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Global Practice Guides

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2025

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INTRODUCTION

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Latham & Watkins is ranked in Band 1 in the USA by Chambers and Partners and advises sophisticated global direct lenders and private capital providers on hundreds of front-end transactions each year, including first and second lien, unitranche and mezzanine loans, and preferred equity and other junior capital. It advises across a range of deal sizes stretching from the middle market through the largest and most complicated unitranche transactions with deal sizes in excess of USD1 billion. It regularly designs and implements multi-tiered capital structures for clients and handles subordination, security, and intercreditor issues, as well as restructurings, equity co-investments and tax and regulatory matters. Its direct lending and private debt practice draws on a long history of innovation and experience. With more than 150 lawyers nationwide, it advises the most active lenders, funds, credit platforms and investment managers as well as borrowers, in the full range of transactions, from the middle market to large-cap.

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INTRODUCTION

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Navigating Opportunities and Challenges in the Global Private Credit Market

The private credit market has emerged as a formidable force in the global financial landscape, offering a compelling alternative to traditional syndicated bank lending. The Private Credit Guide provides a broad overview of trends and developments in the private credit market in the most active jurisdictions around the world, including the US, the UK and beyond, and a detailed look at the full life cycle of a private credit transaction.

A Global Perspective on Private Credit

Private credit, characterised by non-bank lending to public and private companies, has grown exponentially over the last decade. This expansion is driven by a confluence of factors, including regulatory changes, investors searching for better terms and higher yields and the increasing sophistication of private credit providers. As of 2024, the global private credit market is valued at approximately USD1.8 trillion, with projections suggesting it could more than double in the coming decade.

The market's growth is not confined to any single region but is instead a global phenomenon. In the United States, private credit has become a cornerstone of corporate finance, offering flexible and tailored solutions to borrowers. In the UK and Europe, the market is gaining traction as companies seek alternatives to traditional bank financing amidst a challenging regulatory environment. In Asia and Latin America, where the market remains dominated by traditional bank lending, we have nevertheless seen steady growth in the private credit market. Meanwhile, in emerging markets, private credit is playing a pivotal role in bridging the financing gap for mid-sized enterprises. We see this global trend continuing as established asset managers seek increased opportunities in emerging markets, and as the best asset managers continue to outperform on their fundraising targets.

Key Themes and Trends

Several themes and trends that are both influencing market dynamics and are a result of market dynamics have emerged.

Market consolidation and strategic partnerships

The private credit market is witnessing a wave of consolidation, with larger firms acquiring smaller players to enhance their market presence. For instance, BlackRock's USD12 billion acquisition of HPS and Clearlake's purchase of MV Credit are indicative of this trend. Additionally, strategic partnerships between banks and private credit funds are becoming increasingly common, allowing both parties to leverage their respective strengths. Citigroup's USD25 billion partnership with Apollo and Wells Fargo's USD5 billion collaboration with Centerbridge Partners exemplify this "co-opetition" model, which enables banks to offload risk while maintaining client relationships and provides private credit funds with access to a broader range of investment opportunities.

Regulatory developments

As the private credit market matures, it faces increased scrutiny from regulators. In the United States, the Securities and Exchange Commission (SEC) and other regulatory bodies have expressed concerns about the lack of transparency in private credit valuations and potential systemic risks. In Europe, the European Central Bank (ECB) has been proactive in seeking more information on private credit exposures from banks. These regulatory developments underscore the need for private credit providers to enhance their compliance and reporting frameworks to mitigate potential risks.

Innovative financing structures

Private credit providers are continually innovating to meet the evolving needs of borrowers. Hybrid capital solutions, which blend debt and equity elements, have gained traction as a versatile tool for optimising capital structures. These instruments allow firms to manage costs effectively and meet regulatory requirements without over-leveraging. Additionally, liability management transactions are becoming more prevalent, offering both challenges and opportunities for lenders and borrowers. The increased use of payment in kind (PIK) interest, for example, allows borrowers to conserve cash by paying interest in-kind, although it also raises concerns about masking underlying financial issues.

Liability management

Liability management transactions have recently become a focal point in the private credit market, with high-profile and widely publicised transactions capturing the attention of general partners and investors alike. These transactions, which involve restructuring a company's debt obligations, offer both risks and rewards. On the one hand, they can provide companies with the flexibility to manage their capital structures more effectively, potentially avoiding defaults and preserving value, and often creating option value for shareholders. On the other hand, they can lead to complex negotiations and potential conflicts between debtors and creditors and among creditors. The recent Serta decision in the United States, which involved a controversial liability management transaction, has highlighted the need for private credit providers to navigate these transactions with caution and sophistication.

Junior capital

Junior capital provided by private credit and structured equity funds has emerged as a crucial financing tool for private equity firms and non-sponsored companies for a variety of uses. Private credit providers are increasingly offering junior and hybrid capital solutions that blend debt and equity elements, enabling sponsors to monetise assets effectively, de-lever debt capital structures and provide more dry powder for acquisitions. These solutions often involve preferred equity, which positions itself higher in the capital structure than common equity held by private equity sponsors but remains junior to existing creditors. These deals frequently utilise PIK structures, allowing interest payments to be deferred, thereby alleviating immediate cash flow pressures.

UK-specific trends and developments

The UK private credit market is experiencing its own set of trends and developments. The market has been buoyed by a favourable regulatory environment, with the Financial Conduct Authority (FCA) taking a proactive approach to fostering innovation and competition. Additionally, the UK's exit from the EU has created both challenges and opportunities for private credit providers. On the one hand, the uncertainty surrounding Brexit has led to increased caution among investors.

On the other hand, asset managers have expanded their fundraising efforts by opening fund investment opportunities to high net worth individuals and family offices. This has permitted certain private credit funds to offer businesses a lower cost of capital, increasing the fund's assets under management and maximising the deployment opportunity. Private credit providers are also seizing new opportunities to fill the financing gap left by traditional banks. Additionally, the UK's focus on sustainable finance and ESG considerations is also shaping the private credit landscape, with an increasing number of private credit funds incorporating ESG criteria into their investment strategies.

Terms, covenants and documentation

Initially, the growth of private credit deals was mainly driven by the tighter terms, covenants and documentation that govern these transactions. Investors sought to either drive terms that were creditor-friendly or have influence in any given credit by holding positions that were far larger than traditional holds of institutional investors in collateralised loan obligation (CLO) driven broadly syndicated deals. As the market has evolved and matured, these terms have seen a loosening in the market as a result of the expansion of the private credit market and the increased competition brought on by new market entrants.

That said, private credit agreements often continue to feature bespoke terms tailored to the specific needs of the borrower and the risk appetite of the lender. Documentation in private credit deals is becoming increasingly sophisticated, reflecting the complexity of the transactions and the need for clarity and precision.

The rise of covenant-lite or covenant-loose structures, which feature fewer financial maintenance requirements on borrowers, has been a notable trend, particularly in larger deals. However, this has also led to increased scrutiny from investors and regulators, who are concerned about the potential for weakened lender protections. As a result, the most sophisticated and established private credit providers are continuing to place greater emphasis on the quality and tightness of underwriting and documentation. The most sophisticated and established private credit shops are also focused on going back to basics with sole underwriters or tighter club deals remaining a focus and preference over larger, more aggressive deals that resemble broadly syndicated deals.

The rise of asset management M&A and other asset classes

The private credit market is not only expanding in terms of volume but also in the diversity of asset classes it finances. One of the most significant trends in recent years has been the rise of asset management mergers and acquisitions (M&A), driven by the need for scale and diversification. Asset managers are increasingly turning to private credit to finance these transactions, leveraging its flexibility and speed of execution. This trend is exemplified by high-profile deals such as BlackRock's acquisition of HPS and Clearlake's purchase of MV Credit, which highlight the strategic importance of private credit in facilitating growth and consolidation in the asset management industry.

Beyond traditional sponsor finance and corporate borrower transactions, private credit is also being used to finance a wide range of other asset classes, from real estate and infrastructure to technology and healthcare. In the real estate sector, private credit is playing a crucial role in financing development projects and acquisitions, particularly in the face of tightening bank lending standards.

In infrastructure, private credit is being used to fund large-scale projects, such as renewable energy developments, that require significant capital investment. The technology sector, with its rapid pace of innovation and growth, is also a key area of focus for private credit providers, who are keen to support companies with scalable business models and strong growth potential. Private credit asset-backed loans are also a developing sub-asset class, and yet another example of the expanding aperture of the private credit offering.

Conclusion

As we explore the rapidly expanding private credit market and map the contours of the current landscape, we urge readers to think expansively about how it can generate value for sponsors, debtors and creditors. We hope that this first edition can help market participants better navigate the opportunities and challenges that lie ahead.

UK

Law and Practice

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Contents

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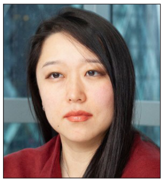

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1. Private Credit Overview

1.1 Private Credit Market

Continued Growth

In 2024, private credit's growth, especially in sponsor-backed leveraged finance, highlighted its expanding role in the financial markets. Traditionally more a mid-market product, private credit funds are now entering the large-cap space due to rising demand for flexible financing and sponsors' need for alternative capital sources with the tightening of the syndicated market.

Dual-Track

Dual-track processes, which explore both syndicated and direct lending, are increasingly common in the large-cap space and, increasingly, the mid-market. This strategy creates competitive tension between banks and private credit funds, with sponsors benefiting from greater flexibility and better pricing.

Sector Focus

Private credit is active across various sectors, particularly in technology, industrials, consumer goods and financial services.

Private Credit CLOs

In November 2024, Barings launched the first European middle-market private credit CLO, valued at EUR380.6 million, highlighting private credit's growing importance and potential for further growth.

Path Ahead

Looking ahead, market participants are expected to innovate in capital structure management and risk strategies. Basel 3.1 reforms may lead banks to be more selective in lending, offering private credit lenders more opportunities. Despite strong 2024 deal flow, private equity sponsors have withheld top assets due to high interest rates and inflation. A surge in M&A activity is expected in 2025 as these assets become available.

1.2 Interaction With Public Markets

In 2024, private credit lenders maintained their competitive edge in the upper middle market by reducing margins and accommodating higher leverage levels, retaining roles in many prominent deals. This adaptability is further evidenced by their ability to offer financing solutions across the capital structure, including junior and hybrid capital instruments, effectively addressing borrowers' needs in the face of rising capital costs and liquidity demands.

Private credit lenders also leveraged their competitive advantage in transactions involving large sterling tranches, which are more challenging in the syndicated loan market due to their relative illiquidity. However, the resurgence of the syndicated loan market has led some private credit lenders to refocus on mid-market strategies, where they continue to provide value and maintain market presence.

In the lower middle market, ongoing bank disintermediation is driving a notable trend of collaboration between banks and asset managers. This collaboration allows for innovative financing solutions and the sharing of expertise, benefiting borrowers seeking more tailored and flexible funding options.

Whilst there has been certain refinancings of private credit debt with public debt market products, this was not a prominent feature in 2024.

1.3 Acquisition Finance

Private credit has been actively used for headline acquisition financing transactions in Europe for the last few years but the reopening of the syndicated market led to a healthy mix of both private credit and banks financing acquisitions in 2024.

A notable development is the increasing collaboration between private credit lenders and banks. Despite competing for market share, both parties are finding common ground and working together on deals. One significant feature is the use of holding company (Holdco) financings, where private credit lenders provide financing at the Holdco level while banks syndicate a loan or bond at the operating company (Opco) level. This synergy allows both private credit lenders and banks to leverage their strengths, offering more comprehensive financing solutions to meet the diverse needs of borrowers.

1.4 Challenges

The return of syndicated markets in 2024 led private credit lenders to reduce pricing to remain competitive, although this may be viewed as a "correction" instead as this debt was priced at all-time highs.

In the European large-cap syndicated loan market, covenant-lite structures have become standard, especially in sponsor-led transactions. Private credit financings, which traditionally include maintenance covenants, are now shifting towards covenant-lite structures, particularly in unitranche and senior direct lending, as private credit funds increase their presence in the large-cap leveraged finance market. This shift highlights private capital providers' growing influence and adaptability, as they innovate to meet borrowers' needs and compete in the large-cap market.

1.5 Junior and Hybrid Capital

In 2024, there was a resurgence in junior financings and hybrid capital from private credit lenders due to the following.

- Flexibility: Holdco debt allows for tailored capital structures, balancing debt and equity and accommodating cash flow patterns.
- Leverage: placing debt at the Holdco level can prevent over-leveraging the Opco group.
- Ratings: maintaining leverage at the Holdco level can improve Opco credit ratings.
- Cash flow: Holdco debt (often payment in kind (PIK) debt) aids cash flow management, allowing cash retention for reinvestment and operations.
- Exit strategy: Holdco debt can simplify exit strategies, making deals more appealing to buyers.

The rise in Holdco/junior financings highlights collaboration between syndicated and private credit lenders, offering comprehensive solutions for large debt amounts. Jumbo Holdco financings have emerged, with private credit funds forming "clubs" to provide more than GBP1 billion financings, pooling resources and sharing risk. This showcases the private credit market's adaptability and innovation in meeting complex sponsor and borrower needs.

Comparatively, the preferred equity market in Europe is still developing. While it offers flexible capital and equity-like returns, it hasn't reached the scale of junior financings. As the market evolves, growth opportunities may arise in preferred equity as sponsors and investors seek diverse financing options.

1.6 Sponsored/Non-Sponsored Debt

Private credit lenders are increasingly providing debt to both sponsor-backed and public companies. For non-sponsor-backed companies and public companies needing event-based funding, private credit offers certainty of funding and terms, unlike the high-yield and syndicated markets. Private credit funds are also typically more flexible when it comes to underwriting deals, which is highly valued by companies navigating complex financial situations. Features like the PIK toggle allow deferred interest payments, adding financial flexibility. Private credit transactions also maintain higher confidentiality, which is crucial for sensitive transitions like public-to-private deals.

Operationally, private credit deals offer streamlined interactions, with borrowers typically dealing with a single or small group of lenders for consents and amendments. This contrasts with the complex process of negotiating with large syndicates in the syndicated loan market, simplifying financing management and enhancing adaptability to changing business needs.

1.7 Recurring Revenue Deals and Late-Stage Lending

While earnings before interest, taxes, depreciation and amortisation (EBITDA)-positive businesses continue to be the primary focus for private credit lenders, there is growing interest in the recurring revenue market within the UK and Europe. Private credit funds are increasingly allocating capital to pre-EBITDA businesses. These funds are able to offer flexible financing structures tailored to the unique needs of these businesses, accommodating their growth trajectories and cash flow patterns.

These businesses, often in sectors like technology and subscription-based services, generate predictable and stable cash flows through recurring revenue models. This financial predictability is appealing to private credit lenders, who can assess the potential for future profitability and growth, providing financing solutions that support these businesses as they scale.

1.8 Deal Sizes, Fund Sizes and Fundraising

Typical Deal Sizes

Jumbo deals

Over GBP1 billion, provided by a "club" of private credit lenders, with major funds holding "anchor" portions (GBP500 to GBP750 million).

Mid-cap

GBP150 million and above, provided by a single private credit lender or "club" deals, with each holding GBP150 to GBP250 million portions.

Typical fund sizes

Private credit funds manage substantial capital, with sizes varying by strategy, market conditions and fundraising success. Established lenders have flagship funds of more than USD10 billion, with mid-market or specialist funds ranging from USD2 to USD5 billion.

Challenges in fundraising for private credit providers

One-stop shop

Capital allocators prefer a one-stop shop approach with pan-European focus, allowing consolidated investment across the capital structure for a streamlined strategy.

Saturation

The upper mid-market is saturated, increasing competition. Interest is shifting to the less competitive lower mid-market, offering more opportunities and potential returns.

Challenges for newcomers

Capital concentration around established funds poses challenges for new entrants. Established funds with proven track records and resources, means newcomers need to differentiate through innovative strategies or a niche focus.

Default risk

Private credit market participants report low default rates despite macro challenges. However, lenders must monitor and manage default risks, as they impact capital access.

1.9 Impending Regulation and Reform

The level of regulatory scrutiny in private credit markets is generally seen to have increased in 2024. The UK Financial Conduct Authority (FCA) conducted a multi-firm review, focused on the risk of inaccurate valuations, conflicts of interest, poor liquidity and leverage controls in private credit markets. As private credit funds broaden their capital sources to include high net worth individuals and family offices, they may face increased regulatory scrutiny, despite not being deposit-taking institutions, as the private credit market continues to mature.

2. Regulatory Environment

2.1 Licensing and Regulatory Approval

Lenders must have an appropriate licence to carry out regulated activities in the UK. Whether lending requires a licence depends on the loan's nature and the borrower's sophistication:

- cash loans: no licence needed for loans over GBP25,000 for "business use"; and
- preferred equity/bonds/convertible instruments can be issued to lenders if the lender is a "professional client" under UK FCA regulations.

