

## DISCUSSION PAPER

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# Discussion paper on recovery analysis for corporate debt instruments

## Introduction

In this discussion paper, we pose six questions and invite feedback from market participants globally to deepen our understanding of recovery analysis for corporate debt instruments. This discussion paper seeks information and does not propose any changes to Moody's Ratings' existing credit rating methodologies.

Our questions relate to the analytical considerations that shape recovery expectations for corporate debt instruments across a range of capital structures, legal frameworks, and bankruptcy and restructuring scenarios. We are particularly interested in how market participants assess the interaction between enterprise value, creditor protections, liability structure and restructuring dynamics when forming views on instrument-level credit risk.

More broadly, this discussion paper invites perspectives on how market participants adapt recovery analysis to evolving market conditions, the proliferation of liability management exercises and distressed exchanges, and to increasingly complex financing structures. These insights will help inform our understanding of current market practices and the factors that influence recovery outcomes across the capital structure.

Our questions are intentionally open-ended. Several are broad by design and aim to address fundamental principles, which will allow us to refine our understanding and develop a fuller picture of market practices.

While this discussion paper focuses primarily on speculative-grade companies, we also seek perspectives on how these topics relate to investment-grade companies, in particular how approaches may be adapted for companies that have moved down to speculative-grade rating categories.

## Questions for discussion and market feedback

### Question 1: How do you assess instrument-level recovery variability for companies as they move from a relatively strong financial position to a higher default risk?

We invite market participants' views on the relative merits and limitations of considering both (1) the current and potential capital structure and (2) variation around enterprise valuation at default of higher-rated speculative-grade companies that may be years away from a potential future default when assessing the credit quality of different debt tranches.

We also seek perspectives on how market participants assess the debt of companies moving from investment-grade to high-speculative-grade levels. These companies typically remain far from default, but debt-instrument features

such as structural subordination and limited operating company security and guarantees can increasingly influence the credit assessment of these instruments as ratings migrate lower.

The capital structure of companies often changes as performance weakens and as they move toward a stress scenario or default. Companies that are further from default, including those rated Ba3 or higher, may also amend their capital structure by expanding, reducing, introducing or removing debt tranches. As a result, uncertainty about how the capital structure may evolve can affect the assessment of individual tranches, alongside the current structure.

As companies approach default, recovery outcomes depend not only on enterprise value at the point of default, but also on the form of restructuring and the composition of the capital structure. For companies with multiple debt tranches, recovery analysis typically involves allocating estimated enterprise value across instruments with different contractual protections, priority and security. Valuation assumptions and recovery estimates require additional analysis, particularly when credit conditions weaken and uncertainty around future performance and restructuring outcomes rises. These outcomes may include a distressed exchange, an out-of-court restructuring or bankruptcy.

Our research indicates that liability management exercises and distressed exchanges more broadly have grown as a share of corporate restructurings, and that companies that undertake them frequently re-default, with subsequent recoveries often lower than those for companies that default only once.<sup>1</sup> These developments underscore the importance of understanding how market participants estimate enterprise value through successive stages of financial stress, incorporate the risk of repeat restructuring into valuation assumptions, and reflect expectations of value erosion and dispersion in recovery analysis across different instruments.

We are interested in the extent to which capital structure evolution is a material consideration and whether participants view it primarily as an issue for higher-rated companies that are further from default. This includes perspectives on how distressed exchanges and limited defaults affect valuation and recovery assumptions, including the treatment of re-default risk and its implications for different debt tranches.

Additionally, we ask how market participants use simulation analysis such as our Loss Given Default model based on multiple recovery outcomes in their assessment of instrument-level recoveries.

## **Question 2: How do you consider regional and sector specificities in your recovery analysis?**

This question explores how market participants view regional and sector differences that can affect defaults and recoveries, and the extent to which they factor these differences into recovery analysis.

Legal, bankruptcy and restructuring frameworks differ widely across jurisdictions. Some frameworks are more creditor-friendly than others, and some restructuring processes are more cumbersome, potentially leading to different recovery outcomes.

At the same time, determining the jurisdiction is not always straightforward. It may be unclear which jurisdiction will apply to a bankruptcy or restructuring, or how the applicable framework may change between the time of an investment and a default. Many companies issue debt under legal frameworks with a predictable and well-established restructuring regime, such as Delaware or English law. However, complex global corporate structures

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may involve issuing debt in multiple other jurisdictions. In addition, out-of-court restructurings and distressed exchanges are prominent in default and workout scenarios.

We invite perspectives on the extent to which market participants incorporate regional differences in legal frameworks when assessing recovery rates in default. A related question is on the benefits and disadvantages of out-of-court restructurings, including whether these are likely to enhance or diminish recoveries, and the extent to which they follow the expected ranking of creditor claims.

