CLIENT BRIEFING

# Unrestricted Subsidiaries in the U.S. Refinancing Cycle Cayman Structuring Considerations in the Next Wave of Liability Management Exercises

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## 1 The U.S. Maturity Wall and the Documentation Stress Test

The refinancing wave of 2020–2022 is now becoming a concentrated 2026–2028 maturity wall. During the low-rate environment of that period, a significant volume of leveraged loans and high yield bonds were refinanced on sponsor-friendly, covenant-lite terms.

As those maturities approach in a materially higher-rate environment, issuers, sponsors and creditors are facing a different capital markets reality: tighter liquidity, higher pricing and more selective access to capital.

This dynamic is not merely a liquidity issue. It is increasingly a documentation issue.

For many CFOs and capital markets teams, the central question is no longer whether refinancing will be required – but what the credit documentation actually permits. In particular, attention has returned to:

- Unrestricted subsidiary designation mechanics
- Investment and restricted payment capacity (including builder baskets)
- Incremental and priming debt flexibility
- Lien baskets and collateral perimeter definitions
- Open market purchase language and pro rata concepts

As a result, Liability Management Exercises (LMEs) have moved from isolated covenant exercises to a repeatable capital structure tool. While usually negotiated under New York or English law, their feasibility often depends on how the group is structured – including any offshore holding and financing layers.

## 2 The Unrestricted Subsidiary Concept in Context

At its core, an unrestricted subsidiary is a group entity that sits outside the “restricted” covenant perimeter.

In most leveraged loan and high yield documentation, subsidiaries are either:

- automatically restricted (unless designated otherwise), or
- capable of being designated as “unrestricted” subject to certain conditions.

Once designated, an unrestricted subsidiary is generally excluded from:

- negative covenants (including debt and lien restrictions),
- guarantor coverage, and
- collateral packages applicable to the restricted group.

This separation can allow assets or financing capacity to be positioned outside legacy creditor claims – subject always to the specific documentation constraints.

In the current refinancing cycle, the practical viability of such mechanics depends less on abstract theory and more on detailed covenant analysis and structural feasibility.

## 3 A Typical 2021-Vintage Definition

To illustrate the documentation architecture commonly seen in 2020–2022 sponsor-backed deals, consider the following stylized extract (simplified for discussion):

> “Unrestricted Subsidiary” means any Subsidiary of the Parent designated by the Board of Directors as an Unrestricted Subsidiary, provided that:
>
> (i) such designation complies with the Limitation on Restricted Payments covenant;
>
> (ii) the Subsidiary does not own any Capital Stock or Indebtedness of, or hold any Lien on property of, the Parent or any Restricted Subsidiary; and
>
> (iii) such designation does not occur during a Suspension Event.

In many such structures:

- The designation is treated as an “Investment” and must fit within restricted payment or investment capacity.
- There may be no express leverage test at the point of designation.
- Material subsidiary or IP transfer blockers may be limited or absent (depending on the deal vintage).

The real constraint, therefore, is often not the formal ability to designate – but the availability of capacity under the relevant baskets.

In today’s environment, lenders and sponsors are revisiting these mechanics carefully.

## 4 Why Jurisdiction Selection Becomes Relevant

While the legal concept of an unrestricted subsidiary arises from the loan documentation, the implementation is a corporate law exercise.

Jurisdiction selection can become relevant in several practical scenarios:

**(a) Speed of Execution**

In time-sensitive refinancings or distressed exchanges, the ability to incorporate a new entity, adopt bespoke constitutional documents and complete corporate approvals efficiently can be critical.

**(b) Equity Structuring Flexibility**

Where share classes, voting rights or board appointment mechanics are relevant, the corporate law framework must allow tailored structuring without undue friction.

**(c) Financing Readiness**

The new entity must be able to incur secured debt, grant security and issue instruments without triggering unintended corporate law constraints.

**(d) Tax Leakage Sensitivity**

Asset transfers or equity movements may trigger capital gains or other tax consequences depending on jurisdiction and structuring choices. Even where offshore entities are tax neutral at entity level, the wider group tax position must be considered.

**(e) Creditor Challenge Exposure**

Execution discipline – including board process, valuation support and conflict management – becomes increasingly important where transactions may later be scrutinized.