Corporate lending alone doesn't generally require UK authorisation but is subject to UK AML requirements, necessitating FCA registration. Offshore entities lending to UK borrowers are typically exempt.

Lenders can generally take security over a UK borrower's assets unless this involves mortgages or property rights over residential real estate.

2.2 Regulators of Private Credit Funds

The FCA is the primary regulator for private credit funds in the UK.

2.3 Restrictions on Foreign Investments

UK-based private credit managers must adhere to UK sanctions regimes under the Sanctions and Anti-Money Laundering Act 2018, which is the legal basis for imposing, updating and lifting sanctions.

HM Treasury, through the Office of Financial Sanctions Implementation, enforces financial sanctions, including asset freezes on designated persons and restrictions on investment and financial services.

Foreign investment in UK private credit funds is only allowed if it does not come from sources on the UK financial sanctions lists or violate UK sanctions.

2.4 Compliance and Reporting Requirements

UK FCA-regulated private credit funds must comply with various regulatory and reporting requirements. Generally, the UK regulatory regime requires:

- compliance with rules for senior managers and material risk takers;
- compliance policies for risk management, market abuse, conduct and staff training;
- maintenance of regulatory capital; and
- reporting on FCA metrics related to regulatory compliance.

UK-regulated lenders or those registered with the FCA for AML purposes have ongoing AML reporting obligations.

In 2024, private credit firms particularly focused on governance and valuation processes due to FCA scrutiny, aiming to address subjectivity, potential conflicts of interest and misalignments in net asset value (NAV) calculations, asset valuations and data availability.

2.5 Club Lending and Antitrust

While UK antitrust enforcers have not brought enforcement actions focused on private credit, co-ordinated lending has the potential to raise antitrust enforcement risk because of the increasing prevalence of intercreditor disputes and general regulatory scrutiny on private capital.

There has, however, been some case law in the US. In the mid-2010s, private plaintiffs brought antitrust claims against private equity sponsors for “clubbing deals,” which were alleged to have reduced the competitive intensity of lending. Plaintiffs alleged that some of the largest private equity firms depressed take-private prices through a code of conduct or “club etiquette” among sponsor groups.

Under US antitrust laws, restructuring discussions that occur within the context of a formal bankruptcy proceeding are potentially immune from antitrust liability. See United Airlines, Inc. v U.S. Bank N.A., 406 F.3d 918, 921 (7th Cir. 2005). Even outside formal court led restructurings, more recent US antitrust cases have distinguished between enforcement of existing debts and prospective lending. One court observed that efforts “maximizing the creditors’ ability to collect an outstanding debt” potentially differed from cases in which courts applied Sherman Act liability that “involved creditors who agreed about whether or on what terms to extend credit in the future”. CompuCredit Holdings Corp. v Akanthos Capital Management, LLC., 916 F. Supp. 2d 1326, 1330 (N.D. Ga. 2011).

Although US case law is not binding on English courts, an English court may draw on such US case law should similar claims arise in England.

3. Structuring and Documentation

3.1 Common Structures

Structures

Common structures include:

- unitranche (term + delayed draw facility) by private credit lenders, with a super senior revolving facility from a bank;
- Holdco facility by private credit lenders, with traditional syndicated structures at Opco level (eg, syndicated loans or high-yield bonds);
- subordinated debt by private credit lenders alongside senior secured financing (syndicated loans or high-yield bonds); and
- preferred equity.

Revolving and Delayed Draw Facilities

Private credit lenders often provide a delayed draw/acquisition-capex facility, a term loan available post-closing (eg, three years) for bolt-on acquisitions. They don't typically provide revolving facilities (RCFs) or ancillary facilities. For tight acquisition timelines, private credit lenders may offer a hollow tranche revolving facility for a limited period (eg, 90 days), functioning like a term facility, expected to be replaced by an RCF. Unplaced commitments by the timeline's end are cancelled or treated as term facility commitments. Many direct lenders collaborate with RCF providers to leverage intercreditor synergies for sponsors.

3.2 Key Documentation

Typical documentation for private credit transactions includes:

- a facilities agreement, which covers commercial terms, representations, undertakings, events of default, transfers, amendments and loan mechanics;
- an intercreditor agreement, which governs rights between creditor classes. Unlike evergreen intercreditor agreements which are typical in syndicated markets, private credit intercreditor agreements are specific to debt classes and terms between unitranche and super senior RCF lenders. In Holdco facilities, private credit lenders aren't typically party to Opco-level intercreditor agreements but enter a subordination agreement for shareholder debt; and
- a fee letter, which documents agreed fees and payment terms.

First-Out-Last-Out (FOLO) Transactions

The rise of collaborative structures like unitranche and super senior debt has reduced FOLO transactions. When used, FOLO transactions are documented under a single credit facility, with a side agreement dividing the loan into first-out and last-out tranches. The higher-risk last-out tranche offers a higher margin, aligning with different lenders' risk preferences.

3.3 Restrictions on Foreign Direct Lenders

In England, foreign lenders don't typically need authorisation to make loans unless engaging in "regulated activities" related to "specified investments" under the Financial Services and Markets Act 2000 (the "FSMA"). "Regulated activities" include accepting deposits, dealing in investments as principal or agent, arranging deals, managing and advising on investments and insurance contracts, requiring authorisation under Section 19 of the FSMA. There are also "change in control" requirements for investing in entities in "regulated activities".

Under Section 21 of the FSMA, only authorised persons can communicate an invitation or inducement to engage in an "investment activity" (a "financial promotion") in the course of business. Unauthorised persons can communicate a "financial promotion" if approved by an authorised person.

Corporate lending isn't a regulated activity in the UK, unlike lending to individuals or certain partnerships, which may fall under the UK consumer credit regime. Corporate lending is subject to UK AML requirements.

The UK doesn't differentiate between the regulatory treatment of term and RCF loans and has no general restrictions on the sale, transfer or sub-participation of loans.

3.4 Use of Proceeds and Acquisition Financings

There are no restrictions on using private credit for take-privates and acquisition financing and no restrictions on a borrower's use of proceeds under English law.

3.5 Debt Buyback

Debt buybacks by borrowers are permitted under English law and facility agreements will typically include provisions governing this. There are usually three options:

- open order transactions: the borrower notifies the lenders of the total amount of the loans it intends to acquire and the price offered. If the offer is oversubscribed, offers from the lenders are accepted on a pro rata basis;
- solicitation transactions: the borrower solicits offers from lenders to purchase its debt, selecting the lowest offers first and, where offers are at the same price, purchasing the debt on a pro rata basis; and
- bilateral transactions: this involves a direct negotiation between the borrower and a single lender. The parties are free to agree the terms. This option is often used when the buyer and seller have a pre-existing relationship or when confidentiality and discretion are important.

Private credit lenders will often require that the open order process is completed first before there is a solicitation or bilateral process.

3.6 Recent Legal and Commercial Developments

Similar to the broadly syndicated market, private credit lenders are focused on limiting the "trap doors"/loopholes in the covenants that allow for sponsors/borrowers to undertake liability management exercises (ie, uptiering transactions and dropdown/asset-stripping transactions). This has led to the development of a few "blockers", ie, contractual protections to prevent the borrower group/sponsor from undertaking these transactions.

Key "blockers" that are now included in private credit transactions are as follows.

- Prevent key assets being transferred to unrestricted subsidiaries, which could use them as collateral for new, senior debt.
- Ensure key assets remain with guarantors, limiting transfers to non-guarantor restricted subsidiaries by imposing caps.
- Cap the aggregate value of assets moved to unrestricted subsidiaries.
- Stop majority lenders from subordinating existing lenders' security/introducing priming debt without unanimous consent.
- Prevent automatic release of a subsidiary guarantor's guarantee if it becomes non-wholly owned through permitted transactions.

3.7 Junior and Hybrid Capital

In the current high interest rate environment, many sound businesses face increased debt service and reduced senior debt capacity. Junior and hybrid capital solutions help alleviate these pressures.

Junior capital, which typically includes subordinated debt or mezzanine financing, supplements senior debt with flexible terms, such as interest deferral or PIK interest, aiding cash flow management.

Hybrid capital solutions, including convertible debt or preferred equity, offer tailored financing with potential capital appreciation and reduced cash outflows.

Preferred equity is attractive in high interest rate or financial distress situations as it offers fixed dividends, priority in liquidation and provides more security than common equity as well as higher returns than debt.

Preferred equity doesn't impose the same repayment obligations as debt, preserving cash flow and reducing strain. It allows companies to raise capital without diluting common equity holders' control, as it usually lacks voting rights.

In high interest rate environments, it offers favourable terms compared to debt costs and aids recapitalisation or restructuring in financial distress situations.

Common Junior/Hybrid Debt Structures

The common junior/hybrid debt structures are as follows:

- Holdco facility by private credit lenders with traditional Opco-level structures (eg, syndicated loans or high-yield bonds);
- junior/second lien facility by private credit lenders with senior financing from syndicated loans or high-yield bonds; and
- preferred equity.

Private credit lenders may also take equity shares (eg, common equity or warrants) along with providing debt.

Security Package

Typically, enforcement for Holdco instruments is above the Holdco borrower, with security over shares and receivables granted by its immediate shareholder. Alternatively, enforcement may be below the Holdco borrower, with a holding company covenant to prevent leakage, involving a share and receivables pledge over the entity below and an account pledge from the Holdco borrower.

3.8 Payment in Kind/Amortisation

In private credit transactions, PIK facilities are common, especially at the Holdco level, offering a "pay-if-you-want" option. Borrowers can choose to pay interest in cash or capitalise it, with discounts for cash payments, enhancing cash flow flexibility during periods of financial constraint.

Senior-level facilities are usually cash-pay, with an option to PIK interest for a set number of periods, applying a premium for deferred payments to compensate for increased risk.

Amortisation is not typically required, with lenders preferring bullet repayment at maturity. For incremental facilities, loan documents often require that additional debt should not be amortising unless existing lenders receive the same terms.

3.9 Call Protection

Call protection is a key feature in private credit loans. Lenders will typically require a prepayment premium ("make-whole") to compensate for the interest income lost due to early repayment. The structure of call protection varies and lenders also agree to a declining premium schedule (eg, NC1, 101). The exact prepayment fee terms are a matter of commercial negotiation.

4. Tax Considerations

4.1 Withholding Tax

While principal and fee payments aren't subject to UK withholding tax, interest payments are generally subject to withholding tax of 20% under the current law.

Double Tax Treaty Exemption

Private credit lenders often rely on an exemption under a double tax treaty ("DTT") if no domestic exemption is available. The conditions of the DTT and tax authority requirements must be analysed to ensure compliance. For example, the benefit of a DTT can generally only be claimed by persons that are "residents" of one or both of the contracting states. A person is usually a "resident" of a contracting state if they are "liable to tax" in it by reason of domicile, residence, etc (Article 4(1) of the OECD model tax convention). If a private credit lender is lending through a tax transparent lending vehicle ie, where the partners or members of the entity are directly responsible for tax arising on the income or gains of the entity, the vehicle itself is not "liable to tax" in that contracting state for the purposes of that treaty and, therefore, will not be a "resident" of that contracting state for those purposes. The application of the DTT to the vehicle would generally be denied.

Beneficial owners of the interest received by the tax transparent lending vehicle should seek relief in their jurisdictions of tax residence instead. The UK's double tax treaty passport ("DTTP") scheme allows expedited authorisation for non-UK lenders to receive UK source interest in line with the DTT rate of withholding tax. To obtain a DTTP, the lender must provide a tax residence certificate from its home jurisdiction tax authority and seek confirmation from HMRC as to its entitlement to treaty benefits.

Tax transparent lending vehicles can only use the DTTP scheme if all constituent beneficial owners of the income qualify for the same DTT benefits under the same DTT. If they do not, the DTTP is not applicable and each beneficial owner will need to make a long-form certificated claim.

Not all DTTs offer complete exemption from withholding tax and DTTP access can be complex, so other exemptions like the qualifying private placement ("QPP") exemption should be considered.

Domestic Exemptions

QPP

Conditions relating to the lender, borrower and terms of the debt (eg, a debt term under 50 years and at least GBP10 million (can comprise a placement of several debt securities)) will need to be satisfied. The lender (or its partners on its behalf) must make several confirmations, including residence in a "qualifying territory" with a DTT with the UK that includes a non-discrimination clause and the borrower must not be connected to the lender. The latter requires careful consideration if the private credit lender is participating in a loan by the main fund's lending vehicle.

Sovereign immunity

This public international law principle exempts certain foreign government entities from withholding tax on income earned in another country.

Corporate-to-corporate

This domestic exemption is available if the private credit lender is lending through a UK tax-resident company or a UK permanent establishment.

4.2 Other Taxes, Duties, Charges or Tax Considerations

For private credit lenders using tax transparent vehicles, a key consideration is that, under the Loan Market Association (LMA) definition of "qualifying lender", these vehicles are not considered "qualifying lenders" because they are not "beneficially entitled" to the interest. However, their ultimate partners or members are. The definition must therefore be amended to reflect this. If a lender is not a "qualifying lender", it cannot benefit from change in law protection in respect of the gross-up.

4.3 Tax Concerns for Foreign Lenders

Certain lending vehicles, particularly tax transparent vehicles, may not qualify for a DTTP. In these cases, a long-form certificated claim for each beneficial owner of the interest income is required, which can be time-consuming. If an interest payment is due before completion, the QPP exemption might be used as an alternative or short-term back-stop until HMRC grants treaty relief.

The QPP exemption is theoretically administratively simple, requiring only a QPP certificate from the lender to the borrower. However, there is some market uncertainty around the interpretation of the regulations. If the QPP exemption isn't viable as a back-stop, it may be possible to include an interest deferral mechanism in the facilities agreement allowing the borrower to defer payments until HMRC issues a gross payment direction.

4.4 Tax Incentives

There are no specific tax incentives for foreign private credit lenders lending into the UK. However, it is worth noting that in 2022, the UK introduced the qualifying asset holding company (QAHC) to enhance the UK's appeal as an asset-holding jurisdiction. This allows funds to establish asset-holding companies in the UK with greater tax efficiency and compete more effectively with the regimes in Luxembourg and Ireland.

To qualify, a QAHC must meet specific conditions including related to ownership and activities, which should be primarily investment-related. Continuous self-monitoring is essential to maintain QAHC status. Foreign private credit lenders wishing to hold UK assets using a UK vehicle should consider if the QAHC regime applies.

4.5 Non-Bank Status

It should be noted that for funds setting up entities in Europe, there has been increased scrutiny on economic "substance" tests, which consider factors like office space and employees. These requirements prevent funds from simply establishing a lending vehicle in a jurisdiction to access double tax treaty relief. The European Commission's anti-tax-avoidance directive (ATAD III) targets shell entities misuse for tax purposes.

EU entities must pass certain gateways related to income, staff and premises to prove sufficient "substance". Entities deemed to be lacking "substance" may be unable to obtain tax residence certificates or benefit from double tax treaties and EU Directives. The draft ATAD III is not finalised, so its impact on private credit finance is uncertain.

5. Guarantees and Security

5.1 Assets and Forms of Security

Under English law, taking security is a relatively straightforward process, allowing security over a wide range of asset classes through charges, mortgages or pledges. Commonly secured assets in sponsor-backed private credit financings include shares, bank accounts and intercompany receivables, with a floating charge often granted over other company assets.

The security package's scope depends on the transaction's nature, guided by "agreed security principles". For instance, loans to groups with valuable intellectual property or real estate may secure these assets to enhance the lender's position.

Loan agreements typically require material subsidiaries to provide security and guarantees similar to those of the borrower. The material subsidiary definition is negotiable but generally includes entities representing a certain percentage of the group's EBITDA or assets, which is typically 5%. Holding companies of material subsidiaries are usually expected to provide share security over the material subsidiaries' shares and any intercompany receivables they owe.

In leveraged financings, a charge is commonly granted by a chargor in favour of the lender (chargee), allocating specific assets to satisfy debt obligations. Charges can be fixed, attaching immediately to defined assets with the chargee exercising control, or floating, covering a fluctuating pool of assets and "crystallising" into a fixed charge upon certain events.

Importantly, the title and possession of the asset remain with the chargor, unlike mortgages or assignments by way of security, which transfer the security provider's title conditionally on release of the security or discharge of secured obligations. Pledges, creating possessory security, are rare in leveraged financings.

Perfection of security interests is crucial for validity and priority over other creditors. Perfection steps depend on the secured asset and the security interest's nature but are generally straightforward and low-cost and include:

- registration: all charges by an English company or limited liability partnership must be registered at Companies House within 21 days. For certain assets, registration at specific UK asset registries, like the Land Registry for real estate, is necessary; and
- notice: providing notice of the security interest to third-party debtors or account banks is essential, as the notice timing often determines the security's priority.

For security over English real estate, specific procedural steps and regulatory conditions must be met. An overseas entity granting security over a qualifying estate in England and Wales must be registered in the register of overseas entities at UK Companies House to register a mortgage at the Land Registry.