Different sectors may also exhibit different default and recovery characteristics. Our research shows relatively limited variation in average family recoveries across sectors, even between asset-heavy industries (e.g., manufacturing) and asset-light industries (e.g., software).<sup>2</sup> However, certain sectors, such as real estate, utilize asset-based financing alongside unsecured holding company debt. We seek perspectives on how market participants view such unsecured financing, and how they incorporate relative proportions of debt, loan-to-value levels and leverage in their assessment. More broadly, we welcome insights from market participants on how default and family recovery experience varies based on the degree of asset coverage, how these recoveries vary by sector and the dispersion of family recovery for individual issuers within a sector.

### **Question 3: How do you incorporate the recent evolution of junior debt levels in your assessment of recoveries?**

We would like to learn more about how market participants reflect changes in capital structure composition, particularly the reduction in junior debt cushions, in their recovery analysis across different instruments.

Our research indicates that junior capital cushions have declined in recent years, a trend associated with lower recoveries for first-lien term loans.<sup>3</sup> At the same time, many structures labeled as first-lien-only include debt that is structurally or contractually senior to the first-lien term loan, such as super-priority revolvers or asset-based lending facilities.

These developments raise questions about how changes in the composition of junior debt affect the credit quality and recovery expectations of senior instruments. In particular, we invite views on how market participants distinguish between situations in which junior debt replaces senior debt in the capital structure, and those in which junior debt substitutes for equity. The former may affect the allocation of recoveries within the debt stack, while the latter may affect overall leverage, default timing and enterprise value at default because the company has less cash interest expense, which can influence recoveries for senior creditors.

Where legal documentation establishes clear absolute priority for senior debt, we ask how market participants assess recovery value for junior tranches in cases when residual enterprise value may be limited or may not exceed the value of senior creditors' claims. This includes views on the extent to which practical restructuring dynamics inform recovery expectations for subordinated instruments, even where strict legal priority might suggest minimal or zero recovery. These dynamics can include, for example, negotiated outcomes, the treatment of holdout claims, and creditor coordination considerations.

We also invite perspectives on the impact of a junior tranche repayment on the recovery of a senior tranche, and if the removal of the debt buffer in such situations has any adverse impact on the recovery expectations of a senior tranche.

**Question 4: How do you assess non-debt liabilities as part of your recovery analysis?**

We would like to learn more about how market participants incorporate non-debt liabilities into recovery analysis.

Trade creditors are typically unimpaired in most going-concern bankruptcies and restructurings. In many bankruptcies and out-of-court arrangements, legal processes or negotiations involve a non-trading holding company and do not include trade creditors and certain non-debt liabilities. Trade creditors are also important to the going concern operations of the company when it is being restructured and not liquidated. We seek views on whether trade creditors or other non-debt liabilities, such as pensions, are likely to have a material effect on instrument recoveries.

Many asset-based debt facilities, such as leases, debt factoring and invoice discounting, property mortgages, securitizations, floor plan financing, and project finance facilities, have separate security and are often viewed as self-liquidating. However, valuable assets supporting these facilities are not available to remaining creditors and may reduce the recoveries of those creditors.

A related question is how market participants view asset-based facilities in the context of recoveries across the capital structure.

**Question 5: How do you assess non-standard structures, such as those with different asset pools for different instruments?**

We seek greater clarity on how market participants consider instrument-level credit quality and relative ranking for complex structures, involving multiple, separate asset pools.

In standard structures, all debt tranches share the same collateral and have access to the same earnings and cash flows. Typically in these structures, an assessment of credit quality assumes that recoveries apply across all tranches based on priority of claim. When structures are complex – for example, if separate assets and cash flows apply to different tranches – recoveries may vary based on each asset pool's collateral quality and valuation.

**Question 6: To what extent do you use Moody's probability of default ratings (PDRs) and Loss Given Default (LGD) assessments in your credit analysis?**

We seek to learn more about how market participants reference Moody's PDRs, LGD assessments and their displayed numerical values within the LGD assessment loss range, in analyzing default risk and loss severity across the capital structure.

PDRs are corporate family-level opinions of the relative likelihood that any entity within a corporate family will default on one or more of its long-term debt obligations.

LGD assessments are point-in-time opinions for a non-structured finance security about expected loss given default expressed as a percent of principal and accrued interest at the resolution of the default. LGD assessments (LGD1 through LGD6) are assigned to individual loan, bond and preferred stock issues.

## How to submit feedback

In this discussion paper, we are seeking feedback and insights on the six questions posed above. We invite market participants to provide feedback by 1 July 2026, no later than 11:59 p.m. US Eastern time, by submitting their feedback to [DiscussionPaperFeedback@moodys.com](mailto:DiscussionPaperFeedback@moodys.com). We will review and consider the feedback through our own internal review. We will not publish the names of entities or individuals who provide feedback or the written submissions provided in response to this discussion paper.

## Moody's related publications

For more information, see *Rating Symbols and Definitions*, which is available [here](#).

## Endnotes

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- <sup>1</sup> “Annual default study: Escalating geopolitical tension adds downside risk to 2026's default outlook,” 12 March 2026.
- <sup>2</sup> “Sector in-depth: No relief in sight for cov-lite loan recoveries,” 23 September 2025.
- <sup>3</sup> “Sector in-depth: No relief in sight for cov-lite loan recoveries,” 23 September 2025.

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