Forbearance Agreements: Bringing the Deal Parties Together

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During times of market disruption and economic uncertainty, the representations and covenants set forth in a credit agreement play an even more important role in the ongoing relationship among the loan parties and lenders. While many credit agreements typically provide fund borrowers with flexibility and certain allowances to permit the fund borrowers to operate and grow their business in the normal course and to avoid unintentional "foot faults" under one or more interrelated provisions, even the most carefully negotiated provisions will not be able to anticipate every future event to impact a fund borrower's business. When a lender is faced with an actual default or even an anticipatory default under a credit facility, a fund borrower will typically request a default waiver from the lender (previously covered by *FFF* **here**). Another approach that a lender may pursue instead of an outright waiver is to forbear taking action with respect to the default, thus providing the fund borrower additional time to cure the default or comply with a new covenant or performance milestone within a certain period of time. A forbearance agreement can be an effective means of providing the loan parties and the lender with an opportunity to resolve the pending default in a timely manner while at the same time restructuring one or more covenants, obtaining additional credit enhancements, such as supplementary collateral, and resetting expectations going forward.

To Forbear

To forbear is the act of refraining from taking action against another party. Under a forbearance arrangement, the lender agrees to forbear from taking any enforcement action against the loan parties as a result of the specifically described events of default. In exchange for such deferral, the loan parties will agree to cure the specific defaults to extent curable, modifications of deal terms, restructure financial covenants, comply with new obligations, provide additional collateral, and incur a forbearance fee as part of the consideration. These modifications strengthen the lender's credit position while providing the loan parties with some breathing room to work through the issues caused by the default. Any modified terms must be strictly adhered to by the loan parties so as not to trigger any additional defaults that could terminate the lender's forbearance. Restructuring one or more of the financial covenants may provide additional headroom to the loan parties while simultaneously providing an acceptable risk rating for credit partners. It is important to note that the act of refraining by the lender doesn't constitute a waiver by the lender or a cure by the loan parties of the specific events of default but instead preserves the lender's rights and remedies to take further actions under the credit documents.

Forbearance Period

The forbearance period is the period of time in which the lender has agreed to refrain from filing any legal action or instituting or enforcing any rights and remedies it may have against the fund borrower. A lender should carefully consider the length of the forbearance period so as to provide a fund borrower with a realistic opportunity to cure the existing defaults and to comply with any required covenants or performance milestones while at the same time protecting against further downside risk and potential deterioration of the collateral. The forbearance period may also be terminated by the fund borrower's failure to comply with any of the terms or undertakings of the forbearance agreement or the occurrence of any other event of default. Upon the expiration or termination of the forbearance period, a lender shall be permitted to exercise any and all of its rights and remedies against a fund borrower as it deems appropriate.

Forbearance Terms

The terms of a forbearance agreement can vary depending on the particular facts and circumstances of the default and the credit profile of the loan party. However, there are a few best-practice provisions that should be included in any forbearance agreement that clearly set forth the forbearance terms agreed to by the loan parties and reserves the rights of the lender.

The forbearance agreement should include factual recitals that provide a basis for entering into the forbearance arrangement and to prevent the loan parties from disputing such facts in a future legal proceeding. It is important for the parties to clearly and accurately identify all existing defaults to be covered by the forbearance agreement. Any other defaults not specifically identified or that may occur after the execution of the forbearance agreement will not be

part of the forbearance agreement. The lender would then have the ability to terminate the forbearance agreement and immediately exercise all rights under the credit documents. Lenders will sometimes include anticipatory defaults in the forbearance agreement if the loan parties have preemptively disclosed to the lender that they will not be in compliance with a covenant, such as a financial or reporting covenant that isn't actually due until after the closing of the forbearance agreement. This approach is helpful to avoid triggering a subsequent default that is known to the loan parties prior to entering into the forbearance agreement. There should be an acknowledgment of the current loan balance, including the unpaid principal and interest, and any other amounts due and owing to the lender. If applicable, there should also be an acknowledgment that the lender issued a reservation of rights letter and/or notice of default letter.

The fund borrower should make certain acknowledgments to the lender, including but not limited to, that (a) each of the credit documents remain in full force and effect, (b) the liens granted by the fund borrower shall remain effective and unimpaired by the transactions contemplated by the forbearance agreement, and shall continue to secure all obligations under the credit documents, (c) ratifies and reaffirms all of its representations, warranties, covenants, and agreements made under the credit documents, (d) the existing events of default are ongoing and continuing, (e) any actions it takes or fails to take is voluntary, informed and taken at its own risk, and (f) it consents to all of the terms and conditions of the forbearance agreement.