Once validly created and perfected, security under English law does not typically require ongoing maintenance. However, risks exist, such as a fixed charge being re-characterised as a floating charge if the chargee does not exercise control. Security is granted to a security trustee (or security agent) who holds the security interests on trust for secured creditors, allowing new lenders to benefit without restarting hardening periods.

5.2 Floating Charges and/or Similar Security Interests

Floating charges over all current and future assets of an English company are commonly granted. Private credit lenders typically require a robust security package with "fixed" security over several asset classes and "floating" security over all or substantially all assets.

5.3 Downstream, Upstream and Cross-Stream Guarantees

Downstream, upstream and cross-stream guarantees may be provided by English companies, subject to having the necessary power, capacity and corporate benefit.

For upstream and cross-stream guarantees, directors must assess the corporate benefit of granting these guarantees and the guarantors' financial standing. They will often seek shareholder approval to ensure alignment with company interests.

In private credit deals, term and revolving facilities and ancillary facilities under the RCF, typically share a common security and guarantee package. This can include permitted secured hedging if hedge counterparties join the intercreditor agreement.

A notable feature of many private credit deals is the super senior ranking of the RCF and certain permitted hedging. This arrangement allows RCF lenders and hedge counterparties to receive security enforcement proceeds before term lenders. This is a hallmark of the UK and European private credit markets. This structure is crucial for attracting RCF lenders, as most private credit funds are not equipped to offer revolving loans and associated clearing facilities.

5.4 Restrictions on the Target

Under the Companies Act 2006 (the "CA06"), public limited companies and their subsidiaries (public limited company or otherwise) are restricted from providing financial assistance for acquiring or refinancing the acquisition of shares in that public limited company, whether listed or unlisted. This includes guarantees, security, indemnities and any other assistance from a target company or its UK subsidiaries. Additionally, a UK public company cannot offer financial assistance for acquiring shares in its UK limited parent company.

Since this prohibition does not apply to private limited companies, lenders financing acquisitions of public limited companies typically require relevant public companies in the target group to re-register as private companies after the acquisition is completed and before providing any financial assistance.

5.5 Other Restrictions

Third-Party Consents

Third-party consents are necessary when there are restrictions on charging or assigning assets such as contractual rights, receivables or leasehold property. For small and medium-sized enterprises, the Business Contract Terms (Assignment of Receivables) Regulations 2018 facilitate access to financing by allowing the assignment of receivables governed by English law to finance providers and nullifying any terms that restrict these assignments in business contracts.

National Security and Investment Act

The National Security and Investment Act 2021 (the "NSIA") grants the UK government extensive powers to scrutinise acquisitions that may pose national security risks. The NSIA impacts secured creditors taking or enforcing security over certain assets. A mandatory notification requirement is triggered for share security involving legal title transfer or the acquisition of voting rights above defined thresholds in an entity carrying out activities in one of the 17 specified sectors subject to the mandatory notification regime under the NSIA. Without prior government clearance, these changes of control are void. The government can also issue a call-in notice if it reasonably suspects a change of control may risk national security.

Hardening Periods

English law includes several hardening periods before insolvency:

- transactions at an undervalue: two years;
- preferences (preferential treatment to one creditor): six months, extending to two years for connected parties;
- floating charges for insufficient value: 12 months, extending to two years for connected parties; and
- transactions defrauding creditors (ie, transactions entered into at an undervalue with the intention of putting assets beyond the reach of creditors): no time limit. Claims can be brought by any "victim" and not just administrators or liquidators.

5.6 Release of Typical Forms of Security

The principle of equity of redemption gives security providers the right to recover a secured asset upon satisfaction of the debt. The terms for releasing security are usually outlined in the security agreement or the intercreditor agreement, with the release of security documented in a deed of release executed by the security taker.

Upon release, the relevant registers, such as Companies House or the Land Registry, are also updated to note the release of the relevant security. These filings are generally straightforward and not costly.

5.7 Rules Governing the Priority of Competing Security Interests and/or Claims

Under English law, multiple security interests are allowed and parties can contractually agree on the order and priority of subordination. Besides contractual subordination, deal structures often involve structural subordination, where parent company's creditors are subordinated to subsidiaries' creditors. This occurs because subsidiary assets and cash flows typically satisfy their creditors first, leaving parent company creditors with structurally subordinated claims, with claims only on residual value after subsidiaries' creditors are paid. Case law supports both simple contractual and turnover subordination agreements, as neither violate the pari passu rule or anti-deprivation principle.

The priority of competing security interests under English law is complex. Generally, security interests rank by creation order, with exceptions:

- legal security interests (acquired for value without notice of prior equitable interests) take priority over equitable interests;
- notice to the debtor/contractual counterparty determines priority in successive purported assignments of the same debt or other chose in action;
- required registration at asset registries, (eg, the Land Registry), usually determines priority among competing interests by registration order, but Companies House registration does not directly affect priority; and
- subsequent fixed charges have priority over earlier floating charges unless the subsequent fixed charge-holder knows the earlier floating charge includes a negative pledge.

5.8 Priming Liens and/or Claims

Methods to Structure Around Priming Liens

Facilities agreements typically restrict incurring debt or granting guarantees/security that rank ahead of the lender's debt, extending to incremental facility provisions, which only allow pari passu debt. Any amendments to these restrictions in the facilities agreement or priority provisions in the intercreditor agreement will also be all-lender consent items. Junior creditors and super senior revolving lenders are usually stayed from enforcing remedies until senior creditors are repaid.

Subordination

Creditors of shareholder loans to the borrowing group are generally expected to become party to the intercreditor agreement as subordinated creditors. Group company creditors providing intercompany loans are also party to the intercreditor agreement, subordinating their claims to senior creditors. Parties may negotiate minimum debt thresholds for these accessions.

Anti-Layering

Private credit lenders typically require an anti-layering provision to prevent additional debt layers that could subordinate existing creditors' claims. These anti-layering provisions restrict borrowers from incurring new debt that ranks senior to existing obligations, maintaining the hierarchy of claims and protecting senior lenders' interests.

"No Short Circuit Clause"

Private credit lenders typically require a "no short circuit clause" to prevent junior creditors from bypassing the priority structure to receive payments or enforce claims ahead of senior creditors. This ensures junior creditors cannot undermine the agreed payment order, such as accessing collateral or receiving payments before senior creditors are fully satisfied.

5.9 Cash Pooling and Hedging/Cash Management Obligations

Cash pooling and other transactions in the ordinary course of banking operations are not usually restricted under the debt or security covenants in private credit transactions (similar to the treatment of these arrangements in broadly syndicated loans).

Any permitted secured hedging (where such hedge counterparties have acceded to the intercreditor agreement) will usually share the security and guarantee package. There may also be an agreed amount of hedging that will rank super senior.

5.10 Bank Licensing

Corporate lending is usually unregulated in the UK (see **2.1 Licensing and Regulatory Approval**). In general, regulatory issues do not arise with the taking or holding of collateral in the UK.

6. Enforcement

6.1 Enforcement of Collateral by Non-Bank Secured Lenders

In private credit transactions, a "single point of enforcement" is common, typically involving a share charge over the shares in a key holding company. This allows the secured lender to appoint a fixed charge receiver (FCR) over the shares or an administrator over the parent company to dispose of the shares of the holding company (and operating group subsidiaries). Enforcement of the share pledge takes control of the group away from the sponsor in order to deliver a going concern sale of the operating group.

Asset level security is increasingly rare and usually limited to subsidiary level bank accounts and intellectual property.

Enforcement typically involves an insolvency officeholder, being either:

- an FCR appointed out of court under the security document; or
- an administrator appointed out of court if lenders have a "qualifying floating charge" over most assets, or by court application.

An FCR, appointed by lenders that hold a fixed charge over specified debtor assets, has enforcement powers under the security document, such as taking custody or managing or selling assets to satisfy secured debt.

An administrator has broader legal duties to all creditors. Administration is a more public process and triggers a moratorium.

With adequate planning and some board or management co-operation, enforcement sales can often be pre-packaged, minimising the taint of insolvency.

6.2 Foreign Law and Jurisdiction

Choice of Foreign Law

Contracting parties can choose the governing law and jurisdiction for any contractual disputes. The choice of law may mirror the jurisdiction. If the governing law differs from the jurisdiction hearing the dispute, the foreign court may require expert evidence on the relevant law.

However, English courts will not uphold a choice of law for contractual obligations if to do so would be inconsistent with or overridden by Regulation (EC) No 593/2008 (Rome I) or for non-contractual obligations if it conflicts with Regulation (EC) No 864/2007 (Rome II), both as amended by the UK's post-Brexit The Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc) (EU Exit) Regulations 2019.

Submission to a Foreign Jurisdiction

Usually when parties agree to submit disputes to a foreign court's exclusive jurisdiction, a party cannot bring proceedings in England and Wales in breach of that agreement. If parties choose non-exclusive jurisdiction, this allows disputes to be heard in the jurisdiction specified in the clause, or the parties may be entitled to take disputes to other jurisdictions. If a claim is filed in England and challenged for jurisdiction, the English court will decide if it is competent to determine the dispute.

Waiver of Immunity

The enforcement of a waiver of immunity clause depends on its wording. The courts of England and Wales take a restrictive approach to state immunity under the State Immunity Act 1978 (the "SIA"), which confers general immunity from English court jurisdiction on foreign states with certain exceptions. These exceptions include where the State agrees to submit to the jurisdiction or to submit a dispute to arbitration and the relevant court proceedings relate to that arbitration. The SIA also provides immunity from execution, with exceptions including for written consent to execution or commercial transactions involving property used for commercial purposes.

6.3 Foreign Court Judgments

The enforcement of foreign judgments in the UK depends on the applicable legal regime, which varies according to the jurisdiction of the originating judgment.

The courts of England and Wales do not generally retry the merits of a recognised foreign judgment or arbitral award. However, a party must first bring a claim or application in England and Wales for recognition, after which the judgment or award becomes domestically enforceable. The recognition application process is typically straightforward, but parties can argue against recognition.

Recognition may be refused based on statutory grounds or under common law. Grounds for refusal include:

- fraud in procuring the foreign judgment;
- contradiction with the public policy of England and Wales;
- judgments related to taxes, or fines/penalties, or otherwise based on foreign laws considered penal or revenue-related by English courts;
- violation of natural justice principles;
- improper service of proceedings on the judgment subject; and
- lack of jurisdiction by the foreign court.

For arbitral awards, specific Conventions or Statutes, such as the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, dictate enforcement requirements. Any irregularities in meeting these requirements can be challenged during the recognition application process in England and Wales.

6.4 A Foreign Private Credit Lender's Ability to Enforce Its Rights

A foreign private credit lender's ability to enforce its rights under a loan or security agreement are no different to the ability of a non-foreign private credit lender to enforce their rights under a loan or security agreement.

6.5 Timing and Cost of Enforcement

The appointment of either an administrator or a receiver can be relatively quick remedies provided that the secured lender observes all contractual and statutory requirements. As a private remedy, the appointment of a receiver can be made on the same day as demand is made of the debtor.

6.6 Practical Considerations/Limitations on Enforcement

Enforcements involve a "change of control", necessitating diligence and structuring similar to M&A deals, including regulatory approvals, material contract reviews and tax planning.

Understanding the intercreditor position of any other creditor classes is crucial. In UK mid-market direct lending, unitranche lenders typically control enforcement, but it's important to consider any super-senior RCF or working capital facilities.

Effective enforcement often requires management support. Early thought should be given to management engagement, incentives or alternative teams. If any directors are uncooperative:

- lenders may remind them in writing of their personal duties, which, under English law shifts towards creditors when insolvency, liquidation or administration is probable; and
- in extreme cases, lenders could use voting rights under share security documents to remove uncooperative directors.

Receivers, administrators or security agents will require indemnification and possibly up-front cost coverage and separate legal counsel.

Insolvency is assessed on a company-by-company basis, so both English and non-English subsidiaries must be carefully managed, with filing obligations monitored according to jurisdiction.

6.7 Claims Against Secured Lenders Post-Enforcement

The value at which secured assets are disposed of is a key focus for potential challenge. Lenders typically protect against these claims by appointing an insolvency officeholder to transact. Administrators are subject to the "Statement of Insolvency Practice 16" or "SIP 16", while fixed charge receivers are not, but both adhere to similar standards in practice.

Valuation invariably requires market testing usually involving:

- a comprehensive sale process run by an M&A adviser, though an abbreviated/desktop process may suffice if urgent or if recent value evidence exists, such as a recent company-led sale process; and
- if feasible, an independent, robust process including a range of financial and trade buyers.

Receivers, administrators and/or security trustees may require a fairness opinion or valuation report from an independent accountancy firm or investment bank, even if not required by the intercreditor agreement. Lenders should not influence the process and are not obligated to delay a sale for junior stakeholders to recover more.

Other potential liabilities include:

- environmental fines or clean-up costs imposed during insolvency. These may rank as insolvency expenses, taking priority over secured creditors' claims. Secured creditors usually incur liability only when enforcing real estate security as mortgagees in possession;
- when an insolvency officeholder sells part or all of an insolvent company's business, employees generally transfer to the purchaser with their employment liabilities under the Transfer of Undertakings (Protection of Employment) Regulations 2006. Dismissals may result in unfair or wrongful dismissal liabilities for both seller and purchaser; and
- if a lender acts as a mortgagee in possession of shares in a borrower company and exercises voting rights, the lender may be liable for pension scheme deficits due to being connected with an employer in an occupational pension scheme.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Administration

The purpose of administration is threefold:

- rescuing the company as a going concern;
- achieving a better result for creditors as a whole than in an immediate liquidation (if the first objective is not reasonably practicable to achieve); or
- realising property for secured or preferential creditors (if the first two objectives are not reasonably practicable to achieve).

An administrator can generally be appointed out of court by the debtor company, its directors or a holder of a "qualifying floating charge".

Administrators have broad powers to conduct the business of the company and, subject to satisfying the requirements under the Insolvency Act 1986 (the "IA86"), dispose of its property, including assets under a floating charge. While an administrator is in office, most of the powers of the board of directors are suspended.

A statutory moratorium prevents enforcement of security or guarantees over the company's property without the administrator's consent or leave of the court. The same requirements for consent or permission apply to instituting or continuing legal processes. The moratorium does not extend to security arising under a "financial collateral arrangement" (generally, a charge over cash or financial instruments such as shares, bonds or tradeable capital market debt instruments and credit claims) under the Financial Collateral Arrangements (No 2) Regulations 2003 (the "FCAR").

Fixed Charge Receivership

An FCR may be appointed pursuant to the Law of Property Act 1925 over assets secured by a fixed charge or more commonly following a default under the terms of a security document that augments the statutory powers.

A receivership may run parallel to liquidation or administration, but an administrator may require a receiver to vacate unless appointed under a "financial collateral arrangement" under the FCAR.

The receiver's primary duty is to realise assets for the appointor, taking reasonable care to obtain the best price, in contrast to an administrator, who acts in the interests of all of a company's creditors and has different statutory objectives. The receiver is entitled to a statutory indemnity for liabilities from asset realisations and may receive a contractual indemnity from their appointor.

Liquidation/Winding-Up

Liquidation involves dissolving a company by realising and distributing assets to creditors and members according to statutory priority under the IA86. A winding-up takes two forms:

- court-ordered compulsory liquidation; and
- members' or creditors' voluntary liquidation.

In a members' voluntary liquidation, the company's directors swear a statutory declaration as to the company's solvency over the following 12 months. In a creditors' voluntary liquidation, the primary ground is the company's insolvency and inability to pay its debts.

Liquidators can bring or defend legal proceedings on the company's behalf, conduct the company's necessary business, sell company property, execute documents and challenge antecedent transactions.

Pre-Pack Sales

Pre-pack sales involve selling a company's business or assets to a third party or a lender owned vehicle immediately upon entering administration or receivership, with the sale arranged before the administrator's or receiver's appointment. Alternatively, a secured lender may appoint a receiver for the same purpose.

Pre-pack sales are frequently used to implement restructurings through share and/or asset sales in conjunction with a security enforcement.

A lender may "credit bid" its outstanding debt as consideration for the sale of the company/its assets to a lender-owned vehicle. Upon the sale, the debt/existing security is typically released by the security trustee under the terms of the intercreditor agreement. A direct lending context is generally straightforward with only one secured creditor (or creditor class) with clear priority on who can give enforcement instructions and more limited value protections in the intercreditor agreement.

The advantages of a pre-pack sale include:

- minimised business disruption, especially in receivership;
- pre-selection of a receiver or administrator and pre-agreed sale terms for a quicker, more economical process compared to a sale during trading administration;
- a faster realisation of cash for secured creditors, potentially yielding better returns due to reduced trading disruption;
- effective security enforcement implementation, triggering the release clause in an intercreditor agreement, enabling business transfer and leaving behind "out-of-the-money" creditors;
- directors benefiting from independent approval of credit bids by the administrator/receiver, reducing liability and minimising challenges from disgruntled creditors;
- limiting adverse publicity, media speculation and potential damage to the business' goodwill; and
- potential preservation of employment.

