

# Fund Finance Friday



## Renewed Attention for Defaulting Lender Provisions

May 5, 2023



By **Danyeale Chung**  
Partner | Fund Finance

In years past defaulting lender mechanics in a subscription credit facility may have been viewed as boiler plate language and, in most cases, the relevant provisions have not received much attention. In light of recent events in the banking industry, defaulting lender provisions have gained some renewed attention. In this article we take a look at the current general state of defaulting lender provisions and the impacts on the lender and borrower.

In the majority of subscription credit facilities, a lender could be classified as a “Defaulting Lender” if certain events have occurred, including, but not limited to the following: (a) failing to fund a loan or pay other amounts due from such lender to the administrative agent or another lender (subject to cure periods); (b) if requested to do so by the administrative agent or a borrower, failing to provide assurances that such lender will comply with its funding obligations; (c) notifying a borrower or the administrative agent that it does not intend to comply with its funding obligations; (d) having appointed for such lender or such lender’s parent company, a receiver, custodian or administrator; or (e) becoming subject to debtor relief laws.

A lender that is classified as a Defaulting Lender under a subscription credit facility stands to lose certain rights and may ultimately involuntarily be removed from a subscription credit facility. Under the terms of a subscription credit facility, a Defaulting Lender is carved out of the definition of “Required Lender.” As a result, the Defaulting Lender loses any rights it may have to approve or disapprove of any amendment to, consent or waiver of any terms of a subscription credit facility.

While in the ordinary course, subject to no event of default, a borrower has the right to direct how payments of principal, interest and fees are applied following a payment; during such time that a lender is classified as a Defaulting Lender, the administrative agent may exercise its discretion to follow the Defaulting Lender waterfall as set forth in the subscription credit facility. Amounts that would otherwise be due to the Defaulting Lender may be applied for amounts owed by the Defaulting Lender or reserved to be applied to potential future funding obligations of such Defaulting Lender. The amount of interest and fees due to the Defaulting Lender may be limited.

If a lender is classified as a Defaulting Lender, without the consent of such Defaulting Lender, the Borrower has the right, generally subject to certain conditions being satisfied (e.g., no event of default or potential event of default has occurred and is continuing) to require such Defaulting Lender to assign its interests, rights and obligations under the subscription credit facility and related loan documents to another person. This provision is often referred to as the “yank-a-bank” provision. We previously visited this provision in another *Fund Finance Friday* article found [here](#). A Defaulting Lender may not be an assignee of another lender’s interests in a subscription credit facility.

If the administrative agent is classified as a Defaulting Lender pursuant to clause (d) or (e) above, the required lenders may remove such person as administrative agent and, in consultation with the borrower, the required lenders may appoint a successor administrative agent.

There are also implications for the borrowers at times a Defaulting Lender remains in a subscription credit facility. If a borrower requests a loan and a Defaulting Lender fails to fund its applicable share of the loan, the borrower may only receive the amount of such loan funded by the non-Defaulting Lenders. In a subscription credit facility where a letter of credit is outstanding, a borrower may be required to cash collateralize the Defaulting Lender’s share of the aggregate

amount of the undrawn stated amount of all outstanding letters of credit (the "Fronting Exposure"). Also, during such times that a Defaulting Lender remains in a subscription credit facility, the letter of credit issuer is not required to issue, extend, renew or increase any letter of credit if the letter of credit issuer is not satisfied that after giving effect thereto, the letter of credit issuer will not have any Fronting Exposure.

While the subscription credit facility terms lay out when a lender may be classified as a Defaulting Lender and how the Defaulting Lender and borrower may be impacted following such classification, the contract terms of the subscription credit facility are subject to applicable law. Applicable law may alter the terms of the subscription credit facility.