

Market flex

What is a 'market flex' provision?

A market flex provision is designed to give arrangers and underwriters some flexibility as to the terms of a financing following the signing of the relevant facility agreement. This is usually with the intention of helping them achieve a successful syndication. The wording typically provides that the arrangers or underwriters may change certain key terms of the financing in order to make it more attractive to potential lenders. Market flex is usually dealt with in the mandate letter or the arrangement fee letter.

For more information on mandate letters, see Practice Note: [Mandate letters](#).

For more on the role of arrangers in loan transactions, see Practice Note: [The finance parties](#).

When can market flex be used?

Market flex provisions can be used by the arrangers or underwriters before or after the facility documentation is signed.

What can be flexed?

The Loan Market Association (**LMA**) standard wording ([The LMA wording](#) set out below) contemplates a change to the 'pricing, terms and/or structure' of the financing, with an option to stipulate that the overall facility amount must not change. However, the scope of a market flex provision can be heavily negotiated and the final position will vary from deal to deal.

Some flex clauses allow a wide range of changes to the terms of the transaction, whereas others are limited and only permit one or two specific amendments. A strong borrower may argue that the market flex provision should be deleted altogether, or at least reduced in scope from that proposed in the LMA wording. There is sometimes a trade-off between allowing a narrow range of potential changes over a wide range of facility terms or having a broad discretion to change only a restricted number of terms.

Flex items can be broken down into three key categories, pricing flex, structural flex and terms flex:

1. Pricing Flex

The 'classic' terms which are made subject to market flex are those that deal with margin and arrangement fees. Typically the use of these flex rights is limited by reference to an overall maximum cumulative effect of the changes on the weighted average cost of funding to the borrower. Any pricing flex is also usually contingent upon financial covenant levels being reset to ensure an equivalent level of headroom to what was originally contemplated on the basis of the original pre-flex margin and fees.

2. Structural Flex

A request for structural flex is also common, particularly on transactions with multiples tiers of secured debt. Being able to 're-tranche' the facility or, more specifically, to move debt from a tranche which has weaker investor demand to one which has stronger market appetite often because of its relative seniority in the capital structure (without changing the overall amount of debt) can be key to syndication.

3. Terms Flex

Market flex can also be applied to any negotiated term of the financing transaction. Common items subject to terms flex include the length of the period for which prepayment penalties are applicable, the application of any margin ratchet and general debt basket levels.

There are clear trends in the documentary terms which are the focus of flex rights. However much will also depend on what the arrangers see as being the "sticking-points" on a particular syndication.

Market flex can be a feature of both leveraged and investment grade transactions. Flex for investment-grade transactions is more likely to be limited in scope to pricing or discrete terms.

Reverse flex

Reverse flex tends to feature in more buoyant market cycles and allows borrower-friendly changes to be made to the facility in situations where syndication is oversubscribed. Typically, the flex items here will be limited to a reduction in margin and fees.

Arrangers will often be incentivized to obtain better pricing for the borrower through the payment of a one-off fee. This fee is structured to be equal to an agreed percentage of the first full year's cost saving achieved for the borrower through the reduced margin and/or fees. It will usually be payable at the end of that one year period.

Who decides to flex (and how)?

Apart from focusing on the terms potentially subject to market flex, a borrower will also want to ensure that the arrangers do not apply an unrealistic test as to what qualifies as 'successful syndication'. 'Successful syndication' should mean the underwriters reducing their aggregate, overall hold position to an agreed level. Generally, the underwriters will insist on a fixed, cash final-hold position (a requirement of their respective credit committees). The amount of flexibility allowed usually has more to do with the regulatory position of the lenders rather than any negotiations by the borrower. However, the borrower will normally argue for a slightly higher final-hold position than the amount initially proposed by the lenders. The borrower will also often require that it is consulted prior to the imposition of market flex and that the arrangers have offered, in good faith, to pay away an agreed portion of their fees to potential lenders.

A further point sometimes made by borrowers is that flex should not be triggered if successful syndication will not be achieved even with the benefit of amended terms (in other words, if the end result is likely to be neutral). Market flex is designed to aid syndication and not reward arrangers or underwriters for a failed (or incompetent) syndication process.

It is important that the flex language is binding on all parties. The obligors are generally required under the mandate documents to execute any amended finance documentation or otherwise to implement the changes flowing from any exercise of the flex provisions so that they are legally binding. To be effective, market flex should be implemented before syndication closes.

The market flex provisions should remain confidential at all times otherwise there is a risk that it will have an impact on the pricing of the transaction.

Timing of exercise of market flex provisions

Market flex is typically available from the date of the mandate documents until the close of primary syndication but is always subject to a backstop date (as discussed below). If syndication is proving difficult, the arrangers may seek to extend the target closing date for primary syndication. However, this can put the borrower in a difficult position—the longer primary syndication goes on, the higher the chance of market flex being invoked. A borrower should, therefore, insist on an absolute 'end date' after which market flex is no longer available, irrespective of any ongoing problems with primary syndication. A borrower can always later agree an extension of time if the state of the syndication market justifies it.

The LMA wording

The market flex wording set out below has been taken from the LMA standard form mandate letter (underwritten):

'During the period from the date of [this letter/the Term Sheet] to the date, following close of Syndication, on which all the Syndication Lenders become party to the Facility Documents, the Majority Bookrunners shall be entitled after consultation with the Underwriter(s) [and the Company] [for a maximum period of [] days] to change the pricing, terms and/or structure [(but not the total amount)] of the Facility/ies if the Majority Bookrunners determine that such changes are advisable in order to enhance the prospect of a Successful Syndication.

The Company agrees to, and shall ensure that each other Obligor shall, act promptly to amend the Facility Documents to reflect any changes made under paragraph [6.1].

For the purposes of this paragraph [6], 'Successful Syndication' means the Underwriters each reduce their participation in the Facility/ies to a final hold of not more than [●].

A 'Bookrunner' is an arranger with particular responsibility for selling the relevant loan to potential lenders and for managing the syndication process. Note that in the LMA standard form mandate letter, the definition of 'Majority Bookrunners' is left open so a decision has to be made whether the reference should just be to a simple majority or whether the definition should refer to Bookrunners with a particular level of commitment.

For a commentary on the provisions in the LMA standard mandate letter, see Practice Note: [Loan Market Association mandate letter—commentary](#).