attempting to collect a debt after the filing. This argument, and its various component positions discussed below, were squarely rejected in an April 2023 decision by Judge Laurie Selber Silberstein of the United States Bankruptcy Court for the District of Delaware (the “CII Decision”).^[i] In her opinion for the court, Judge Silberstein held that the parent company could not recover control of its subsidiary whose lenders had properly exercised voting proxy rights prior to the parent’s bankruptcy filing.

We agree completely with Judge Silberstein’s conclusion that, under Delaware law, a properly executed board flip in furtherance of well-drafted loan and security documents should withstand scrutiny in or outside of bankruptcy and will effectively divest a parent company of control over its borrower subsidiary. While exercising proxy rights is not the optimal recourse in every event of default, it is a valuable remedy that lenders rely upon when making investments and should rightfully be secure from post hoc attack on the grounds asserted by the debtor, and rejected by the court, in the CII Decision.

2. Background

CII Parent, Inc. (the “Parent”) owns 100% of the equity of Community Investors, Inc. (the “Portfolio Company”), which in turn owns several indirect operating subsidiaries.[ii] Twin Brook Capital Partners LLC (the “Agent”) is the agent for a group of senior secured lenders. In May 2019, the lenders made term and revolving loans secured by a pledge of the Parent’s equity interests in the Portfolio Company (the “Equity Pledge”). In July 2022, following the occurrence of certain events of default, the parties entered into a written forbearance agreement, which expired in mid-November 2022.[iii]

In December 2022, the Agent notified the Parent and the Portfolio Company that it was exercising the voting proxy rights granted to it under the Equity Pledge. Contemporaneously, and as is common in these situations, the Agent used its proxy rights to (i) amend the organizational documents of the Portfolio Company, (ii) remove existing directors from the board, and (iii) appoint a new board consisting of independent directors. Six days later, the Parent filed for relief under Chapter 11 and made a written demand to the Agent to rescind its actions so that the Parent could reorganize the Portfolio Company and its subsidiaries.

3. Alleged Violations of the Automatic Stay

In its motion to enforce the automatic stay against the Agent, the Parent argued that (i) by refusing to return voting control over the Portfolio Company to the Parent, the Agent was exercising control over property belonging to the bankruptcy estate (i.e. the pledged equity), (ii) by preventing the Parent from controlling the board of the Portfolio Company, the Agent was interfering with property of the estate, and (iii) the Agent’s refusal to rescind its proxy exercise and its execution of the board flip constituted a post-bankruptcy attempt to collect its debt – all in violation of the automatic stay imposed under section 362 of the Bankruptcy Code.

4. Was the Agent Exercising Post-Petition Control Over Estate Property?

There was no dispute that the Parent’s stock in the Portfolio Company was property of its bankruptcy estate. To determine whether the Agent was violating the automatic stay, however, the court was required to examine a more specific question: whether the **voting rights** associated with the Parent’s stock in the Portfolio Company were estate property.

Judge Silverstein’s analysis started with the underlying loan and security documents. In addition to the Equity Pledge itself, the loan documents included a broad power of attorney containing an immediate and irrevocable appointment of the Agent as attorney-in-fact for the Parent. This appointment expressly authorized the Agent to act in the Parent’s “place and stead” as a stockholder, including voting the pledged equity at any meeting of the stockholders or in any written consent as if the Agent were the owner. The court noted that a separate one-page proxy was included within the loan documents, and it too contained a broad appointment provision. The power of attorney provisions in the loan documents were supplemented by separate remedial provisions that gave the Agent equally broad authority to act with respect to the pledged shares. _

a. Decoupling Economic Interests from Voting Rights

Recounting the history of Delaware law on the subject, Judge Silberstein observed that Delaware courts have historically expressed concern that voting proxies, which decouple the economic interests of equity ownership from stockholder voting rights, were at odds with stockholder welfare. More recently, however, courts have been increasingly willing to enforce proxies consistent with the treatment afforded voting trusts and other vote-buying arrangements. Despite this trend, Judge Silberstein observed that voting proxies will still be “narrowly” construed in favor of the stockholder.

