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Fund Finance Friday

An Actual Cure or Delaying the Inevitable? Acceleration Cure Provisions in Enforcement of NAV Facilities

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Enforcement of NAV facilities is complex and highly bespoke. The path to enforcement depends heavily on how the facility was structured and what collateral package was negotiated. Enforcement will also depend on the underlying asset class and it will be different in credit fund structures (being the most straightforward), private equity and infrastructure funds (which are the most complex to enforce) and secondaries NAVs (sitting somewhere in between).

In NAV facilities, the practical reality is that even with a well-structured security package, enforcement will rarely be a quick process. Central challenges will be around asset transfer restrictions which often are inevitable and can effectively block enforcement even when the security interest is properly created. Furthermore, GP cooperation is frequently necessary and GPs have limited incentive to facilitate a forced sale. The underlying collateral assets may also have their own leverage facilities with change-of-control provisions that could trigger mandatory repayment upon foreclosure. Shareholder agreements in relation to private equity investments may contain drag/tag-along rights, pre-emptive rights and other transfer restrictions. Regulated or other sensitive industries as well as antitrust/competition considerations may require time-consuming regulatory approvals vis-a-vis the enforcement.

Against this backdrop, acceleration cure provisions may be beneficial on the premise that sponsors whose business is buying and selling assets may be better placed to realise the full value of collateral than lenders. Those cure provisions can however only be mutually beneficial for both sponsors and lenders as long they are not solely intended to provide sponsors with a limited window to avoid enforcement of security and they actually present a credible plan as how to repay the facility in full.

Acceleration Cure Provisions – A Deeper Dive

Acceleration cure provisions allow sponsors to inject capital or sell assets before formal enforcement. Lenders typically allow sponsors to manage the disposition of certain collateral, but they reserve the ability to intervene and direct the process when a sponsor fails to satisfy the required repayment of the financing within a pre-agreed timeframe or when a predefined event of default occurs.

In NAV financings, it is fairly common to take security over a borrower's equity from its parent. It is also common to take security over the bank accounts into which proceeds from the underlying collateral portfolio are paid. Depending on the agreed security package, additional security may also be taken. It is usual that the acceleration cure provisions will only apply in respect of the ‘structural security’ i.e., the borrower's equity security and any underling asset portfolio security. Possibly, also other security (e.g. receivables or the underlying assets security, if forming part of the collateral) may be included in this “contractual stay” but acceleration cure provisions will typically not apply to the bank account security which can be enforced immediately upon acceleration.

A well-calibrated sponsor monetisation plan is a fundamental premise for an acceleration cure to be successful. Details of how the relevant investments will be sold or how the borrower will be recapitalised so that the facility can be repaid will not be set out in the facility agreement. The level of ‘control’ over the cure plan will be the focus for both sponsors and lenders. Central to this is the question whether such control will be limited to mere ‘consultation rights’ or require ‘consent rights’ by the lenders. With consultation rights, lenders will typically have the right to consult with a sponsor for up to a certain period after receiving the draft cure plan on any material aspects or timelines thereof, but will not have

any approval rights in respect of the plan. With consent rights, on the other hand, lenders will have approval rights and the key focus will be whether this will be a simple majority, super majority or all lender matter and any standards such as good faith requirements and reasonableness, etc., qualifying such consent.

The actual implementation of the cure plan is of key importance. A sponsor typically must demonstrate its ability to manage an orderly sale of the relevant investments or effectuate a recapitalisation in accordance with the monetisation plan. For example, if a sponsor does not deliver a plan by the repayment plan deadline, the acceleration cure period ends. Equally, if a sponsor fails to follow the cure plan in a material way, lenders will typically reserve a right to step in or alternatively direct an independent investment bank to execute the sale or recapitalisation on behalf of a sponsor.

Closely connected with the implementation of any cure plan is the level of reporting requirement. It is natural that lenders will require that sponsors keep them updated as to the progress of the sales or recapitalisation process. In particular, it is critical that key milestones set out in the monetisation plan are not only met but reported on.

A sponsor in respect of the acceleration cure provisions will be typically focused on these areas:

- The level of approval rights, as discussed above.

- Reasonableness and good-faith requirement – in particular, that lenders must act reasonably and in good faith throughout.

- Fiduciary-duty consistency – in particular, the cure plan must not conflict with the GP’s duties to the fund/borrower, LPs, or other contractual restrictions.

- Material-non-compliance triggers – lenders may step in only if the sponsor materially breaches the plan but not for minor delays or minor deviations from the cure plan.

- Independence of the investment bank – if an investment bank drafts or executes the cure plan, parameters around that investment bank such as it cannot be the affiliate of any lender (unless the sponsor agrees).

Lenders will be typically focused on when they may step in and take direct control of the enforcement. This will typically include the instances where sponsors do not meet the stipulated reporting, timing or other procedural obligations, described above. A common trigger will also be typically tied to occurrence of certain (major) events of default (EoDs). Those will customarily include insolvency EoDs. Depending on the relative strength of a sponsor, negotiation will focus on inclusion of other EoDs – typically of the major EoDs; those can include non-payment EoD, breach of the default LTV, dissolution, liquidation and termination of the borrower, and possibly other EoDs. An often overlooked point is to switch off the acceleration cure period in case of non-payment on the stated maturity date. Generally, it should be a non-controversial principle that there should be no acceleration cure period post the stated maturity date and lenders should be able to enforce from that point onwards.

Conclusion

Remedies in NAV financings customarily escalate from cash management (cash sweeps, blocked accounts), through controlled sales/monetisation plans (cure plans for recapitalisation or sale of assets) to actual acceleration and formal enforcement of the security.

While acceleration cure provisions limit the rights of lenders to sell-off the structural security upon acceleration, lenders might take some comfort in the fact that a well-designed acceleration cure plan is (or, in theory, should be) value-accretive. However, calibration of the acceleration cure provisions can be complex and clients are advised to be mindful of the pitfalls and ideally consult Cadwalader when negotiating those provisions in the facility agreements.