Recent updates to the pre-pack administration legal framework impose greater scrutiny on connected party transactions. However, this should not unduly impact secured creditors.

7.2 Waterfall of Payments

The general priority on insolvency is as follows (in descending order of priority).

- Holders of fixed charge security (but only to the extent the value of the secured assets covers that indebtedness) and parties with a proprietary interest in assets in the possession (but not under the full legal and beneficial ownership) of the debtor (but only with respect to the assets in which they have a proprietary interest).
- Expenses of the insolvent estate (there are statutory provisions setting out the order of priority in which expenses are paid), in certain circumstances, specific moratorium debts may rank ahead of expenses.
- Ordinary and secondary preferential creditors:
  - (a) ordinary preferential debts include (but are not limited to) debts owed by the insolvent company in relation to:
    - (i) contributions to occupational and state pension schemes;
    - (ii) certain wages and salaries of employees for work done in the four months before the insolvency date;
    - (iii) holiday pay due to any employee whose contract has been terminated, whether the termination takes place before or after the date of insolvency; and
    - (iv) certain bank and building society deposits eligible for compensation; and
  - (b) Secondary preferential debts rank for payment after the discharge of ordinary preferential debts and include claims by HMRC in respect of certain taxes (including VAT, PAYE income tax and employee NI contributions) which are held by the company on behalf of employees and customers as well as certain bank and building deposits that are not ordinary preferential debts.
- Holders of floating charge security, according to the priority of their security. This would include any security interest that was stated to be a fixed charge in the document that created it but which, on proper interpretation

by the court, was rendered a floating charge. However, before distributing asset realisations to the holders of floating charges, the "prescribed part" (a ring-fenced fund of up to GBP800,000 for the benefit of unsecured creditors) must, subject to certain exceptions, be set aside for distribution to unsecured creditors.
- Debts and liabilities:
  (a) provable debts of unsecured creditors and (to the extent of any unsecured shortfall) secured creditors, in each case including accrued and unpaid interest on those debts up to the date of commencement of the relevant insolvency proceedings;
  (b) interest on the company's unsubordinated debts in respect of any period after the commencement of liquidation or after the commencement of an administration which has been converted into a distributing administration; and
  (c) non-provable liabilities, being liabilities that do not fall within any of the categories above and therefore are only recovered in the (unusual) event that all categories above are fully paid (this does not include currency conversion claims).
- Shareholders: if, after the repayment of all unsecured creditors in full, any remaining funds exist, these will be distributed to the shareholders of the insolvent company.

7.3 Length of Insolvency Process and Recoveries
In general terms, the longer an insolvency process takes the greater the losses incurred by creditors. A pre-pack enforcement executed at the holding company level will typically protect the wider operating group from the taint of insolvency and preserve value in its operating subsidiaries. Trading administrations will require funding either from the business itself or from the group's creditors while the business is marketed. Depending on the group in question, this is usually for a limited period while the insolvency officeholder explores disposal opportunities.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency
See **7.9 Dissenting Lenders and Non-Consensual Restructurings** for descriptions of schemes of arrangement and restructuring plans.

7.5 Risk Areas for Lenders
See **7.6 Transactions Voidable Upon Insolvency** for descriptions of antecedent transactions that may be challenged by an insolvency officeholder of the borrower/guarantor. English law does not contain a concept of lender liability for deepening the insolvency of a borrower through further lending. Liability may arise if a lender acts as a shadow director of the borrower (ie, a person in line with whose directions or instructions the directors of a company are accustomed to act) but this threshold is a high one and requires a lender to act outside of its usual lending capacity.

7.6 Transactions Voidable Upon Insolvency
Under English insolvency law, certain transactions can be challenged if a company enters administration or liquidation within a specific period after entering into the transaction.

Transactions at an Undervalue
A liquidator or administrator can apply for a court order to set aside a transaction at an undervalue.

The transaction can be challenged within a period of two years from its entry if at the time of the transaction or as a result of it, the company was unable to pay its debts (as defined in Section 123 of the IA86) unless a beneficiary of the transaction was a connected person, in which case there is a presumption of insolvency and the connected person must demonstrate that the company was not unable to pay its debts at the time of the transaction or became unable to do so as a result of the transaction.

A transaction may be set aside as a transaction at an undervalue if the company made a gift to a person, received no consideration or received significantly less value than the company gave. However, a court will not make an order if it is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business and that, at the time it did so, there were reasonable grounds for believing the transaction would be beneficial.

If the court determines that the transaction was a transaction at an undervalue, the court will make such order as it sees fit to restore the company to the position it would have been in had it not entered into the transaction.

Preferences

A liquidator or administrator can apply to the court for an order to set aside a preference.

A transaction will only be a preference if, at the time of the transaction or as a result of the transaction, the company was or became unable to pay its debts (as defined in Section 123 of the IA86). The transaction can be challenged if the company enters into insolvency within a period of six months (if the beneficiary of the security or the guarantee is not a connected person) or two years (if the beneficiary is a connected person, except where such beneficiary is a connected person by reason only of being the company's employee) from the date the company grants the preference. A transaction will constitute a preference if it has the effect of putting a company's creditor (or a surety or guarantor for any of the company's debts or liabilities) in a better position than it would otherwise have been in the company's insolvent liquidation without the transaction. However, a court will not make an order unless the company was influenced by a desire to prefer the recipient.

If, however, the beneficiary of the transaction was a connected person it is presumed that the company desired to prefer that person unless the contrary is shown.

If the court determines that the transaction was a preference, it will make such order as it sees fit to restore the company to the position it would have been in had it not entered into the transaction.

Transactions Defrauding Creditors

A transaction may be set aside by the court as a transaction defrauding creditors if the transaction was at an undervalue and the court is satisfied that it was made for the substantial purpose of putting assets beyond the reach of a person who is making, or may make, a claim against the company, or of otherwise prejudicing the interests of a person in relation to the claim which that person is making or may make. Any "victim" of the transaction (with the leave of the court if the company is in liquidation or administration) may bring a claim under this provision, which is not limited to liquidators or administrators. There is no statutory time limit to initiate the challenge (subject to the normal statutory limitation periods) and the company does not need to be insolvent at the time of, or as a result of, the transaction.

If the court determines that the transaction was a transaction defrauding creditors, the court may make such order as it sees fit to restore the position to what it would have been if the transaction had not been entered into and to protect the interests of the "victims" of the transaction.

7.7 Set-Off Rights

Set-off of mutual debts in insolvency (liquidation and administration) is mandatory and self-executing.

7.8 Out-of-Court v In-Court Enforcement

See **7.1 Impact of Insolvency Processes** for a description of pre-pack sales. Consensual restructurings and semi-consensual restructurings (involving some type of enforcement action) are typically effected outside of court unless a statutory creditor compromise is required (see **7.9 Dissenting Lenders and Non-Consensual Restructurings**).

7.9 Dissenting Lenders and Non-Consensual Restructurings

Scheme of Arrangement

Although not an insolvency proceeding, under Part 26 of the CA06 the English courts have jurisdiction to sanction a scheme of arrangement that effects a compromise of a company's liabilities between a company and its creditors (or any class of its creditors). An English company or, provided certain conditions are met to engage the jurisdiction of the English court, a foreign company may propose a scheme with respect to its financial liabilities.

Before the court considers the sanction of a scheme of arrangement, affected creditors will vote on the proposed compromise or arrangement in respect of their claims in a single class or in a number of classes, depending on the rights of such creditors that will be affected by the proposed scheme and any new rights that such creditors are given under the scheme.

This compromise can be proposed by the company or its creditors. If a majority in number representing 75% or more by value of those creditors present and voting at the meeting(s) of each class of creditors vote in favour of the proposed scheme, irrespective of the terms and approval thresholds contained in the finance documents, then that scheme will (subject to the sanction of the court) be binding on all affected creditors, including those affected creditors who did not participate in the vote and those who voted against the scheme.

The scheme then needs to be sanctioned by the court at a sanction hearing where the court will review the fairness of the scheme and consider whether it is reasonable. The court has discretion as to whether to sanction the scheme as approved, make an order conditional upon modifications being made or refuse to sanction the scheme. Once sanctioned, the scheme of arrangement binds all affected stakeholders whose rights will be as set out in the scheme of arrangement, which will be effective (in line with its terms) upon delivery of the court's order sanctioning the scheme of arrangement to the Registrar of Companies.

Unlike an administration proceeding, the commencement of a scheme of arrangement does not automatically trigger a moratorium of claims or proceedings.

Restructuring Plan

Like a scheme of arrangement, a restructuring plan is a procedure under Part 26A of the CA06 which allows the English courts to effect a compromise of a company's liabilities between a company and its creditors (or any class of its creditors), but with the added possibility of a "cross-class cram-down". While generally available to the same domestic and foreign companies as schemes of arrangement, a company seeking to enter into a restructuring plan process must show that:

- it has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern; and
- a compromise or arrangement has been proposed between the company and its creditors (or any class of them) for the purpose of eliminating, reducing or preventing, or mitigating the effect of, any of those financial difficulties.

A restructuring plan may be proposed by the debtor company, any creditor of the company or any liquidator or administrator appointed to the company. Affected creditors will vote on the proposed compromise or arrangement in respect of their claims in a single class or in a number of classes depending on the rights of such creditors which will be affected by the proposed restructuring plan and any new rights that such creditors are given under the restructuring plan.

A restructuring plan will be deemed to be approved if at least 75% in value of the creditors and/or members (if applicable) present and voting at the meeting of at least one class of creditors vote in favour of the proposed compromise. There is no requirement for the approving creditors to constitute a majority in number of those creditors present and voting, and there is crucially no requirement for each and every voting class to approve of the plan, provided that the court is satisfied that:

- none of the members of a dissenting class would be any worse off if the restructuring plan were to be sanctioned than they would be in the event of the "relevant alternative"; and
- the restructuring plan was approved by at least one class of creditors who would receive a payment or have a genuine economic interest in the company in the event of the "relevant alternative".

The "relevant alternative" for the purposes of this assessment is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned. By virtue of these mechanisms, the restructuring plan process provides for the possibility of a "cross-class cram-down", meaning the courts may sanction a restructuring plan even if one or more classes of affected creditors do not vote in favour of the restructuring plan, effectively allowing the vote of one class of stakeholders to bind other classes.

Following approval of the restructuring plan at the creditor meeting(s), the restructuring plan needs to be sanctioned by the court at a sanction hearing where the court will review whether the applicable statutory conditions have been met and may also consider whether the restructuring plan is just and equitable. The court has discretion as to whether to sanction the restructuring plan as approved, make an order conditional upon modifications being made or refuse to sanction the restructuring plan.

Once sanctioned, the restructuring plan binds all affected stakeholders whose rights will be as set out in the restructuring plan, which will be effective (in line with its terms) upon delivery of the court's order sanctioning the restructuring plan to the Registrar of Companies or, where the company is an overseas company, publication of the court's order in the Gazette. As with a scheme of arrangement, the commencement of a restructuring plan process does not automatically trigger a moratorium of claims or proceedings.

7.10 Expedited Restructurings

See **7.1 Impact of Insolvency Processes** for a description of pre-pack sales.

8. Case Studies and Practical Insights

8.1 Notable Case Studies

In general, concerns relating to leakage permissions in the covenants and liability management that apply to syndicated loans also apply to private credit loans. These concerns may be heightened in private credit transactions due to:

- the lack of liquidity, which means that private credit lenders cannot easily exit their positions, prompting them to seek stricter terms to protect their investments over the loan's duration;
- private credit lenders often provide bespoke financing solutions tailored to specific borrower requirements. In exchange for this customisation and flexibility, stricter covenants and terms to ensure that the borrower adheres to agreed-upon financial and operational metrics are required; and
- private credit lenders often take a more active role in monitoring and engaging with borrowers compared to syndicated lenders. Stricter terms facilitate this involvement, allowing earlier intervention if a borrower's performance deviates from expectations.

On Holdco deals, even if there are significant flexibilities in the Opco documents, private credit lenders will require certain flexibilities to be limited at the Holdco level.

8.2 Lessons Learned

Due Diligence and Risk Assessment

Thorough due diligence and robust risk assessment are crucial in private credit transactions. Recent deals underscore the need for lenders to deeply understand the borrower's business model, industry dynamics and financial health to mitigate risks effectively.

Covenant Structures

The use of covenants remains a critical tool for managing risk. Recent transactions illustrate the trend towards more nuanced covenant structures that balance protection for lenders with operational flexibility for borrowers.

Market Adaptability

The private credit market is influenced by broader economic conditions, such as interest rate fluctuations and geopolitical events. Recent transactions demonstrate the importance of adaptability, with lenders and borrowers adjusting terms and strategies to reflect changing market conditions.

Partnerships and Collaboration

Collaboration between private credit lenders and other financial institutions can enhance deal execution and broaden the range of available financing solutions. Recent deals highlight the benefits of strategic partnerships in expanding market reach and leveraging complementary strengths.

Focus on ESG

ESG considerations are increasingly important in private credit transactions. Recent deals reflect a growing emphasis on incorporating ESG criteria into investment decisions, aligning with broader trends towards sustainable and responsible investing.

8.3 Application of Insights

Acknowledging the bespoke nature of private credit offerings is essential for both lenders and borrowers. Private credit funds are known for their underwriting flexibility, which allows them to tailor financing solutions to meet the specific needs of borrowers. This flexibility is a significant advantage, enabling private credit lenders to structure deals that might not fit the more rigid frameworks of traditional bank or syndicated loans. However, this adaptability also means that the documentation for private credit transactions tends to be more nuanced and requires careful negotiation.

While there are similarities between private credit products and those offered by the syndicated market, the tailored approach of private credit necessitates a distinct strategy. By engaging specialist teams early on, both lenders and borrowers can optimise their strategies, ensuring that the final terms of the transaction are well-suited to their respective needs and objectives.

Trends and Developments

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Latham & Watkins advises sophisticated global direct lenders and private capital providers on hundreds of front-end transactions each year, including first and second lien, unitranche and mezzanine loans and preferred equity and other junior capital. It advises across a range of deal sizes stretching from the middle market through the largest and most complicated unitranche transactions with deal sizes in excess of USD1 billion. It regularly designs and implements multi-tiered capital structures for clients and handles subordination, security, and intercreditor issues, as well as restructurings, equity co-investments and tax and regulatory matters. Its direct lending and private debt practice draws on a long history of innovation and experience. It advises the most active lenders, funds, credit platforms and investment managers as well as borrowers in the full range of transactions from the middle market to large-cap.

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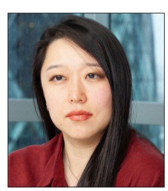

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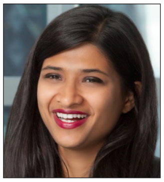

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Increasing Prominence of Private Credit

Private credit has become an increasingly prominent form of non-bank lending since the global financial crisis, representing a critical component of the financing sources which drive the global leveraged finance market. Pressures of inflation, increasing interest rates, geopolitical unrest and other macroeconomic factors served to push the private credit market to exceed approximately USD1.5 trillion in assets under management (AUM) at the end of 2024, with current growth projections implying a continuing upwards curve.

Once labelled as "alternative lending", private credit providers now compete on a level playing field with more traditional bank lenders or bank arranged lending, both in the context of providing financing to private equity-backed or "sponsored" businesses, as well as non-sponsored businesses. This type of lending plays an important role in leveraged buyouts (LBOs), refinancings, dividend recapitalisations and other forms of financing arrangements, and has become a crucial alternative to the bank-driven lending market.

As regulatory changes and financial market shifts have led to a reduction in traditional bank lending, particularly to middle market and higher-risk borrowers, private credit has stepped in to fill this void, offering both flexibility and customised solutions for businesses in need of capital. This chapter explores the trends that have already shaped private credit in the UK, as well as emerging trends that are set to redefine its role in leveraged finance.

Growth in market size

Private credit has grown significantly in recent years, especially in the wake of post-2008 regulatory changes that increased the difficulties higher-risk borrowers faced in accessing loans from traditional banks. As of 2024, the global private credit market is estimated to exceed USD1.5 trillion in AUM, with projections suggesting this figure could continue to grow by between 10% and 15% annually over the next few years.

This rapid expansion can largely be attributed to the rise of institutional investors, including pension funds, insurance companies and sovereign wealth funds, seeking higher yields than those offered by traditional fixed-income instruments.

Increased competition between private credit and syndicated bank markets

The key benefits of private credit as a source of capital have traditionally been:

- the increased speed of execution that smaller, more nimble private credit teams can provide with quicker response and decision-making times;
- increased flexibility regarding the types of capital solutions private credit can offer, including an ability to provide debt, equity and hybrid capital solutions. This flexibility has made private credit financing particularly attractive; and
- additionally, if a business is acquisitive or has plans for future expansion through acquisitions, private capital lenders' ability to provide capex acquisition lines from day one and additional incremental capital for businesses' future growth is highly attractive to sponsors and management teams.

