

Fund Finance Friday



How to Account for an Account Switch

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By **Clay Talley**
Counsel | Fund Finance

With the recent downgrades issued to several banks by Moody's and S&P in August, as well as the recent banking turmoil which occurred earlier this year, and the flurry of assignment activity in the market, lenders and borrowers alike have become increasingly focused on deposit accounts.

In a typical subscription credit agreement (each, an "SCF"), the relevant fund entities (the "Sponsors") are required to deposit capital call proceeds (the "Collateral") into a collateral account (the "Collateral Account"). For banks located in the United States where such Collateral Accounts are held, perfection and the ability to foreclose on the Collateral Accounts are typically governed by a deposit account control agreement ("DACA"), which is typically between the administrative agent acting on behalf of the lenders to the relevant SCF (the "Administrative Agent"), the Sponsor and the Eligible Institution (defined below) where such Collateral Account is held (for a more fulsome breakdown of how Collateral Accounts operate in practice and on an ongoing basis, please see "[Control or Control Agreement](#)," recently written by my colleagues Chad Stackhouse and Kaitlin Clardy).

However, the Collateral Account typically cannot be held at any bank selected by the Sponsor. Most SCFs will provide a list of criteria outlining the requirements of an eligible institution (the "Eligible Institution") where such Collateral Account may be held. These requirements typically include a dollar amount threshold of capital held by such Eligible Institution, along with a short-term unsecured debt rating from Moody's, S&P or another customary rating agency (the "Eligible Institution Requirements"). These Eligible Institution Requirements are put into place in order to provide assurance to the lenders that any such Eligible Institution remains properly capitalized and to mitigate the risk that any such Eligible Institution could become bankrupt or declared insolvent, which could have an adverse effect on the Collateral held at such Eligible Institution. If such Eligible Institution's credit rating were to be downgraded or such deposits were below such Eligible Institution Requirements, the Sponsor and Administrative Agent would need to switch the Collateral Account(s) to a bank that is an Eligible Institution within a specified grace period.

If an account switch is required (or if a Sponsor is looking to switch accounts for any other reason), the Administrative Agent will need to consider how to document such account switch, with a few initial considerations noted below:

1. Collateral Account Pledges – New collateral account pledges ("Collateral Account Pledge") will need to be entered into in order to grant a security interest to the Administrative Agent in such Collateral Account and the proceeds thereof. The Collateral Account Pledge in most instances will specifically note the account number of the Collateral Account, as well as the Eligible Institution. As such, the prior Collateral Account Pledge should either be terminated simultaneously or be amended and restated in order to properly identify the new Collateral Account (and new Eligible Institution) that is to be pledged going forward.
2. DACAs – As the Collateral Accounts will be held with a new Eligible Institution, the prior DACAs will need to be terminated and new DACAs between the Sponsor, the Administrative Agent and the new Eligible Institution will need to be executed. One important point to note is that when terminating and entering into new DACAs, this should be done simultaneously so as to avoid a potential issue arising where the prior Collateral Account is terminated before the new Collateral Account is opened (and such new DACA entered into), which could result in a lapse whereby the Administrative Agent no longer has a perfected security interest over the Collateral Account

and the Collateral.

3. SCF Schedule Updates – In some instances, the relevant SCF will provide the account information on, or granting language with regard to the Collateral Accounts. In most cases, it will be desirable and/or legally prudent to amend the SCF to update the schedules or any operative granting language to ensure continued accuracy of the representations and warranties and covenant compliance as it relates to the Collateral Accounts.
4. Revised Security Agreements – In some instances, security agreements entered into will include information related to the prior Collateral Account. Counsel will need to review this document (as well as the other documents which could contain such references to the Collateral Account) to ensure these agreements are updated accordingly, via omnibus amendments or otherwise, to include the proper references to the new Collateral Account.
5. Opinions – Because new security documents are being entered into (i.e., Collateral Account Pledges, DACAs), the Administrative Agent will frequently need new security interest opinions in order to be in the same position as the original closing. It should be expected that perfection, proper security and enforceability opinions will be required. For due authorization, good standing and other such Sponsor entity-specific opinions, the Administrative Agent may take into account when delivery of such opinions was last provided to determine whether these are necessary. For example, if the Sponsor recently entered into an amendment which delivered such authority/good standing opinions shortly before an account switch, a lender may agree to waive these certain opinions based upon the remoteness of a substantive change occurring in such a short time. However, each lender will need to assess their own acceptable level of risk when waiving any requirement for new opinions.

We should highlight that this discussion only involves an account switch between accounts located in the United States. Although the above analysis would still generally apply, Luxembourg accounts (as well as other foreign accounts) require different security documents than those required in the United States. Each transaction will require its own unique analysis and will take into account its own set of circumstances to be reviewed in connection with any potential account switch. As always, CWT is happy to assist and provide any guidance in any such process.