b. Notice Requirement

The Parent first argued that the Agent’s proxy exercise was ineffective because the Agent failed to provide advance notice.^[iv] The Agent responded by pointing to numerous other loan terms where advance notice was expressly required.^[v] That was not the case with respect to its proxy rights. Indeed, like many loan and security documents, the Agent was merely required to notify the Parent “substantially concurrently” with its exercise of proxy-related rights.^[vi] Siding with the Agent, the court ruled that only concurrent notice was required to be provided and that such notice had in fact been given.^[vii]

c. Duration

The Parent also argued that the Agent’s proxy rights had expired at the time it purported to exercise them. Delaware law provides for a three-year limit on voting proxies “unless the proxy provides for a longer period.”^[viii] In this regard, the loan and security agreement provided that “the power-of-attorney and proxy granted hereby is coupled with an interest and shall be valid and irrevocable until the secured obligations have been paid in full”^[ix] The court noted that the separate one-page proxy contained a similar provision that more clearly spoke to the duration of the proxy.^[x] Despite a clever argument by the Parent that “until paid in full” referred to irrevocability and not duration, the court found the language of the loan documents to be clear on this point and “consistent with the entire thrust of this commercial transaction.”^[xi]

d. Action by Written Consent

Finally, the Parent claimed that even if the Agent’s notice was proper and the proxy remained in effect longer than three years, the board flip was ineffective because the Agent lacked the authority to act by written stockholder consent.^[xii] Although the court found that the language contained in the separate one-page proxy was insufficient on this point, the loan and security documents contained several other provisions that authorized the Agent to act by written consent.^[xiii]

5. Conclusion

The court held that the Parent’s claims of an automatic stay violation required it to establish that the Agent did not properly exercise its proxy. Because she concluded to the contrary, Judge Silberstein rejected these claims and found no stay violation. Noting that the purpose of Section 362 is to maintain the status quo at the time of the filing,

the court concluded that the Agent's board flip validly occurred prior to bankruptcy and therefore that the status quo was preserved by denying the requested relief.[xiv] We agree fully with this decision.

[i] *In re CII Parent, Inc.*, Case No. 22-11345 (LSS) (Bankr. D. Del. April 12, 2023).

[ii] *Id.* at 4.

[iii] *Id.* at 6.

[iv] *Id.* at 16.

[v] *Id.*

[vi] *Id.* at 17.

[vii] *Id.*

[viii] *Id.* at 18 (citation omitted).

[ix] *Id.* at 18 (citation omitted).

[x] *Id.* at 19-20.

[xi] *Id.* at 21.

[xii] *Id.*

[xiii] *Id.*

[xiv] *Id.* at 25-31.

The “Golden Share”: All That Glitters Is Not Gold

May 18, 2020

A recent, highly anticipated ruling by a Bankruptcy Court in Delaware has reilluminated the concept of a "golden share". While an appeal of the ruling seems likely, this latest ruling by Delaware Bankruptcy Judge Mary F. Walrath suggests that as the COVID-19 outbreak continues to disrupt businesses and send shockwaves through the economy, courts may look at the specific circumstances of each case and weigh the interests of all corporate stakeholders in determining whether to enforce a "bankruptcy blocker".

What is a "Golden Share"?

A "golden share" refers to an equity interest in a company that affords the owner a number of consent rights. A key right is the right to block a company from filing for bankruptcy. Private credit lenders may rely upon a "golden share" structure when making preferred equity investments or in connection with a loan restructuring.

The Checkered History of the Enforceability of the "Golden Share" in Delaware

The first Delaware case to address the enforceability of the "golden share" was *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016). In that case, as a condition to waiving all of the company's existing events of default, a secured creditor required a borrower to amend its corporate charter to include a "golden share" provision, which required the unanimous consent of the company's common unitholders to file for bankruptcy. The company was also required to issue one common unit to the secured creditor. In response to a subsequent Chapter 11 filing by the company, the secured creditor filed a motion to dismiss, insisting that the key protection it had contracted for be enforced. Because the company had not obtained the unanimous consent of its unitholders, the secured creditor argued that the bankruptcy filing was unauthorized. Finding that the secured creditor was only a nominal unitholder and was primarily a creditor which, unlike a director, does not owe any fiduciary duties to the company, the court held that allowing the parties to contract around the constitutional right to seek bankruptcy relief would be contrary to federal public policy, and therefore, the "golden share" was unenforceable.

