

## Navigating the Grey Area: Financial Covenant Amendments and the Doctrine of Purview

March 14, 2025



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The doctrine of purview under English law plays a critical role in determining whether amendments to a secured facility require reaffirmation or re-execution of guarantees and security. However, when it comes to adjustments in financial covenants, there is often a grey area which invites examination and nuance.

Two differing views emerge when considering whether tightening a financial covenant, by amending a NAV Ratio test, for example, triggers concerns under the doctrine of purview. One perspective argues that such changes do not materially alter the secured obligations and therefore should not necessitate new security arrangements. The opposing view suggests that these changes could introduce new risks, potentially meaning the existing security will not extend to the amended obligations unless reaffirmed.

Exploring both viewpoints not only sharpens our legal analysis but also anticipates pushback from stakeholders who may seek to challenge or defend the necessity of additional security.

### **Purview: The background**

The starting point to remember for thinking about purview is that as a result of the case law evolution of the doctrine in the English courts, it is only applicable to guarantors and third-party security givers: it is not applicable to the security given by a borrower for its own borrowing liabilities. So a borrower's security should generally not be prejudiced by adverse amendments made during the life of the financing. But this is not the case for guarantors and third-party security providers, for whom the question is whether, when originally granting that guarantee or third-party security, they anticipated and agreed that a later amendment made to the finance documents would continue to be covered by that guarantee or security. If the answer is yes, that amendment is within the original "purview" and the original guarantee or original third-party security should continue to guarantee or secure the amended liabilities. If it was outside purview, and is adverse to the guarantor or security grantor, then the original guarantee or security may not cover the amended liability and a new guarantee or security will be required.

So the question really is what were the parties at the time of the original transaction expecting? There is, as yet, no case law directly on point for a complex, bespoke financing transaction such as a fund finance facility. So market practice has cautiously developed to agree that clearly anticipated changes, such as extension or increase mechanics included in a facility agreement as originally signed, are within purview, but material extensions or increases which are not originally included are outside purview. There is then a market acceptance that smaller unanticipated amendments are probably within purview as part of a reasonable expectation that details of the financing may need to change over the life of that financing. And this is where the question comes in of how financial covenant amendments fit in to the purview analysis.

### **View one: The case for no material change**

The first perspective contends that tightening a financial covenant does not, in itself, create new secured obligations. Instead, it merely adjusts the framework for assessing compliance with existing obligations. Key arguments include:

1. No new indebtedness: A financial covenant is a monitoring tool, not a direct financial obligation. Unlike increasing loan principal or introducing new debt instruments, adjusting a financial covenant does not impose additional financial burdens on the borrower (and by extension on a guarantor or third-party security provider) beyond what was originally contemplated.
2. Security scope remains unchanged: Security documents typically define “Secured Liabilities” broadly to cover all obligations under the finance documents. Unless the security explicitly references a specific covenant threshold, modifying the covenant does not alter the fundamental nature of the obligations secured.
3. Market practice often supports flexibility: In practice, lenders frequently amend financial covenants without requiring new security. If every such adjustment triggered a need for security reaffirmation, the administrative burden would be significant, disrupting market efficiency and increasing transaction costs.
4. Enforcement rights vs. fundamental obligations: While tightening a financial covenant may increase the likelihood of a breach (and thus the lender’s ability to enforce the security), the underlying secured obligation—the repayment of principal and interest—remains the same. Since enforcement is tied to default rather than the covenant itself, the change does not necessarily affect the validity of the security.

In this view, the doctrine of purview should not be engaged because the amendment does not introduce new obligations; it merely shifts the conditions under which the borrower remains in compliance.

### **View two: The risk of purview issues and security erosion**

The opposing argument is more cautious, asserting that tightening a financial covenant—particularly an amendment to a key financial ratio—could create risks under the doctrine of purview. The reasoning here is that such an amendment could be viewed as a material adverse change that potentially renders the existing security ineffective in relation to the changes.

1. The amendment creates a more stringent obligation: By changing, for example, an LTV (loan-to-value) ratio to make it a lower percentage, the borrower’s ability to comply with the test is directly and adversely affected, which in turn means there is a higher likelihood of the guarantees being called on or the third-party security enforced.
2. Potential for a court to challenge security validity: In an insolvency scenario, a liquidator or third-party creditor may argue that the security does not validly cover the amended obligations. As a result, a court may find that the amendment significantly increases or alters the borrower’s liabilities under the finance documents and consequently, the existing third-party security may be deemed ineffective in securing the amended loan.
3. Conservative approach: mitigating legal and enforcement risk: Given these potential risks, the more cautious and market-prevalent approach is to obtain a guarantee and security confirmation from relevant third-party security providers and guarantors for any adverse amendments that were not clearly anticipated in the original finance documents and to retake the relevant transaction security. This should ensure that the amended obligations remain unquestionably within the scope of secured liabilities.
4. Judicial uncertainty and precedent: While there is no absolute precedent confirming that financial covenant adjustments inherently trigger purview concerns, the doctrine remains open to judicial interpretation. Given this uncertainty, lenders and legal advisors may prefer a proactive stance to avoid any argument that security has been compromised.

Ultimately, the determination of whether a financial covenant amendment triggers purview concerns depends on a case-by-case analysis, factoring in the nature of the amendment, the drafting of security documents, and market expectations. As outlined above, the considerations are not as simple as whether the changes affect only core obligations such as increasing the amount of secured debt, but turn on the original expectations of the parties at the time they entered into the deal, including, under the original terms, the likelihood of the guarantees and third-party security being called upon.

While lenders may prefer efficiency and flexibility, courts may scrutinize amendments more rigidly in distressed scenarios. Given this, legal practitioners often default to a cautious approach: if there is any reasonable risk that a financial covenant amendment could impact the security enforceability, reaffirmation and retaking of the security is the safest route.

The debate, however, remains open-ended. In the absence of definitive judicial guidance, the grey area persists—ensuring that legal minds will continue to navigate this issue with curiosity and caution.