Despite the attractiveness of private credit as a capital source, the broadly syndicated loan markets remain active and highly competitive in terms of loan pricing. For a period of time following the beginning of the Ukraine war, syndicated bank lending volume in Europe severely declined and the majority of transactions were consummated using private capital. As syndicated markets reopened, a number of private credit deals were refinanced with cheaper debt, leading to increased competition between banks and credit funds to provide financing solutions to businesses and retain market share. This trend is likely to continue into 2025 as call protection in private credit deals signed up during 2022 and 2023 begin to taper off. However, a number of private credit funds are pre-empting this potential shift by offering price cuts and greater covenant flexibility in order to maintain their hold on market share.

As the M&A pipeline throughout the later part of 2024 and into 2025 has started to build, both broadly syndicated financing and private capital financing will remain highly relevant in the leveraged finance landscape. Some situations will inevitably favour one form of lending over another, whether due to sectoral, geographic or currency constraints. However, many situations (indeed those involving businesses with more complex capital needs) will require both forms of financing simultaneously, for example by way of multi-tranche senior secured debt, senior bank debt plus private junior debt and/or equity capital or hybrid-style financings.

Diversified sources of private capital

While private credit yields remain attractive relative to other asset classes, increased competition from the syndicated bank market, in particular, downward pressure on pricing, has encouraged diversification of financing sources by private credit funds whose underlying investors traditionally expect a higher rate of return than bank shareholders. Several larger asset managers have deployed insurance-based acquisition strategies to boost capital available for deployment at a lower cost than traditional sources of funding. In addition, a number of asset managers have expanded their fundraising efforts by opening fund investment opportunities to high net worth individuals and family offices. This has permitted certain private credit funds to offer businesses a lower cost of capital, increasing the fund's AUM and maximising deployment opportunity.

Bifurcation of private credit market

In the last five years the ever-growing private credit market has clearly bifurcated into an elite camp of super-private credit providers and a more crowded group of competitor funds lending smaller amounts. Several big-ticket asset managers have effectively used scale and size to become super-private credit providers, allowing large-cap businesses to use private credit as a one-stop shop for senior and junior financings, with credit funds underwriting ever-larger capital needs and allocating that capital to multiple different accounts under a single asset manager. Several ground-breaking private credit financings have taken place in recent years with private credit lenders providing multibillion-dollar loans to businesses in transactions which more typically would have been financed using the broadly syndicated markets.

Identifiable clear water has developed between a smaller number of mega-funds and a larger number of credit funds which operate in a more crowded and competitive landscape, typically lending smaller amounts to a greater number of businesses. Numerous private credit funds continue to operate multi-strategy approaches. However, many funds invest across the whole credit spectrum, from performing loans to special situations and distressed lending.

Convergence of lending activity

This rise of the mega-funds has created an interesting development over the last three to five years. The larger funds' ability to compete with traditional bank markets has given rise to an increased level of interest in private credit within banks, which has spurred several banks to establish their own private credit platforms.

Conversely, the increased frequency and attractiveness to businesses of the jumbo-private credit transaction has encouraged private credit lenders to underwrite entire capital structures, then syndicate that risk to incoming lenders, limited partners and other investors, in some ways mirroring the traditional activities of syndicated lending arrangers.

In addition, we have recently seen a noticeable increase in partnerships between traditional bank lenders and private credit funds. This is not a new phenomenon (such joint ventures were explored in the years immediately following the 2008 global financial crisis), but in 2024 the number of new co-lending platforms being created between banks and funds increased in both the US and Europe. These joint ventures are mutually beneficial for all stakeholders and allow credit funds access to a wide network of corporate borrowers through the banks' relationships, while allowing banks to deploy capital to private credit borrowers while maintaining sufficient regulatory capital reserves. Borrowers also benefit from a "one-stop" relationship and are able to efficiently access products such as revolving credit and guarantee lines, which private credit funds have not traditionally offered.

Convergence of documentary terms

In addition to this reallocation of traditional roles in the leveraged finance market, legal documentary terms between broadly syndicated deals and private credit deals have converged.

In recent years, in the large-cap financing markets, the gap between documentary terms of loans provided by private credit funds and those financed by the broadly syndicated loan market has narrowed considerably. Increasing pressure to deploy capital coupled with private credit funds developing stronger relationships with private equity sponsors, particularly in Europe, has led to a commoditisation of senior secured lending terms, whereas historically, private credit and bank markets catered to different borrower needs. The trend towards documentary term convergence is also becoming more evident in the mid-market space where private equity sponsors are increasingly likely to run dual track processes for smaller deals, creating increased competition in a space that has historically been serviced by private credit funds and smaller bank clubs.

In the leveraged finance market, private credit has increasingly accepted covenant-lite financings with no financial maintenance covenants and high-yield style covenant packages, albeit with tighter controls around debt incurrence and value leakage. Private credit funds' acceptance of these features is now commonplace, in particular for strong borrowers in robust defensive sectors. There is now tighter alignment between syndicated pricing and private credit pricing, including as to arrangement fees. Private credit interest rate spreads, while still higher, no longer reflect the more substantial premia seen in past years.

That said, as private credit funds hold risk to maturity and typically do not operate an originate-to-distribute model like traditional arranger banks, documentation remains more lenderfriendly in certain respects. Key differences continue to revolve around debt incurrence capacity, dividend and other leakage regimes, call protection and prepayment requirements, as well as the imposition of tighter controls around sponsors' ability to run liability management exercises. Private credit funds' closer attention to downside risk is off-set by the flexibility offered to sponsors and companies through creative capital solutions and the ability to offer payment in kind (PIK) interest structures.

Future deployment trends

One of the many benefits the private credit industry offers to companies is the ability to offer flexible financing all across the capital structure. We have seen an increase in the popularity of junior financing and hybrid capital solutions, such as Holdco PIK financing and private credit funds offering preferred equity solutions as part of their multi-strategy investment mandate.

While PIK financing may not be appropriate for every business and is often sector-specific, it offers sponsors and companies the advantage of maintaining greater cash liquidity within their operating businesses. This liquidity can be crucial for businesses planning to expand through acquisitions or, as has been particularly relevant recently, for those preferring to retain more cash on their balance sheets for debt servicing due to the higher interest rate environment.

Similarly, with the reopening of the broadly syndicated markets throughout 2024, companies are seeking favourable ratings on their senior debt issuances. Private credit funds have been able to provide preferred equity investments and hybrid instruments in lieu of debt, satisfying ratings criteria. We see this trend continuing into 2025 and beyond and a number of large private credit asset managers have raised substantial junior capital funds for this purpose.

As competition in the leveraged finance space increases for credit funds, we have seen a recent increase in diversification of investment mandates towards other areas of finance which were formerly the preserve of more specialist lenders. Areas of increased attention from private credit include infrastructure and project financings as well as asset-based lending, both of which increased substantially in 2024. We expect this trend to continue as private credit seeks to expand its horizons beyond the leveraged finance landscape.

For borrowers, private credit provides advantages that traditional bank loans do not, including flexible repayment terms, fewer covenants and quicker loan processing times. In a competitive financing environment, private credit allows businesses to tailor loan structures that better meet their strategic needs, making it an appealing option for companies involved in mergers and acquisitions, restructurings or growth initiatives.

Regulatory change

Regulatory developments will continue to shape the private credit landscape. While the regulatory environment for private credit is generally less stringent than for traditional banks, governments and regulatory bodies may introduce new rules to address concerns around financial stability, systemic risk and transparency. While private credit funds are not deposit-taking institutions, as they expand their sources of capital into high net worth individuals and family offices, this is likely to attract more scrutiny from regulators as the private credit market matures.

Conclusion

Private credit is poised to continue its rapid growth and transformation, driven by the shifting dynamics of the global finance industry. With increasing demand for flexible, customised financing, coupled with a broader range of lending strategies, private credit will play a central role in the leveraged finance market and beyond for years to come. As the market adapts to economic, regulatory and technological changes, private credit will remain a key asset class for institutional investors seeking higher returns and diversification.

USA

Law and Practice

Contributed by:
Stelios Saffos, Dan Seale, Peter Sluka and Alfred Xue
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Contents

Latham & Watkins is ranked in Band 1 in the USA by Chambers and Partners and advises sophisticated global direct lenders and private capital providers on hundreds of front-end transactions each year, including first and second lien, unitranche and mezzanine loans, and preferred equity and other junior capital. It advises across a range of deal sizes stretching from the middle market through the largest and most complicated unitranche transactions with deal sizes in excess of USD1 billion. It regularly designs and implements multi-tiered capital structures for clients and handles subordination, security, and intercreditor issues, as well as restructurings, equity co-investments and tax and regulatory matters. Its direct lending and private debt practice draws on a long history of innovation and experience. With more than 150 lawyers nationwide, it advises the most active lenders, funds, credit platforms and investment managers as well as borrowers, in the full range of transactions, from the middle market to large-cap.

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1. Private Credit Overview

1.1 Private Credit Market

The private credit market had previously flourished at the same time as the broadly syndicated market experienced a dislocation. However, over the last 12 months, banks have been returning to the syndicated market strongly, resulting in tougher competition for private credit lenders. At the same time, a wave of repricings reduced the higher spreads that had traditionally been a feature of the private credit market and created downward pressure on the size of loan commitments provided by direct lenders. Moreover, M&A and IPO activity was muted as many prospective deal makers sat on the sidelines waiting out the results of the US Presidential election. As a result of these increased challenges in the private credit market, lenders focused more on new asset classes and industries such as infrastructure, consumer lending and real estate to carve-out gains in a tepid landscape for deal activity.

That said, with the 2024 Presidential election behind us, the 2025 outlook points towards gaining momentum for M&A and IPO activity. Given the repeated success of the private credit market in providing private equity sponsors with speed, innovative financing solutions and execution certainty, the private credit market will be poised to capitalise on this increased activity over the next 12 months.

1.2 Interaction With Public Markets

Public debt markets have become increasingly competitive with the private credit market over the course of 2024, marking a shift from 2023 when the vast majority of acquisition financings were provided by private credit lenders. With falling interest rates tightening credit spreads, the broadly syndicated market roared back in 2024 to recapture the market share that investment banks had ceded to private credit lenders, in particular through refinancings, which, according to LCD data, accounted for 20% of financing transactions by deal count in 2024.

Despite this competitive landscape, banks have been increasingly involved in a number of key partnerships with private credit players, showcasing the undeniable strength of the private credit market and signalling the evolving relationship between the public and private debt markets. For example, Citigroup Inc entered into a USD25 billion partnership with Apollo Global Management in 2024 and Wells Fargo teamed up with Centerbridge Partners in a USD5 billion partnership. We expect more partnership announcements of this kind in 2025 as market participants look to consolidate and strengthen their positions as the outlook brightens with increased M&A and IPO activity.

1.3 Acquisition Finance

Private debt continued to play a major role in acquisition financings over the last 12 months as private credit lenders stepped up with committed financings in the form of jumbo unitrache debt facilities to support some of the largest acquisition financings on tight timelines. To meet the demand of rising deal sizes, private equity sponsors have increasingly been building larger clubs of private debt lenders rather than relying on a single or small number of underwriters.

1.4 Challenges

The main challenge for the expansion of private credit has been the re-emergence of the broadly syndicated market against the backdrop of tightening credit spreads, which in turn increased competitive pressure from investment banks in the syndicated space. Private credit lenders have also become more cautious and conservative following the erosion of deal protections stemming from the fast growth of the private credit market. Private credit lenders have sharpened their focus on liability management issues, particularly following the Pluralsight drop-down of assets to ensure that the erosion of terms does not become commonplace in the market.

1.5 Junior and Hybrid Capital

The primary product for private credit providers remains the unitranche facility. However, private equity sponsors have also turned to private credit lenders for a variety of creative hybrid financing packages including Holdco facilities, mezzanine debt and junior capital positions to provide additional liquidity to support acquisitions in the United States without sacrificing leverage levels. Private equity sponsors in the United States have been increasingly taking advantage of debt-like, non-convertible preferred equity in order to supplement the liquidity of the operating company within the corporate structure, with the preferred equity allowing sponsors to incur additional leverage without the burden of cash interest payments (as these products often have a payment in kind (PIK) feature).

1.6 Sponsored/Non-Sponsored Debt

Private credit providers are primarily focused on private equity sponsors and their portfolio companies. At the same time, private credit solutions also support emerging growth companies and non-investment grade corporate borrowers (including public borrowers). By contrast, private credit providers are not particularly active in the investment grade space. Yields are therefore often insufficient to satisfy a private credit provider's investment strategy.

1.7 Recurring Revenue Deals and Late-Stage Lending

Recurring revenue deals are still a relatively new innovation allowing lenders to finance growth-stage companies that have low or negative earnings before interest, taxes, depreciation and amortisation (EBITDA). Amid the increasing interest rate environment in the back half of 2022 and throughout 2023, the number of recurring revenue deals coming to market slowed dramatically. This last year, however, saw the re-emergence of these transactions both in the context of new take-private acquisitions (including Vista's closing in Q1 of EngageSmart) and the private M&A markets.

1.8 Deal Sizes, Fund Sizes and Fundraising

Overall transaction size between private credit transactions and syndicated matters has continued to converge further. Private credit continues to see a greater number of jumbo deals at market.

The private credit asset class continues to attract investor interest. In the last 12 months, traditional banks have pushed further into the private credit space via partnerships and also internal focus on private credit solutions. Additionally, the continued enthusiasm for private credit has spurred a wave of consolidation (including Blackrock's planned acquisition of HPS Investment Partners).

1.9 Impending Regulation and Reform

With a new US administration, the Federal Trade Commission (FTC) and the Justice Department more broadly are expected to reduce regulatory scrutiny around M&A and financial services. Accordingly, many are anticipating a robust year for the M&A markets with private credit serving to support many transactions.

2. Regulatory Environment

2.1 Licensing and Regulatory Approval

While no US federal regulatory framework applies to non-bank lenders that are engaged in commercial lending in the United States, a few US states require non-bank lenders to obtain a licence before engaging in commercial lending activities (ie, lending activities between corporate lenders and corporate or institutional borrowers for business or commercial purposes) under certain circumstances. The commercial lending licensing requirements of some of these states are generally only triggered when a commercial loan is secured by real property located in the state. In our experience, California is the state most often implicated in the commercial lending context due to the broad scope of California's commercial lender licensing requirement. The US states that may impose commercial lending licensing requirements (unless an exemption from such licensing requirements applies), generally include California, Florida, Nevada, North Dakota, South Dakota and Vermont.

While New York has a commercial lending licensing requirement, the requirement only applies to business and commercial loans in the principal amount of USD50,000 or less that also meet other specified conditions.

2.2 Regulators of Private Credit Funds

Certain US state banking regulators are the primary regulators for private credit activity in the United States.

2.3 Restrictions on Foreign Investments

Special rules may apply depending on the industry and asset. Generally speaking, typical areas of regulatory approval for acquisitions (or financings thereof) include US antitrust regulations, foreign direct investment laws applicable to the industry and asset (for example Committee on Foreign Investment in the United States (CFIUS) approvals), along with customary sanctions, anti-money laundering and KYC rules that apply to lenders generally.

2.4 Compliance and Reporting Requirements

Private credit providers may have specific reporting requirements to their investors and to regulators depending on the vehicle utilised. For example, business development companies (BDCs) arranged by private credit providers may have to meet specific disclosure and reporting requirements.

2.5 Club Lending and Antitrust

Private credit providers are able to provide sole underwrites or club deals for large multibillion-dollar transactions on terms that are competitive. This approach of forming clubs to facilitate larger transactions has not raised any regulatory impediment.

3. Structuring and Documentation

3.1 Common Structures

In recent years, we have seen the size of private credit transactions continue to grow while the dry powder available for deployment by such direct lenders has simultaneously increased.

Increasingly Shorter Process

The timeline for transactions in the private credit space is consistently shrinking. In recent times, sponsors have increasingly elected to equity back-stop new acquisitions and skip a commitment letter process and move directly into the credit agreement negotiation instead. Of course, this type of process would not be possible in the syndicated market.

Recurring Revenue Transactions

2024 saw the emergence of transactions based on annual recurring revenue (including Vista's announced take-private of Smartsheets). Only private credit providers have been involved in supporting these transactions, which involve lenders supporting high-growth technology businesses with strong recurring revenue and a promising future which would allow for the transaction to flip to EBITDA metrics down the line.

Delayed Draw Term Loans

Private credit providers are well-positioned to make delayed draw facilities readily available. In instances where a sponsor is looking to implement a "growth by acquisition" strategy, this ability can make a private credit solution more attractive than a syndicated option which may not include an accompanying delayed draw component. It is less typical for syndicated solutions to offer sizeable delayed draw components.

Portability

Private credit lenders are typically closely engaged with the sponsor and well-positioned to move quickly on amendment transactions. In 2024, a number of amendments and refinancings included the addition of portability (ie, a "permitted change of control") allowing the Opco to trade hands without triggering an event of default.