The Fifth Circuit Court of Appeals, however, interpreting Delaware law, came to a different conclusion when the "golden share" was held by a preferred shareholder. In *In re Franchise Services of North America, Inc.*, 891 F.3d 198 (5th Cir. 2018), a preferred shareholder agreed to make a \$15 million investment in a company so long as the company reincorporated in Delaware and amended its corporate charter to include a "golden share" provision. When the company filed a Chapter 11 petition, the preferred shareholder sought to dismiss the case, arguing that the petition could not be authorized without a shareholder vote. The company responded by asserting that the shareholder's argument was a pretense for its true motivation—to secure undue leverage for repayment of its \$3

million claim for unpaid consulting fees. In dismissing the bankruptcy case, the Fifth Circuit Court of Appeals agreed with the preferred shareholder and upheld the right of a bona fide preferred shareholder to exercise its "golden share".

Recently, the efficacy of the "golden share" was tested again in a bankruptcy filing by Pace Industries (*In re: Pace Industries, LLC*, Case No. 20-10927-MFW (Bankr. D. Del.)). In connection with its \$37.15 million preferred equity investment, the preferred shareholder obtained various rights and protections, including an amendment and restatement of the company's corporate charter to include a "golden share" provision. In the wake of the COVID-19 pandemic, Pace Industries found itself in dire financial straits, unable to pay hundreds of millions of dollars of debt, closing many of its manufacturing facilities, and laying off the majority of its employees. However, the company successfully negotiated a restructuring and filed a Chapter 11 petition to implement the restructuring, which was supported by the company's secured creditors and which proposed to pay unsecured creditors in full. The preferred shareholder did not consent to the petition and moved to dismiss the case.

In denying the motion to dismiss, Judge Walrath was keenly focused on the harsh reality facing Pace Industries. The court was persuaded by the fact that the COVID-19 outbreak had forced the company to shut down most of its operations and that the proposed debtor-in-possession financing was the company's only source of liquidity in the midst of the global pandemic. Furthermore, Judge Walrath observed that the preferred shareholder had not offered any viable alternatives. As a result, the court concluded that permitting the bankruptcy filing would likely benefit the greatest number of stakeholders, while dismissing the bankruptcy case would violate federal public policy by taking away a debtor's constitutional right to bankruptcy relief. In declining to follow the Fifth Circuit's interpretation of Delaware state law, Judge Walrath went so far as to conclude that a blocking right might create a fiduciary duty on the part of a minority shareholder.

Key Takeaway

Unlike Franchise Services, the bankruptcy court's ruling in Pace Industries echoes the sentiment expressed in Intervention Energy and at a minimum calls into question the enforceability of the "golden share". As Judge Walrath noted, "a minority shareholder has [no] more right to block a bankruptcy . . . than a creditor does." While the Judge Walrath's comment that the "golden share" may create a fiduciary duty may be a bridge too far, the case is a reminder that in these extraordinary times, bankruptcy courts will look skeptically on the enforceability of so-called bankruptcy blockers.