In this context, jurisdiction is not the strategy. But it can materially influence whether a strategy is implementable.

## 5 Why Cayman Often Features in Sponsor-Backed Structures

Cayman Islands entities are frequently embedded in U.S. sponsor-backed and cross-border capital structures as:

- Holding companies,
- Issuers of high yield notes,
- Financing SPVs, or
- Intermediate holding vehicles.

This existing structural presence often makes Cayman a practical jurisdiction when evaluating unrestricted subsidiary mechanics.

Key Cayman considerations include:

**(a) Corporate Flexibility**

Cayman entities offer significant flexibility in relation to:

- Multiple share classes
- Differential voting rights
- Bespoke articles of association
- Board composition and appointment mechanisms

There is no rigid capital maintenance regime comparable to certain onshore jurisdictions, subject instead to a solvency-based distribution framework.

**(b) Efficient Incorporation and Corporate Action**

Incorporation and corporate approvals can typically be effected promptly, which is relevant in compressed refinancing timelines.

**(c) Financing Familiarity**

Cayman entities are widely used in international capital markets transactions. Market participants are familiar with Cayman share pledges, security structures and issuer frameworks.

**(d) Tax Neutrality at Entity Level**

Cayman does not impose corporate income tax or capital gains tax. While this does not eliminate onshore tax considerations, it avoids additional Cayman-layer taxation.

**(e) Cross-Border Recognition**

Cayman offers established restructuring tools and has experience interacting with Chapter 15 proceedings in the United States, which may form part of broader restructuring strategies.

Taken together, these factors can make Cayman a natural platform where an offshore execution layer is already present within the group.

## 6 Documentation Stress Points in the Current Cycle

In assessing whether unrestricted subsidiary mechanics are practically available, particular attention should be given to:

**(a) Designation Conditions**

- Is there a “no default” requirement?
- Is pro forma leverage testing required?
- Is designation treated as an Investment or Restricted Payment?

**(b) Investment and Restricted Payment Capacity**

- What builder basket capacity remains?
- Are reclassification mechanics available?
- Are grower baskets tied to EBITDA or total assets?

**(c) Collateral and Guarantee Perimeter**

- Does designation automatically release guarantees?
- Are equity transfers of guarantors restricted?
- Are “material subsidiary” blockers present?

**(d) Debt and Lien Flexibility**

- Can the new unrestricted entity incur secured debt?
- Are liens permitted outside the restricted group?

#### (e) “Control” Definitions

- Is “Subsidiary” defined by voting control, board control or beneficial ownership?
- Could governance structuring affect classification?

These are highly deal-specific questions, but in the current refinancing environment they are receiving renewed scrutiny.

## 7 Governance and Risk Considerations

Any use of unrestricted subsidiary mechanics must be evaluated in light of:

- Directors’ fiduciary duties
- Conflict management
- Valuation and fairness considerations
- Potential fraudulent transfer or preference risks
- Cross-border tax implications

Transactions executed under time pressure require particular attention to board process and documentary discipline.

From a Cayman perspective, directors must consider the best interests of the company and, in circumstances approaching insolvency, creditor interests.

## 8 Practical Takeaways for CFOs, Sponsors and Advisors

As the U.S. maturity wall approaches, several themes are emerging:

1. Documentation flexibility is becoming a strategic asset.
2. LMEs are part of the mainstream capital structure toolkit.
3. Offshore entities already embedded in group structures can influence execution feasibility.
4. Jurisdiction selection and corporate design should be considered early — not only at the point of distress.

While LME strategies are typically negotiated under New York or English law, their practical implementation often depends on the corporate layer beneath the documentation.

In the current refinancing cycle, Cayman structures may therefore play a meaningful role in preserving refinancing optionality where unrestricted subsidiary mechanics and perimeter decisions are under consideration.

## 9 Conclusion

The maturity wall is transforming covenant flexibility from a theoretical feature into a practical constraint.

In many cases, the decisive issue will not be whether an LME-style tool exists in principle, but whether it can be implemented efficiently and defensibly within the existing group structure.

Documentation will shape the strategy. Structure will determine whether it works.

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