PIK

Sponsors are often seeking PIK options in private credit transactions to allow the sponsor increased flexibility in managing liquidity.

Financial Covenants

Financial covenants in private credit transactions increasingly look more like financial covenants included in syndicated transactions. In other words, where private credit lenders had previously sought financial maintenance covenants applicable to the full facilities, recent private credit transactions mirror syndicated documentation in providing for a springing financial covenant only applicable to the revolver and only triggered when the revolver is drawn above a certain threshold.

3.2 Key Documentation

Many middle market and larger private credit transactions are being structured as unitranche deals with a payment waterfall directly included in the credit agreement itself. This removes the need for a separate agreement among lenders. Still, where a capital structure includes an unsecured mezzanine debt component, the senior secured facility and the mezzanine debt facility will be bound together by a subordination agreement designed to restrict payments on the mezzanine debt (for the benefit of the senior secured facility).

3.3 Restrictions on Foreign Direct Lenders

Foreign lenders may be subject to certain limitations that prevent them from leading deals or serving in the agency function.

3.4 Use of Proceeds and Acquisition Financings

Using proceeds to acquire (or carry) "margin stock" is subject to certain limitations and restrictions. These apply if the direct or indirect security for the acquisition financing consists of securities that are traded on an exchange in the US, or "margin stock". These restrictions (often referred to as the "margin regulations") limit the amount of loans that can be collateralised by these securities.

The US margin regulations can also be triggered by the existence of arrangements that constitute indirect security over "margin stock", such as through negative pledge provisions or other arrangements that limit a borrower's right to sell, pledge or otherwise dispose of "margin stock". In addition, borrowers and issuers are restricted from using proceeds in violation of applicable laws, including anti-money laundering, sanctions and anti-corruption laws, and these restrictions are usually included in the financing agreement.

As a market convention, the use of proceeds for an acquisition financing is often limited by contract to the financing of the acquisition (including purchase price adjustments), the refinancing of existing indebtedness and, to a limited extent, for initial working capital. Acquisition financings rarely also permit additional special dividends but earn-outs and appraisal rights are often funded with proceeds of acquisition financings.

3.5 Debt Buyback

Generally speaking, borrowers, and their sponsors, are contractually permitted to buy back term loans (but not revolving debt). The extent to which these purchases may be conducted is often limited to between 25% and 30% of total outstanding term loans.

Loan documentation (in both the syndicated and private credit markets) has developed since the great financial crisis to permit non-pro-rata debt buybacks. All except the lowest middle market loan documentation will include customary provisions permitting Dutch auction buybacks offered to all lenders. Many sponsors also insist on the ability to buy loans from lenders via "open market repurchases", which may not expressly need to be offered to all lenders.

Any analysis should be undertaken on a case-by-case basis.

3.6 Recent Legal and Commercial Developments

Liability Management Transactions

Certain liability management exercises have impacted private credit transactions (eg, Pluralsight) and increased the focus of private credit lenders on capacity for investments in non-loan parties and in liability management protections more generally. At this point, private credit lenders are increasingly assessing not only the presence of liability management protections but also the flavour of the protections included in debt documents.

Portability

While M&A and capital markets activity is increasing, the prior trough in deal activity prompted an increasing number of sponsors to seek portability in the form of "permitted change of control" provisions.

3.7 Junior and Hybrid Capital

Private credit providers continue to develop and deploy new junior and hybrid capital solutions to provide additional liquidity. These options allow for higher overall leverage levels. In many instances, sponsors are looking to debt-like, non-convertible preferred equity at the Holdco level.

3.8 Payment in Kind/Amortisation

Private credit transactions are increasingly including PIK components.

Availability of PIK Option

In the context of a typical private credit transaction with an Opco (as opposed to a Holdco debt), a PIK option is limited to the first two or three years following the closing date. In other words, after year two (or, in some cases, year three), all interest payments must be made fully in cash.

Amount of PIK

When available, a PIK option will allow for some portion of the "applicable margin" due on a term loan facility to be paid-in-kind. The amount of "applicable margin" that may be paid-in-kind is typically capped at 50% although this is negotiated between the parties. Moreover, where a term loan facility includes a pricing step-down (or series of step-downs), private credit providers may expect a "minimum cash pay" construct which prevents the amount of cash margin paid from dipping below a certain level (eg, a 2.50% "minimum cash pay").

PIK Premium

Where a PIK option is available, private credit providers expect to be paid a premium when the PIK option is exercised. This premium may be hardwired at 50 bps so that any usage of the PIK option produces a 50 bps premium. Alternatively, some formulations will allow the borrower to only use a portion of the PIK option and only pay a portion of the PIK premium (eg, only convert half of the allowable 50% of the margin into PIK (ie, 25% PIK) and only pay half of the premium (ie, 25 bps).

Amortisation

Private credit transactions that include a PIK option often include some level of amortisation holiday. A common formulation would be to forgo amortisation in any quarter in which a PIK election is made. That said, there are some private credit deals in the market without any amortisation at all for the life of the loan.

3.9 Call Protection

Private credit providers continue to seek broader call protection than that typically offered in the syndicated market. But while private credit providers continue to seek 103/102/101 or 102/101 "hard call" formulation these protections have been diluted by various carve-outs not historically included in "hard call" formulations.

Exclusions

Recent private credit transactions generally include some combination of the following exclusions:

- internally generated cash;
- a qualified IPO;
- sale of all or substantially all of the applicable borrower's assets;
- change of control;
- dividend recapitalisations; and
- some sort of "transformative transaction" or "enterprise transformative event" (typically defined as: (x) an acquisition or disposition of significant size; (y) a transaction that is not permitted by the existing debt documents; and/or (z) a transaction that if consummated would not leave the borrower sufficient flexibility under the existing debt documents).

Of course, many transactions will include some subset of this list and there is certainly room for negotiation around underlying definitions like "internally generated cash" and "transformative transaction".

Step-Downs

In a traditional 102/101 "hard call" formulation, any prepayment made in year one (if not eligible for an exclusion/carve-out), would be accompanied by a 2.00% premium. In the most recent matters, sponsors have sought interim step-downs such that the prepayment premium would decline by 25 bps per quarter (ie, a prepayment in the third full fiscal quarter following the closing date would only garner a 1.50% premium).

4. Tax Considerations

4.1 Withholding Tax

Payments by US issuers or borrowers to US holders or lenders are not subject to withholding taxes under federal law.

4.2 Other Taxes, Duties, Charges or Tax Considerations

The US federal government generally imposes a 30% withholding tax on interest paid to non-US lenders on a debt obligation of a US person (and certain non-US persons engaged in trade or business in the US). For this purpose, payments with respect to any original issue discount, if not considered less than de minimis, are also treated as interest income and subject to such withholding tax.

If a lender is qualified for the benefits of an applicable double taxation treaty between the US and its country of residence, the withholding tax may be reduced or eliminated.

A non-US lender may alternatively qualify for exemption under the "portfolio interest exemption" (the "PIE"). To qualify, the lender must not:

- be a controlled foreign corporation related to the borrower or a bank receiving interest on an extension of credit entered into in the ordinary course of its trade or business; or
- own directly, indirectly or by attribution equity representing 10% or more of the borrower's total combined voting power of all voting stock (or, if the borrower is a partnership, 10% or more of its capital or profits interest).

The PIE is only available for debt in "registered form" for US federal income tax purposes and does not apply to certain contingent interest, such as interest determined by reference to any receipts, sales, cash flow, income, or profits of or the fluctuation in value of property owned by, or dividends, distributions or similar payments by the borrower or a related person.

To claim an exemption or reduction under an applicable double taxation treaty or the PIE, the beneficial owner of interest must generally submit a completed IRS Form W-8BEN-E (or, IRS Form W-8BEN, if an individual).

If interest paid to a non-US lender is effectively connected with the lender's trade or business in the US, such interest will not be subject to US federal withholding tax if the lender submits a completed IRS Form W-8ECI, but will generally be subject to net income tax in the US and, for foreign corporations, branch profits taxes.

Other exemptions may be available for foreign governments or governmental entities assuming they provide the applicable completed IRS Form W-8EXP.

Withholding taxes may also apply upon:

- payment to a US person that does not demonstrate an exemption by providing an applicable completed IRS Form W-9;
- payment of US source interest and certain other amounts to entities treated as "Foreign Financial Institutions" not eligible for an exemption from Foreign Account Tax Compliance Act (FATCA) withholding tax; and
- payment of various fees (such as letter of credit fees), modifications to debt obligations and various adjustments on debt obligations convertible into stock.

Payments under a guarantee are generally similarly treated, with the source of payments for US federal income tax purposes generally determined based on the residence of the borrower. If the lender is receiving security proceeds, the transaction may generally be treated as a payment on the loan. Under certain circumstances, the lender may be treated as the owner of the foreclosed property, resulting in adverse tax consequences (especially cases of US real property held by a foreign lender).

4.3 Tax Concerns for Foreign Lenders

Continuous and regular lending to US borrowers may result in the US government considering the person as engaged in US trade or business, requiring the lender to file a US tax return and pay income taxes on income attributable to the trade or business. Any activities considered secondary trading are generally exempted from these rules, irrespective of continuity or regularity.

Foreign lenders should therefore take care to limit the extent and scope of their origination activities. If foreign lenders that are engaged in extensive origination activity are also qualified for the benefits of a double taxation treaty and do not have a permanent establishment in the US, the foreign lenders may be protected under the rules of the treaty.

4.4 Tax Incentives

There is no applicable information in this jurisdiction.

4.5 Non-Bank Status

There is no applicable information in this jurisdiction.

5. Guarantees and Security

5.1 Assets and Forms of Security

As is the case with syndicated loans, private credit lenders typically take a security interest in substantially all of the property and assets of the company group. These assets can be broadly divided into real property interests and personal property interests. Where real property constitutes collateral, a lender takes a valid security interest by execution of a mortgage, deed of trust or similar security interest under applicable state law where the real property is located. The creation and enforcement of a security interest in real property is governed by the law of the state where the real property is located, so engagement of counsel in this jurisdiction is important to ensure that necessary local law requirements are adhered to.

Security interests in personal property are governed by Article 9 (Secured Transactions) of the Uniform Commercial Code (the “UCC”) of the applicable jurisdiction. To create a valid security interest in personal property, including equipment, inventory, deposit accounts, investment property, instruments, intangibles, receivables and shares in companies (as well as the other categories of collateral governed by Article 9 of the UCC):

- a security provider (the grantor) must execute or authenticate a written or electronic security agreement that provides an adequate description of the collateral;
- the grantor must have rights in the collateral or the power to transfer such rights; and
- value must be given.

Although the last two requirements are mandatory, an oral security agreement may be sufficient if the secured party is in possession or control of the collateral. However, the absence of a signed and written security agreement would be rare in a commercial transaction. The security agreement is typically selected to be governed by the same law as the law of the state that governs the loan agreement even though the assets intended to be covered by such security agreement may be located outside of such state. The UCC is state statutory law and each state of the United States has enacted its own version of it. Although a variety of relatively minor differences exist, Article 9 of the UCC is substantially the same across each and every state.

Therefore, little concern typically arises about a debtor in one state granting a security interest under a security agreement governed by the law of a different state. The parties in commercial financings commonly choose the law of a single state (for example, New York law) to govern both the loan agreement and the security agreement, even if some or all of the debtors (or their assets) are located in another jurisdiction. Although parties are generally free to choose what law governs the creation or "attachment" of the security interest, the choice of law rules governing perfection, including where to file a notice filing under the UCC (referred to as a UCC-1 financing statement) and priority are mandatory.

A security interest in personal property is said to have "attached" when it becomes enforceable against the debtor. A secured party will also want to "perfect" the security interest so that it is also enforceable against third parties, such as other voluntary or involuntary lienholders and against a trustee in bankruptcy proceedings.

A security interest in most types of personal property collateral governed by the UCC may be perfected by filing a UCC-1 financing statement with the Secretary of State in the "location" of the debtor, although important exceptions apply. A UCC-1 financing statement is ineffective to perfect in deposit accounts, money or letter of credit rights as original collateral. Perfection in some assets are governed by US federal law (which pre-empts state law such as the UCC), including registered copyrights, aircraft and related assets, most ships and other vessels, rail cars and other rolling stock.

Perfection in these assets therefore requires compliance with the perfection scheme established by the applicable federal statute. Security interests in vehicles and other assets subject to certificates of title must be perfected by applicable state law certificate of title statutes. Security interests in real estate and other assets excluded from the scope of Article 9 of the UCC (such as insurance, as original collateral) require compliance with the applicable state law governing the assets.

For debtors that are "registered organisations" (which includes most domestic corporations, limited liability companies and limited partnerships), the UCC-1 financing statement must be filed in the jurisdiction in which the grantor was formed or incorporated. Special rules apply to other types of organisations, including non-US entities, natural persons and other special types of debtors.

In addition to perfection by filing a UCC-1 financing statement, a secured party may perfect its security interest in certain assets by taking possession and/or "control" of the assets. Goods, instruments, tangible negotiable documents, certificated securities and tangible chattel paper are examples of collateral that may be perfected by possession. Obtaining "control" of assets such as deposit accounts, investment property (including share certificates), letter of credit rights and electronic chattel paper perfects a security interest and may provide additional protections or priority to the secured party over perfection by filing.

Certain collateral such as accounts (ie, receivables that are not evidenced by an instrument or chattel paper) and general intangibles (a residual category describing intangible collateral that does not fall into another UCC category) may only be perfected by the filing of a UCC-1 financing statement. Article 12 of the UCC, which at the time of writing has been enacted in some but not all states, will permit perfection by control of digital assets, such as cryptocurrencies and non-fungible tokens (NFTs), as well as certain electronic accounts and payment intangibles that exist in controllable form.

In certain circumstances, a security interest may be perfected automatically without any further action, but in commercial transactions relying on these exceptions is unusual and at a minimum a UCC-1 financing statement would be filed. A secured party may perfect its security interest by multiple methods (eg, by filing as well as by possession and/or control) and in the case of important assets such as certificated equity interests, a secured party will typically prefer to use every method of perfection available.

Perfection by possession and/or control is generally preferable to perfection by filing of a UCC-1 financing statement alone, as this entitles the secured party to higher priority, may protect the secured party from third parties acquiring better rights in the collateral and as a practical matter may facilitate enforcement on the asset in the case of a foreclosure.

The security agreement is signed at closing and contemporaneously with the loan agreement. UCC-1 financing statements and intellectual property filings made with the US Copyright Office (in the case of copyrights) and the United States Patent and Trademark Office (in the case of patents and trade marks) are typically filed at closing. Physical share certificates are usually delivered to the secured party at closing although in the case of an acquisition these are sometimes permitted to be delivered shortly after closing. Real estate mortgages and control agreements with third parties (for example, deposit account control agreements entered into with a third-party depositary bank), when part of the collateral package, are often post-closing items to be delivered within a few months of closing.

It should be noted that security interest in collateral that is perfected beyond 30 days of the loan closing may be avoided as a preference transfer by a bankruptcy trustee in the event a grantor goes into insolvency proceedings within 90 days (or one year if the lender is an "insider") of the perfection. If a preference action is successful, the lender will need to return the collateral or the proceeds from it to the grantor's estate. A lender should conduct routine collateral audit post-closing to identify any gaps in perfection before the borrower group gets into potential financial distress.

5.2 Floating Charges and/or Similar Security Interests

US law does not categorise grants of security as being "fixed" or "floating," nor do those terms have legal meaning under US law, but by analogy these grants are permitted and common. Under New York law and in the US more generally, grants of security over personal property security routinely cover both presently owned and after-acquired assets.

Certain personal property collateral is excluded from Article 9 of the UCC and therefore obtaining a valid security interest over those assets is more difficult. The primary methods of perfection in personal property are the:

- filing of a UCC-1 financing statement;
- filings with the US Copyright Office with respect to registered copyrights; and
- filings with the United States Patent and Trademark Office with respect to patents and trade marks.

However, the current law suggests that only a UCC-1 financial statement filing is sufficient for perfection in these assets and physical share certificates and debt instruments must be delivered to the secured party.

Other methods of perfection by "control," for instance by control agreements with respect to deposit accounts or securities accounts, are negotiated deal points. Security interests in real property, where negotiated to be part of the collateral package, typically take the form of a security instrument such as a mortgage, deed of trust, a trust indenture or a security deed (ie, a deed to secure debt), depending on the jurisdiction in which the property is located, with a mortgage being the typical security instrument used in New York.

A blanket lien on all assets, including future assets, is possible, but is often limited by market convention to have customary exclusions. Private credit transactions are typically supported by "all asset" or "blanket" liens (subject to agreed exceptions) over the assets of the target and its subsidiaries and an equity pledge by a holding company in the top-tier operating company.