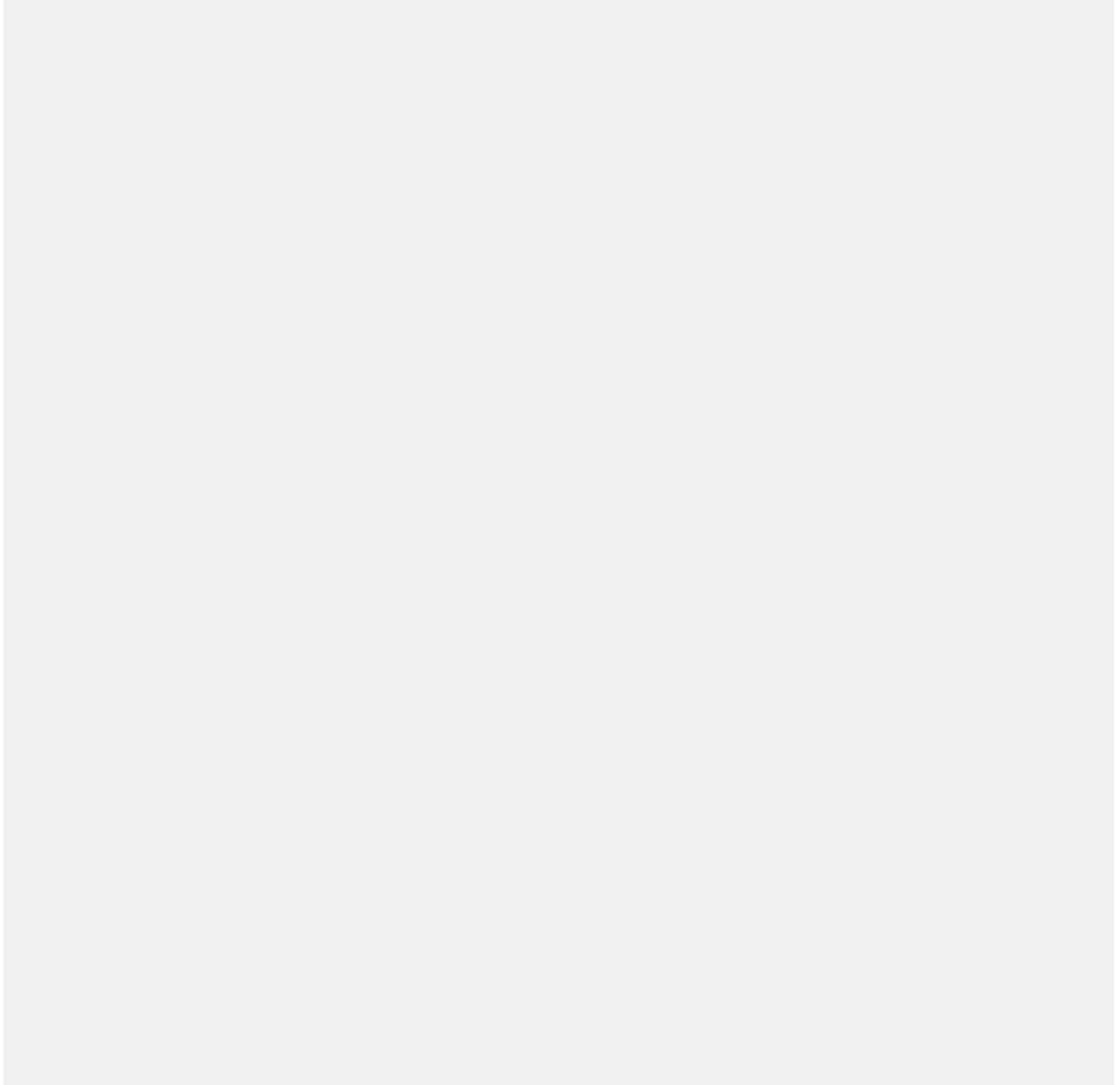
The Private Credit Group and The Private Credit Restructuring Group at Proskauer are closely monitoring the impact that COVID-19 will have on judicial decisions that may affect private credit lenders.

* * *

Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, related regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our Coronavirus Resource Center for guidance

2024 ANNUAL SPRING MEETING

on risk management measures, practical steps businesses can take, and resources to help manage ongoing operations.



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Faculty

Samantha Fang is a vice president of D. E. Shaw & Co., L.P. in New York and a member of the D. E. Shaw Group's Corporate Credit investment unit. In that capacity, she primarily works on investments in distressed and special situations, including bankruptcies, restructurings, opportunities in stressed equities and litigation plays. Prior to joining the firm in 2019, Ms. Fang was an attorney at Wachtell, Lipton, Rosen & Katz, where she represented public and private clients on a wide range of transactions, including mergers and acquisitions, strategic investments, financings, and corporate governance and shareholder activism matters. Prior to that, she clerked for Hon. Thomas M. Hardiman of the U.S. Court of Appeals for the Third Circuit. Ms. Fang received her A.B. in economics from Harvard College, where she was designated a John Harvard Scholar for academic distinction, and her J.D. from Harvard Law School, where she served as an editor of the *Harvard Law Review*.

Michael Fixler is a managing director with SC&H Capital in Chicago. He has spent his more than 25-year career advising companies and their stakeholders in a variety of transactions related to mergers and acquisitions, capital-raising and special situations, including bankruptcy cases. Advising clients from both public and private companies, institutional investors, statutory committees, and special situation buyers/investors, Mr. Fixler's experience includes crafting and executing a variety of strategic transactions to maximize value for his clients. Most recently, he co-led the Restructuring Investment Banking practice at B. Riley Securities, Inc. and he led the Special Situations group for FocalPoint Partners, LLC before its acquisition. Prior to corporate finance, Mr. Fixler practiced corporate and securities law in private practice and then joined one of his clients, where he served as general counsel and also led the company's corporate development efforts, ultimately resulting in the sale of the company to a strategic buyer. He holds Series 24, 63, 79 and 82 FINRA licenses and is active in ABI, the Turnaround Management Association and the Secured Finance Network. Mr. Fixler received his B.B.A. from the University of Miami and his J.D. from Case Western Reserve University.