In consideration for the forbearance, a lender may decide to modify existing or include new affirmative and negative covenants, that a fund Borrower must comply with during the forbearance period and sometimes after, as an ongoing covenant requirement. Covenants may include a full or partial repayment of the outstanding loan balance, no additional advances during the forbearance period, maintenance of depository accounts with the lender in a minimum amount or percentage of global cash, modified financial covenants, and performance milestones, such as future closes of additional equity commitments, which if achieved may be a condition precedent to a conditional default waiver. The grant or pledge of additional collateral by a loan party to further secure the obligations under the credit documents may provide additional credit enhancement to the lender, but such additional collateral may be invalidated in a subsequent bankruptcy proceeding as a preferential transfer.

Forbearance Release and Reservation of Rights

It is imperative that a forbearance agreement contains a broad and general release of all claims by the loan parties. At a minimum, the release by the loan parties should include all possible known and unknown claims, demands, actions, losses and liabilities in any case arising on or before the effective date of the forbearance agreement under any of the credit documents and forbearance agreement. The release may be pleaded as a full and complete defense against any legal proceeding that may be instituted in breach of the release. In addition, the loan parties should acknowledge that the release constitutes a material inducement to the lender to enter into the forbearance agreement.

Another important provision that should be included in any forbearance agreement is a reservation of all legal rights and remedies of the lender under the credit documents and forbearance documents. These rights and remedies include the right upon the expiration of the forbearance period to immediately foreclose on any collateral and exercise any and all other remedies available under the credit documents or applicable law.

A forbearance agreement can be a very useful and effective tool to bring the deal parties together to collaboratively work on a resolution of an existing default. It provides a fund borrower with the opportunity to remedy the breach, increase covenant flexibility, or unlock a conditional default waiver upon the achievement of a performance milestone. Moreover, it strengthens a lender's credit position by implementing new covenants, obtaining additional collateral, and receiving a full release of all claims.

Oh, Those Disqualified Lender Lists...

April 7, 2023

Bloomberg recently **reported** that some lenders were setting up trading desks focused on private debt. This, together with the recent events in the banking market and regulatory capital-driven exposure reductions that have been underway for some time now, has caused many lenders to examine the restrictions on loan sales imposed by borrowers via assignment consent rights and the disqualified lender list (the "DQ List") – the list of entities that are disqualified from becoming lenders or participants under the credit agreement.

This once-off list that was limited to a handful of commonly-known "loan to own" funds – those funds purchasing distressed debt with the intention of taking action against the borrower and gaining a controlling stake in the company – has grown to be a list containing, in many cases, every single competitor in a given sponsor's market. Long before the Great Financial Crisis, these lists picked up momentum as borrowers became more and more concerned about who owned their debt. Capital markets desks, now eager to trade potentially troubled loans, may be surprised to discover how extensive the DQ Lists have become and how permanent the restriction on trading. While DQ lists are not common on many subscription loans, similar concepts do exist in many large sponsor deals via competitor anti-assignment clauses and related consent rights.

Just last year, the LSTA published a market advisory outlining some of the more recent changes to the disqualified institution provisions set forth in the LSTA's Model Credit Agreement Provisions (the "MCAPs"). It contained certain updates to the 2014 LSTA DQ Structure that was originally formulated to balance competing interests of borrowers, sponsors and lenders. For years, market participants grappled with the many issues surrounding the DQ Lists: At what point in the transaction were they required to be delivered? Could the borrower add to the DQ List? Did it go away upon a default? What happened if the loan sale was to an affiliate of an entity on the DQ List? Could the list be publicly disclosed? To whom and how? And the list (*no pun intended*) went on ... Who would be responsible for enforcement? What happens if the loans ended up with an entity on the DQ List who in turn trades the loan to another party? What are the mechanics of an unwind?

Here is a brief review of the LSTA DQ structure with some commentary about where the market generally landed. Perhaps now is the time to revisit some of the negotiated points to allow the debt to more freely trade. Lengthy DQ Lists negotiated during a period of low interest rates and abundant credit may now cause heartburn when banks want to quickly liquidate and trade their positions.

Creation of the DQ List: Entities included on the DQ List include (i) any entities the borrower identified to the agent at or prior to the *closing of the commitment letter*, (ii) any other entities that the borrower identified to the agent from time to time that are competitors of the borrower or its subsidiaries, and (iii) any affiliates of those entities that are identified to the agent. Emphasis should be on early delivery of the DQ List because far too often the DQ List is the last thing to be delivered prior to close, leaving very little time for the agent to review the list and determine whether it is reasonable. Does this list contain all or most all of the likely purchasers of the debt once it is distressed? Likely it does. Has the trading desk been consulted and reviewed the list? Is there sufficient liquidity in this loan to warrant the size of the list that has been delivered? Don't overlook the affiliate point: some of the largest credit funds and potential buyers may be affiliates of sponsors on the DQ List.