Although collateral exclusions are negotiated on a deal-by-deal basis, common exceptions to an all-asset grant include assets for which a grant of security is subject to legal restrictions or consequences, such as "margin stock" or "intent-to-use" trade marks, assets for which a grant or perfection is determined to be overly costly, such as mortgages for real property located in a "flood zone" or assets subject to certificate of title statutes and assets for which a grant of security would violate or impair other contractual relationships of the debtor, such as security interests in purchase money, or capital lease assets or assets subject to securitisation financings.

Often general exclusions exist for any assets in which the grant of security would violate any laws or regulations, would require third party (including governmental) consents or for which the burden or cost of granting a security interest outweighs the benefits afforded thereby. Exceptions may also apply to the requirement to perfect security interests in certain collateral, particularly if the relevant perfection action is costly or time-consuming. Although these exceptions are common, the business context of any particular deal will dictate which exclusions are acceptable.

5.3 Downstream, Upstream and Cross-Stream Guarantees

US companies are generally permitted to guarantee and secure the obligations of another group member, via upstream, downstream or cross-stream guarantees, subject to certain considerations and limitations.

To be enforceable, the guarantee needs to comply with certain general principles like receipt and sufficiency of consideration and, in some states, be in writing and duly executed by the guarantor to comply with the statute of frauds. However, showing direct corporate benefit to the guarantor is not necessary to determine sufficiency of consideration where the intercorporate guarantee benefits the group as a whole. The US does not generally have any restrictions on "financial assistance" that would prohibit providing guarantees or security to support borrowings to finance the acquisition of a target company.

In insolvency proceedings, corporate benefit consideration is relevant to determine whether the guarantee can be challenged as a fraudulent transfer under the US Bankruptcy Code. Under fraudulent transfer analysis, a transfer of an interest in property of the debtor may be voidable if:

- made with actual intent to defraud or deprive creditors of value; or
- made:
  - (a) when the debtor is insolvent or that render the debtor insolvent; and
  - (b) for which the debtor receives less than reasonably equivalent value.

The company and the lenders will need to be comfortable with the solvency of the guarantors and security providers, requiring solvency representations to this effect. In addition, the estates of an entity subject to a Chapter 11 bankruptcy proceeding would have the right to pursue any claims of the debtor, including claims for breach of fiduciary duty claims against directors and officers, such as for the approving of fraudulent transfers (to the extent available under applicable law).

In the case of upstream guarantees or other credit support from foreign subsidiaries in support of the indebtedness of a US debtor, deemed dividends may apply under US federal tax law. Since 2019, limited tax law reform has reduced the impact of upstream guarantees and other credit support from non-US subsidiaries.

Notwithstanding the positive tax reform opening the door to more non-US credit support, as a general matter and except in rare occasions where it is critical from a credit perspective, non-US upstream guarantees and credit support are often excluded outright from the guarantee and collateral package of US debt financings, primarily on cost and complexity grounds.

5.4 Restrictions on the Target

The US does not generally have any restrictions on "financial assistance" that would prohibit providing guarantees or security to support borrowings to finance the acquisition of a target company. However, there may be regulatory issues to consider when the guarantee or security provider is a specialised or regulated entity.

5.5 Other Restrictions

The US is a flexible jurisdiction from the perspective of "financial assistance" by the target, and no whitewash is necessary. No governmental approval is generally required for providing guarantees or security, although exceptions exist for highly regulated entities. US law does not have a concept of "hardening," but transfers, including creation or perfection of a security interest, on account of an antecedent (pre-existing) debt made within the 90 days prior to a bankruptcy filing when the debtor was insolvent, are voidable if they permit the creditor to receive more than they would in a hypothetical liquidation under Chapter 7 of the US Bankruptcy Code. The 90-day period is extended to one year for "insiders". There are a variety of statutory defences and safe harbours to preference claims.

US law does not generally recognise retention of title transactions and will instead recharacterise such an arrangement as merely the reservation of a security interest. Article 9 of the UCC broadly overrides restrictions on assignment under contracts or applicable law that would prohibit or restrict the creation of a security interest in the asset. The extent of the override depends on several factors, including the type of asset in question and whether the restriction is on the sale of the asset or only the creation of a security interest in it.

5.6 Release of Typical Forms of Security

The primary method of lien release is an agreement or acknowledgment by the secured party, together with terminations of financing statements or other filings made in public records. The security agreement or loan agreement typically contains provisions setting out the circumstances in which the security interest in collateral will be released, including upon payment in full of all outstanding obligations. To the extent a sale or disposition of collateral is permitted under the credit agreement, it is common to provide a corresponding release of lien in the collateral.

Although the lien release provisions may be drafted to occur automatically upon the repayment or disposition, it is market practice to include agreement from the lender (or its agent) to expressly release and terminate the applicable liens, such as in a loan payoff letter (in the case of loan repayment) or a lien release instrument (in the case of a disposition). In connection with the release, physical collateral of share certificates and promissory notes that were delivered to the lender will be returned to the debtor. In addition, the lender will:

- file (or authorise the filing of) UCC-3 termination statements with respect to all UCC-1 financing statements filed against the debtor and termination of the security interest filings made at the US Copyright Office and the United States Patent and Trademark Office; and
- provide notice of lien release to applicable third parties who have entered into control arrangements with the lender.

If other perfection methods were undertaken in connection with the collateral (such as real estate mortgages or entry into control agreements with third parties), additional termination agreements or instruments may also be required.

5.7 Rules Governing the Priority of Competing Security Interests and/or Claims

In the US, borrowers often incur multiple financings with different lenders, each secured by a valid and enforceable security interest in a common pool of collateral. The UCC provides statutory rules to determine priority of competing liens in personal property collateral. Among secured creditors, a perfected security interest has priority over an unperfected one. Among creditors with perfected liens, a security interest perfected by control or possession generally has priority over a security interest perfected only by a UCC-1 financing statement filing and among creditors who perfect only by UCC-1 financing statement filing, the first in time to file generally has priority. The most notable exception to the first in time rule is the priority given under the UCC to creditors secured by a purchase money security interest (PMSI) so long as the PMSI lender complies with the filing (and, in the case of inventory, notification) requirements within the period set out under the UCC.

The statutory rules of priority under the UCC can be contractually altered by the lenders, typically in an intercreditor agreement entered into by the different lenders (or their agents) and acknowledged by the grantors. Intercreditor agreements are generally held to be enforceable in line with their terms by the bankruptcy court under Section 510(a) of the US Bankruptcy Code. Intercreditor agreements establish lenders' relative priorities in common collateral, whether as first lien/second lien, pari passu (or equal) lien, or split lien (ie, first lien in one pool of collateral and second in rest), including enforcement or exercise of remedies with respect to the collateral upon default under the financing agreements and order of payment from proceeds of the collateral, including under 363 sale or other collateral liquidations in case of the bankruptcy of the borrower group.

5.8 Priming Liens and/or Claims

Liens arising by operation of US state or federal law are wide-ranging. Liens may arise in connection with unpaid taxes, judgments, goods in possession of bailees, shippers or service providers, landlords, depositary institutions providing financial services to their customers and numerous federal statutes applicable to agricultural products, to name a few. In many cases the general rules of Article 9 of the UCC establish lien priority as among competing interests, but in some cases the UCC either expressly defers to another statutory priority scheme or, in the case of federal law or international treaties, the UCC priority rules are pre-empted.

Parties are generally permitted to contractually alter their priority in collateral and therefore a party with a priming statutory lien may voluntarily agree to subordinate their lien to that of a secured lender, but in many cases a secured lender avoiding a priming statutory lien is not feasible. Liens arising by operation of law are often solely applicable to specific assets and/or secure only specific obligations, so with routine diligence lenders may be comfortable that the impact of any such actual or hypothetical liens is negligible in the context of the overall transaction or otherwise draft covenants to mitigate the risk.

5.9 Cash Pooling and Hedging/Cash Management Obligations

Under the UCC deposit accounts as original collateral may only be perfected by "control". The most common method in secured lending transactions is a deposit account control agreement entered into between the debtor, the secured party and the depositary bank. A UCC-1 financing statement is ineffective to perfect in deposit accounts as original collateral. It is therefore common for private credit transactions to either exempt deposit accounts from the perfection requirement or, in some cases, partially or entirely exclude deposit accounts from the collateral. A depositary bank has an automatically perfected lien under the UCC over the deposit accounts of its customer and a secured lender wishing to obtain priority over the lien will need to obtain the depositary's agreement to subordinate its interest. However this is moot in lending transactions where deposit accounts are either not required to be perfected or are excluded from the collateral.

It is common for secured hedges and cash management obligations to be secured by the same collateral that secures private credit transactions. These interests are most often secured under the same collateral documentation as the bank loans and these obligations are secured on a pari passu basis.

5.10 Bank Licensing

In financings provided by multiple lenders in the US, the lenders typically appoint a collateral agent under the credit agreement to hold security interest in collateral granted by debtors on behalf of the lenders. There is no US law requirement that security interest be granted directly to each lender individually nor is there any requirement that the collateral agent be licensed or regulated in the taking or holding of collateral.

If a loan is assigned by a lender (assignor) to a new lender (assignee), typically pursuant to an assumption and an assumption agreement attached to the credit agreement, the assignee will purchase and assume all of the assignor's rights and obligations under the credit documents, including all rights of the assignor as a secured party in the collateral. No additional steps to re-grant or re-perfect liens would be needed.

6. Enforcement

6.1 Enforcement of Collateral by Non-Bank Secured Lenders

Remedies are available for lenders with a valid security interest immediately upon the occurrence of a default or an event of default on the secured obligations, subject to any contractual agreements to the contrary and application of the "automatic stay" in the event that the grantor is subject to a bankruptcy proceeding. The definitive documentation under private credit transactions usually rigorously defines what constitutes a "default" or "event of default" (or like term) after which the secured party may exercise remedies against the collateral. Although creditors that are secured parties generally have the option of judicial enforcement, out-of-court "self-help" options are available under the UCC, which are cheaper, faster and therefore much more common than resorting to judicial remedies.

Among other "self-help" remedies, a secured party may:

- commence collection activities with respect to deposit accounts, receivables or other rights to payment;
- repossess; and/or
- sell collateral and exercise rights of set-off.

Any exercise of remedies or enforcement by a secured party is required to avoid a breach of the peace and in general must be commercially reasonable. The UCC also requires various notices in connection with the exercise of certain remedies such as sales of collateral or retention of collateral in full satisfaction of the debt, but market practice has also imposed various contractual limits (usually contained in the applicable collateral agreement) on the enforcement of security without additional notices or grace periods.

Private credit transactions commonly include an equity pledge of the borrower and its subsidiaries, and if an out-of-court foreclosure sale is contemplated, a sale of some or all of the equity of the company group is an attractive option. Before, or in connection with the enforcement, the secured party may wish to exercise voting or other rights inuring to the holders of the equity interests, including replacing the board of directors or other governing body of the borrower, but any such voting or proxy rights must be specifically negotiated in the security agreement and may be subject to limitations under the borrower's organisational documents.

Even so, secured lenders may not have an opportunity to exercise "self-help" remedies before the debtor seeks the protection of the US Bankruptcy Code. Lenders and a debtor may alternatively reach a consensual out-of-court agreement whereby the debtor will peacefully transfer collateral to the lender in exchange for consideration such as releases and/or residual equity, etc.

6.2 Foreign Law and Jurisdiction

The United States consists of multiple states' jurisdictions and any agreement must specify the state law that will apply (as opposed to federal law). The law of the State of New York is typically chosen as the governing law for sophisticated debt financing transactions in the United States, particularly for acquisition financings. This is the most common governing law for private debt unitranche deals, broadly syndicated deals and capital markets transactions, including bond financings. It is also common for State of New York law to govern acquisition financings of non-US acquisitions. While the laws of California and Illinois were historically used for lower middle market jurisdictions, the overwhelming majority of sophisticated debt documents are currently governed by State of New York law in practice.

Subject to limitations and qualifications, courts in the State of New York generally permit parties to choose the substantive laws of another jurisdiction to govern a contract, including the substantive laws of other states and/or jurisdictions outside the US. A few other states permit the choice of their law to govern a contract even in the absence of any contacts if the contract satisfies certain dollar thresholds. However, some US states may not respect this choice of law if litigated in such US states in the absence of a reasonable relationship to the chosen governing law.

6.3 Foreign Court Judgments

The US is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral awards, which has been incorporated as Chapter 2 of the Federal Arbitration Act, 9 USC. Section 200 et seq. The US is not a party to any treaties for reciprocal recognition of foreign judgments. Foreign judgments are therefore enforced pursuant to applicable state statutes, which generally follow the Uniform Foreign Money-Judgments Recognition Act, the Uniform Foreign-Country Money Judgments Recognition Act, or common law principles of international comity. Final and binding money judgments that are enforceable in the country where they were rendered are generally enforceable.

Subject again to limitations and qualifications, courts in the State of New York generally recognise:

- judgments from other states in the US, under Article 54 of the New York Civil Practice Law & Rules; and
- some international money judgments from outside the US, under Article 53 of the New York Civil Practice Law & Rules.

In the latter case, there are fraud and public policy exceptions. Courts in the State of New York will reject a foreign country judgment rendered under a judicial system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law or a judgment rendered where the foreign court did not have personal jurisdiction over the defendant or where the foreign court did not have jurisdiction over the subject matter.

6.4 A Foreign Private Credit Lender's Ability to Enforce Its Rights

Special rules may apply depending on the specific industry and asset in question. However, typical areas of regulatory approval for acquisitions (or financings thereof) include US antitrust regulations, foreign direct investment laws applicable to the industry and asset (for example, CFIUS approvals), along with customary sanctions and anti-money laundering and KYC rules that apply to lenders and persons acting in the US market generally.

Cross-border lending is generally common and is mainly subject to customary sanctions and anti-money laundering and KYC rules that apply to lenders generally.

6.5 Timing and Cost of Enforcement

Enforcement can take many forms and therefore it is difficult to say how long a typical enforcement process would take.

In the case of a foreclosure sale, among other requirements, notices must be sent to debtors and other parties with an interest in the collateral, in most cases at least ten days prior to the sale. In the case of a public sale, the secured party will also need to publish a public notice in appropriate newspapers and periodicals. However every aspect of the foreclosure process must be commercially reasonable and, especially where the collateral is of high-value, unique and/or complex, a commercially reasonable process may take much longer than ten days.

In the most likely case of enforcement on the equity interests of a borrower and its subsidiaries a commercially reasonable enforcement process in the form of a public sale may take approximately six to eight weeks (although this can be significantly faster or slower depending on the facts). Typical costs include attorney costs in conducting the enforcement process, costs for advertising in periodicals or other publications (in the case of a public sale) and possibly hiring professional advisors in connection with finding potential buyers.

6.6 Practical Considerations/Limitations on Enforcement

For personal property, secured creditors must generally proceed in a commercially reasonable manner or risk losing their advantage and potentially being liable for damages. This vague standard is generally left to courts to resolve and an antagonistic debtor or holder of a competing interest may raise any number of plausible arguments that a foreclosing secured creditor's enforcement process was commercially unreasonable in one way or another.

A secured lender pursuing a public sale of collateral may for example decide to run a slower sale process, hire a professional sell-side advisor and/or spend more time and resources advertising or finding potential bidders in an effort to preempt challenges of commercial unreasonableness. In developing a commercially reasonable process it is generally advisable for the secured party to consider what steps it would take if it were selling its own assets.

6.7 Claims Against Secured Lenders Post-Enforcement

There is no applicable information in this jurisdiction.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

The filing of a bankruptcy case under the US Bankruptcy Code will result in an automatic stay that prevents lenders (and all creditors) from enforcing any security without prior relief from the bankruptcy court or otherwise taking an affirmative action against property of the debtors' estate (including terminating contracts, etc). Relief from the stay is available upon application and a showing of cause, including the lack of "adequate protection" of a lender's interests in its collateral.

Lack of "adequate protection" means a lack of security to protect against the diminution in value of the secured lender's collateral during the bankruptcy case (eg, from the debtor's use/dissipation of the collateral). Any property acquired after the date of the filing of a bankruptcy petition is not subject to a secured party's after-acquired property provisions of its security agreement and the security interest will not attach to the property, although lenders will frequently receive liens on after-acquired property as "adequate protection".

Secured lenders may be "under-secured" or "over-secured" in a Chapter 11 bankruptcy proceeding. An "over-secured" creditor (ie, where the value of creditor's collateral exceeds the amount of its debt) is entitled to interest, fees and related charges as part of its allowed secured claim in a bankruptcy case, whereas an "under-secured" creditor (ie, where the value of creditor's collateral does not exceed the amount of its debt) may not.

Given the requirement that "adequate protection" is a condition to a priming debtor-in possession (DIP) financing, this is a central area of focus during most bankruptcy proceedings in which substantially all of the assets of a Chapter 11 debtor are otherwise encumbered by senior secured debt and insufficient collateral is available for junior DIP financing. Given the difficulty in demonstrating adequate protection, a non-consensual priming DIP financing is also extraordinarily rare.