David M. Hillman is a partner with Proskauer LLP in New York, co-head of both its Private Credit Restructuring Group and its Business Solutions, Governance, Restructuring & Bankruptcy Group. He has more than 25 years of experience with an emphasis on representing private credit lenders, private funds, sovereign wealth funds and other alternative lenders and distressed investors in special situations and restructurings both in and out of court, whether the lender is secured or unsecured, unitranche or structured preferred. Mr. Hillman has experience in every phase of restructuring and distressed investing, including credit bidding sales under § 363, debt-for-equity swaps, chapter 11 plans, out-of-court restructurings and foreclosures, and navigating intercreditor issues involving the relative rights of majority and minority lenders. He also litigates the issues facing private credit lenders, including issues involving plan confirmation, solvency, valuation, intercreditor disputes, financing and cash-collateral disputes, fraudulent transfers, equitable subordination, recharacterization, breach of fiduciary duty and similar disputes. Mr. Hillman was listed as a "leading individual" in bankruptcy/restructuring by *Chambers USA* and as a leader in his field by *New York Super Lawyers*. A member of ABI, he speaks frequently on bankruptcy-related topics, including recent decisions affecting secured creditor rights and preparing creditors for bankruptcy risks. Mr. Hillman received his B.A. *cum laude* from the State University of New York at Oneonta and his J.D. *cum laude* from Albany Law School, where he was associate editor of the *Albany Law Review*.

Teresa C. Kohl is a managing director for SSG Capital Advisors, LLC in West Conshohocken, Pa., and is responsible for originating and leading investment banking transactions, as well as managing SSG's litigation advisory practice. She has completed more than 200 restructuring matters, including refinancing and sale transactions for middle-market companies in bankruptcy proceedings and out-of-court workouts. Prior to her transition to investment banking, Ms. Kohl led financial and operational restructuring engagements for boutique advisory firms. Her past clients include publicly traded, privately held, private-equity sponsored and family-owned companies in the health care, retail, manufacturing, building products and financial services industries. Ms. Kohl is a frequent speaker on financial and operational restructuring issues, bankruptcy, and special-situation transactions, as well as a contributing author to the *Norton Journal of Bankruptcy Law and Practice*. She is a Fellow of the American College of Bankruptcy, and she has served on ABI's Board of Directors and in leadership positions of the Turnaround Management Association (TMA Global), for which she was the first woman to lead TMA's largest global chapter (New York City) as president and co-founded TMA Global's Network of Women. She also is the immediate past board chair of Living Beyond Breast Cancer, a national nonprofit that connects people with trusted breast cancer information and a community of support. Ms. Kohl is a member of the Association of Insolvency and Restructuring Advisors, INSOL International, the International Women's Insolvency and Restructuring Confederation and The Forum of Executive Women. She serves on the steering committee of the Eastern District of Pennsylvania Bankruptcy Conference, and as a mentor for ABI's Diversity and Inclusion Working Group Mentoring Program. Ms. Kohl has received numerous awards, including the Global M&A Network's SHE for SHE Leader Award, the Top Restructuring Investment Banker (2022), The M&A Advisor's Distressed M&A Dealmaker of the Year Award (2021 and 2019) and TMA Global's Outstanding Individual Contribution Award (2017). In addition, she was named a U.S.A. Top Women Dealmaker by the Global M&A Network (2019). Ms. Kohl received her B.S. from Villanova University School of Business.

Geoffrey A. Richards is a managing director and head of Private Capital Solutions and of Capital Recapitalization & Restructuring for Raymond James Financial, Inc. in New York. He has complex transaction experience in a range of financing, restructuring, and mergers and acquisition engagements, both in and outside of chapter 11. Mr. Richards has advised public and private companies, private-equity sponsors, hedge funds, purchasers of distressed assets and businesses, key secured and unsecured creditors, DIP lenders, and creditors' committees. He was previously head of North America Debt Finance & Restructuring at Canaccord Genuity Inc., head of Special Situations & Restructuring at William Blair & Co. and a partner in the Kirkland & Ellis LLP restructuring practice. Since 2001, Mr. Richards has taught corporate restructuring as an adjunct professor at Northwestern Pritzker School of Law. He received his B.A. in 1992 from the University of Wisconsin and his J.D. in 1995 from Brooklyn Law School.