7.2 Waterfall of Payments

Creditors in a bankruptcy proceeding are ranked. Under the absolute priority rule, secured parties are generally paid before unsecured creditors, including administrative claims that arise during a bankruptcy proceeding. Secured parties are classed into groups of similarly situated creditors depending on their relative priority in the assets, comprising collateral they receive and the proceeds of collateral when realised.

Among unsecured creditors, post-petition administrative and priority claims listed in statute (eg, taxes) will be paid first before other unsecured claims and a Chapter 11 debtor may not be able to reorganise under the US Bankruptcy Code if the administrative and priority claims are not paid in full (or unless the creditors holding such claims agree otherwise). These claims are then followed by other general unsecured or "under-secured" claims. Notwithstanding this, certain unsecured creditors are often paid in a bankruptcy through "critical vendor" orders, 503(b)(9) claims (which require payment for goods delivered in the 20 days preceding a bankruptcy filing) and assumption of executory contracts in a plan or sale (which requires the resolution of any pre-petition default). Customers are often paid through "customer programme" orders and employees are generally paid, aside from certain types of claims (eg, severance claims).

7.3 Length of Insolvency Process and Recoveries

The length of an insolvency proceeding depends heavily on the type of bankruptcy (pre-arranged, pre-packaged, freefall or 363 sale case) and how much litigation is involved.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

See **7.8 Out-of-Court v In-Court Enforcement**.

7.5 Risk Areas for Lenders

A secured party seeking to enforce a loan, guarantees of the loan and/or a security interest securing these obligations must comply with any legal requirements under applicable law, primarily Article 9 of the UCC for personal property and applicable real property law for real property, and any enforceable terms in the underlying loan documentation. The UCC provides debtors with various protections that cannot be waived by the debtor prior to default (eg, the right to receive pre-foreclosure notice and the right to have any sale of the collateral conducted in a commercially reasonable manner). There are also overarching doctrines of good faith and fair dealing imposed by state law.

A secured party who fails to comply with the requirements of the UCC risks losing some or all of its advantage claim and could be liable for damages. A secured party who takes control of a company through enforcement of an equity pledge (for instance by replacing the company's board of directors or other governing body) prior to actually foreclosing on the shares may also have its appointed directors, etc owe fiduciary duties to the company (and, depending on applicable law, potentially others with interests in the company).

A lender is generally not liable under environmental laws for actions of a borrower or other security provider. A lender whose only relationship to a contaminated site is that it has lent to the owner or has taken a security interest in the land will not be primarily or secondarily liable under environmental laws for the actions of the owner. However, if a lender exercises management over the property beyond that of a traditional lender, there may be some risk of liability. Similarly, if a lender forecloses on a contaminated property to enforce its security interest and becomes the owner thereof, there is a risk that it may thereby subject itself to liability.

In bankruptcy, certain claims, such as environmental liabilities, will run with the asset even after a bankruptcy. Creditors should therefore take care to avoid accepting unwanted liabilities in these situations. This issue is particularly in focus for industries that are heavily regulated and/or which may require regulatory approval prior to a change of control (including by exercise of remedies by lenders).

7.6 Transactions Voidable Upon Insolvency

The primary focus in the case of avoidance actions will be on preferences and fraudulent transfers and the primary beneficiary of any avoidance action will be unsecured creditors. Notably, preferences and fraudulent transfers can be brought under both applicable state law as well as under the US Bankruptcy Code and the particular requirements of each may vary (including the length of the statute of limitations).

First, transfers on account of an antecedent debt (a debt that precedes the creation of the security interest) made within the 90 days prior to the bankruptcy filing when the debtor was insolvent are voidable as preferences if they permit the creditor to receive more than they would in a hypothetical liquidation under Chapter 7 of the US Bankruptcy Code. The look-back period for insiders is one year as opposed to 90 days and there are a variety of statutory defences and safe harbours to preference claims. Exemptions do, of course, exist. For example, if the security interest in question is granted substantially contemporaneously with the occurrence of the debt being secured and is perfected within 30 days of its creation, it is then generally exempt from attack as a preference.

Second, transfers of an interest in property of the debtor may be voidable if they:

- are made with actual intent to defraud or deprive creditors of value;
- are made when the debtor is insolvent; or
- render the debtor insolvent, in each case for which the debtor receives less than reasonably equivalent value (ie, constituting constructive fraud).

In addition to preference and fraudulent transfer claims, a DIP or any Chapter 11 estate would have the right to pursue any claims of the debtor, including breach of fiduciary duty claims against directors and officers, such as for approving fraudulent transfers (to the extent available under the applicable law).

Proceeds of avoidance actions are unencumbered assets available for unsecured creditors. As a matter of practice, an unsecured creditors' committee will seek to prevent a post-petition DIP lender, especially one that is a pre-petition secured creditor, from obtaining DIP liens over avoidance actions and bankruptcy judges will often side with the creditors' committee on this point (although there are many examples of proceeds of avoidance actions securing DIP financings).

7.7 Set-Off Rights

Section 553 of the US Bankruptcy Code preserves set-off rights with respect to mutual debts.

7.8 Out-of-Court v In-Court Enforcement

Out-of-court restructurings are the most common restructurings in private credit. While they take many forms, the most common is the lenders' "taking the keys" and the private equity sponsor(s) receiving a mutual release. As part of these restructurings, the lenders often exchange some quantum of their debt for the equity of the borrower or the holding company that owns the borrower. It is also commonplace for the lenders to provide new funding to the company to defray the cost of the restructuring and provide go-forward liquidity.

Bankruptcies in private credit usually occur when:

- the buyer of a distressed company prefers to purchase in bankruptcy because of the court ordering the sale to be "free and clear" or all liens and other encumbrances;
- there are burdensome leases or other contracts that the lenders or the buyer wishes the company to reject; or
- there is litigation that the lenders or the buyer want to leave behind.

7.9 Dissenting Lenders and Non-Consensual Restructurings

Out-of-court, dissenting lenders' rights are typically limited to so-called "sacred rights" in the credit agreement. The scope of "sacred rights" is credit agreement-specific and is currently being litigated in several high-profile cases.

In bankruptcies, dissenting lenders can vote to reject a bankruptcy plan and if the dissenting lenders constitute at least half of the creditors in that class, or hold more than one-third of the claims in that class, the bankruptcy plan will need to be approved under the US Bankruptcy Code's "cram-down" procedures. If dissenting lenders constitute a smaller amount of the class, they still have rights to object under the "best interests of creditors" test, which requires that a creditor receive at least the recovery it would receive in a liquidation.

7.10 Expedited Restructurings

Pre-arranged and pre-packaged plans are available in the United States. A true pre-packaged plan, in which votes are solicited and received pre-filing, is the most expedited type of bankruptcy and there are precedents for these bankruptcies lasting a very short time (less than one week). A pre-arranged case can be somewhat faster than a freefall bankruptcy but is not as fast as a pre-packaged case.

8. Case Studies and Practical Insights

8.1 Notable Case Studies

In 2024, one of the more notable restructurings in the private credit space was the Pluralsight restructuring. Even though Pluralsight did not file for bankruptcy, it was widely reported that the private equity sponsor transferred intellectual property to a non-guarantor restricted subsidiary, loaning money to that entity on a structurally senior basis. This made news because it was viewed as "liability management" coming to private credit. The private equity sponsor ultimately unwound the transaction and consummated a more traditional debt-for-equity out-of-court restructuring.

8.2 Lessons Learned

Private credit is not immune to liability management transactions.

8.3 Application of Insights

While private equity sponsors will need to carefully determine whether to consummate a liability management transaction without the consent of their secured lenders, the threat has become more credible and could be used as leverage in more traditional workout negotiations.

Trends and Developments

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Latham & Watkins is ranked in Band 1 in the USA by Chambers and Partners and advises sophisticated global direct lenders and private capital providers on hundreds of front-end transactions each year, including first and second lien, unitranche and mezzanine loans, and preferred equity and other junior capital. It advises across a range of deal sizes stretching from the middle market through the largest and most complicated unitranche transactions with deal sizes in excess of USD1 billion. It regularly designs and implements multi-tiered capital structures for clients and handles subordination, security, and intercreditor issues, as well as restructurings, equity co-investments and tax and regulatory matters. Its direct lending and private debt practice draws on a long history of innovation and experience. With more than 150 lawyers nationwide, it advises the most active lenders, funds, credit platforms and investment managers as well as borrowers, in the full range of transactions, from the middle market to large-cap.

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Private Credit Growth in the US Market

The US private credit market grew to USD1.8 trillion in 2024, roughly ten times larger than in the pre-Basel III world. However, bullish market observers predict the private capital market could more than double in size in the coming decade.

Macro trends going into 2025 include falling (or perhaps plateauing) interest rates, and global geopolitical change which will impact all players in the financial markets. However, several trends specific to the private credit space will be important for funds deciding where and how to deploy their capital and for borrowers deciding what types of terms and covenants to agree to in order to most efficiently access capital that will allow them to achieve their business goals.

There are four key trends to watch in the private credit space:

- consolidation of the market and increasing partnership between banks and private credit funds;
- the impact of the resurgence of the syndicated loan market on private credit deals;
- the perils and potential upside of liability management transactions on private credit deals; and
- the strategic use of junior capital to further widen the aperture of capital solutions.

Co-opetition: A maturing market leads to new relationships

The US private credit market is increasingly marked by consolidation among private credit funds as well as partnerships between traditional banks setting up their own private credit lending arms and well-established private credit funds. This development will reshape the private credit landscape, offering both opportunities and challenges for market participants.

The need for scale is driving this wave of consolidations of private credit capabilities. Larger private capital firms are acquiring established players to expand their portfolios and enhance their market presence. Recent high-profile acquisitions, such as BlackRock's USD12 billion purchase of HPS and Clearlake's acquisition of MV Credit reflect the growing importance of private credit as a strategic asset class for asset managers and private capital players.

Banks, which faced regulatory burdens that initially led to the growth of the private credit market, have developed partnerships with private credit funds in order to expand their access to private credit borrowers. These collaborations highlight the complementary strengths of both parties: banks with their built-out infrastructure for originating loans, and private credit funds which excel at raising, managing, and deploying capital. This co-opetition model allows banks to offload risk while maintaining client relationships and provides private credit funds with access to a broader range of investment opportunities.

Citigroup's USD25 billion partnership with Apollo and Wells Fargo's USD5 billion collaboration with Centerbridge Partners are proofs of concept that will likely be repeated across the investment banking sector. These alliances enable banks to tap into the growing private credit market, which offers attractive yields and diversification benefits. For private credit funds, these partnerships provide a steady pipeline of deals, access to money centre banks' cash management and other services, and the ability to scale their operations more efficiently.

Rebound: Syndicated loan market challenges private credit deals

The resurgence of the syndicated loan market from its post-COVID-19 lull is poised to significantly impact private credit deals, giving sponsors and borrowers more viable options and reshaping the dynamics between these two asset classes.

The syndicated loan market, traditionally dominated by banks arranging deals syndicated to collateralised loan obligation (CLO) investors, is experiencing a more favourable macroeconomic environment, characterised by cooling inflationary pressures and modest interest rate decreases. Increased loan volumes and demand from CLOs are leading to tighter pricing, incentivising sponsors and borrowers to consider syndicated loans to refinance existing private debt platforms and fund new acquisition platforms.

The syndicated loan market's resurgence has led to the compression of spreads for private credit deals to stay competitive. As arrangers re-enter the market with competitive pricing (often even when fully accounting for any flex provisions), private credit providers that want to continue to deploy large volumes of capital may need to adjust their pricing strategies to remain attractive to borrowers. This could lead to a narrowing of the yield differential between syndicated loans and private credit and also lead to convergence on terms, potentially affecting the alpha offered by private credit that is so attractive to investors.

Companies that previously relied on private credit due to its flexibility and speed of execution may now consider syndicated loans as a viable alternative, especially for larger transactions, particularly if arrangers can work to reduce the time between committing to the deal and getting the deal printed on screens for lenders. This shift to faster marketing and smoother execution could result in a more competitive landscape, with private credit providers needing to differentiate themselves through innovative deal structures and value-added services.

This increase in syndicated loans may drive private credit funds to establish partnerships with banks.

Liability management in private credit

Liability management transactions are increasingly becoming a market practice that the private credit markets cannot ignore, offering both challenges and opportunities for lenders and borrowers.

Before the rapid expansion of the private credit market, single lender or small club deals dominated the private credit market, largely with tight underwriting and conservative documentation, leading to limited scope for lender-on-lender conflict and liability management generally. The expansion of the private credit market and the increased competition brought on by new market entrants has led to more flexible documentation standards and larger clubs. This has in turn created the conditions for liability management transactions more usually seen in the bond and syndicated markets to cross over into the private credit space.

The very public disclosures in the financial press in mid-2024 of drop-down transactions in private credit has led to increased scrutiny by limited partners (LPs) of private credit underwriting, terms, and marks in portfolios. This scrutiny has in turn led to an increased focus on documentation and covenants.

As companies restructure their debt, they may seek new financing to support their revised capital structures, creating openings for private credit providers to offer innovative financing solutions that cater to the specific needs of companies undergoing liability management. By providing tailored capital solutions, private credit funds can differentiate themselves from traditional lenders and capture a larger market share.

Here too, private credit providers will need increasingly sophisticated advice as they navigate complex, bespoke documentation that reflects an up-to-the-minute familiarity with evolving case law, innovative structuring options, and market practices. The very rapid response from private credit fund managers to the latest Serta decision from the Fifth Circuit rendered at the end of 2024 is a perfect example of the very fast feedback loop.

Junior capital provides a maturing market with new options

In the current landscape of subdued M&A activity and muted IPO markets, junior capital has emerged as a crucial financing tool for private equity firms seeking to maximise returns. Private credit providers are increasingly offering hybrid capital solutions that blend debt and equity elements, enabling sponsors to monetise assets effectively and to provide more dry powder for acquisitions. These solutions often involve preferred equity, which positions itself higher in the capital structure than private equity but remains junior to existing creditors. These deals frequently utilise payment in kind (PIK) structures, allowing interest payments to be deferred, thereby alleviating immediate cash flow pressures.

Hybrid capital solutions have gained traction as they allow private equity firms to extract dividends from mature portfolio companies, even when market conditions make it challenging to sell businesses. This approach helps firms return capital to LPs without relinquishing control, allowing them to hold onto well-performing investments until favourable valuations are achieved. By avoiding the need to set a company valuation, sponsors can sidestep potential complications in future transactions.

The scarcity of alternative financing options has driven an increase in hybrid investments by debt funds, enhancing the negotiating power of hybrid investors. These investors can secure downside protections and board seats, offering tailored investment structures that meet sellers' specific needs while safeguarding their interests. This dynamic strengthens the appeal of hybrid investments and positions hybrid investors more favourably compared to traditional syndicated or unitranche deals.

Hybrid capital solutions are also instrumental in recapitalisations and acquisition financings, helping to de-lever expensive capital structures and facilitate amend and extend transactions in both syndicated and private markets. The PIK feature of hybrid capital allows sponsors to leverage portfolio companies without increasing cash interest burdens or breaching existing debt covenants. Preferred equity is structured to receive equity credit from rating agencies and lenders, enabling investors to PIK over-levered unitranche structures and access companies with suboptimal capital structures, offering higher returns due to the leverage and special situations involved.

In M&A markets, hybrid capital fills gaps in conservatively levered structures, providing additional resources for larger investments or add-on acquisitions when common equity falls short. Credit funds are deploying a mix of PIK-like instruments and common equity solutions to bridge financing gaps in acquisitions or recapitalisations.

Junior capital also supports equity bridges for sponsors needing rapid movement but requiring large equity syndications. Hybrid capital providers often overcommit to instruments, expecting reductions through common equity syndication, with incentives for quick sell-downs and economic adjustments based on final holdings.

Hybrid capital is increasingly significant in entertainment, sports, and media, with joint ventures in music catalogue acquisitions and greater use in sports leagues due to liberalised rules. Media company financings continue to play a substantial role.

Looking ahead to 2025 and beyond, traditional buyout firms are likely to be drawn to junior capital solutions due to their versatility and potential equity upside. The trend towards bilateral deals is expected to persist, with fewer hybrid “tourists” and limited club deals, allowing hybrid capital providers to negotiate tighter documentation. The focus on anti-short circuit provisions and anti-layering to protect enforcement integrity is likely to remain, as hybrid providers adapt to lessons from sponsors injecting primary capital into stressed situations. Sponsor firms are anticipated to continue innovating ways to challenge hybrid capital terms to facilitate liability management transactions, despite a generally favourable documentation environment for providers.

Conclusion

The US private credit market is at a pivotal juncture, shaped by significant trends that are redefining its contours. The consolidation of the market and the increasing partnerships between banks and private credit funds are fostering a more integrated financial ecosystem, while the resurgence of the syndicated loan market is introducing new competitive dynamics. Liability management transactions are becoming an increasingly important tool for financial restructuring, offering both risks and rewards for market participants. Meanwhile, junior capital solutions are providing innovative financing avenues, particularly in sectors like entertainment and media.

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