Additions to the DQ List: Under the LSTA DQ Structure, borrowers are permitted to add competitors to the list with sufficient notice, understanding that the borrower is required to deliver confidential information, such as financial statements and management reports, under the credit agreement, and permitting competitors to see that information is of utmost concern. Borrowers are not, however, typically allowed to add financial institutions as that should be determined at the outset and they represent the most likely purchasers of debt.

Expiration of the DQ List: Here is where the rubber hits the road. Lenders argue that once there is a default, all bets are off: the list falls away and the lenders should be able to freely trade the loan because the borrower has stopped performing – the benefit of the bargain has expired. Borrowers, on the other hand, often have the opposite view: a default situation is exactly the time when lenders should be restricted from selling the loans to purchasers and competitors whose interests diverge from the borrower/sponsor. The LSTA DQ Structure permits the DQ List to stay in place and large cap sponsors are largely successful in the broadly syndicated loan market on this point; however, the same is not true in many fund finance or middle market transactions. While in the broadly syndicated loan market, this approach might make sense given the wide variety of participants, in the middle market, and in certain parts of the fund finance market, these loans do not enjoy the same kind of liquidity and, as a result, the pool of potential purchasers is far fewer. In a newly-minted private debt trading platform, participants may want to reexamine their positions on this issue.

Disclosure of the DQ List: Lenders were always hesitant to disclose the existence of DQ Lists because, among other things, the entities on the DQ Lists were also their clients. Sponsors similarly wanted confidentiality around who they were restricting. Nondisclosure presents challenges in the broadly syndicated market, however. Purchasers of loans need to know at the outset the extent to which there are limitations on the sale of these loans. The MCAPs settled this by making it easier for lenders to see the DQ List by authorizing the administrative agent to post the DQ List on Intralinks or a similar debt platform on the public side.

Liability for Violations of the DQ List: Taking a cue from the LSTA DQ Structure, most documents make clear that the administrative agent has no liability for monitoring the DQ List; the DQ List has no retroactive application, and transferring a loan to a Disqualified Lender does not void the trade but rather allows the borrower to, among other things, "limit the Disqualified Institution's access to confidential information, engaging in fundamental lender actions or taking part in creditor decisions." As a remedy, Borrower may also buy back the loans, thereby settling the operational nightmare of unwinding a trade.

Is it time to revisit these extensive DQ Lists and the various credit agreement permutations and ask whether the negotiated provisions are the right construct for each segment of the market? Might lenders want more flexibility as they examine the vast portfolios of loans they have amassed over the last decade of low interest rates? Might they be better off with limited lists that fall away upon a default, and certainly, upon a payment default? Should some of these restrictions be applicable in a nearly $3TN broadly syndicated market? Similarly, should the same constructs be applied in the much less liquid middle market fund finance market? There is no time like the present...

PEI Provides an Update on Fundraising

April 7, 2023

PEI's ***Fundraising Report 2023***, published this week, provides a timely update on the state of play in private market capital formation.

The feedback loop conundrum facing private markets emerges as one of the main themes in the report. GPs are seeking to avoid selling investments into a weak market, distributions are therefore curtailed, leading LP allocations to private funds higher as a result and fundraising lower. Some GP responses to these challenges, such as maximizing capital from existing funds through capital recycling and capital calls for follow-on investments, can reinforce the cycle. The upshot: expect 2023 fundraising totals to be challenged, fundraising periods to stretch, and terms to tilt LP-friendly at the margin.

In this context, GPs are clearly motivated to use secondaries transactions and NAV financing as liquidity solutions. Tender-offers-plus-staple deals − a process in which a sponsor offers to buy LPs stakes in a particular fund at a preset price paired with an LP commitment to invest a portion of the proceeds in a new fund − receive a dedicated article. Co-investment opportunities with stapled commitments add a variation to the theme. NAV financing also gets some press. As *FFF* readers will know, NAV loans can be particularly helpful in the current environment to help sponsors raise capital against in-place investments to facilitate distributions and fund investments while avoiding an inopportune sale.

Constraints on institutional LPs mean sponsors are now also motivated to pursue non-institutional sources of capital. On-ramps for retail, HNW, and UHNW investors, including wealth manager partnerships, aggregation vehicles, and perpetual capital sources, are becoming a more important piece of the long-term platform growth strategy.

Inaugural WFF Wit and Wisdom Program in Charlotte

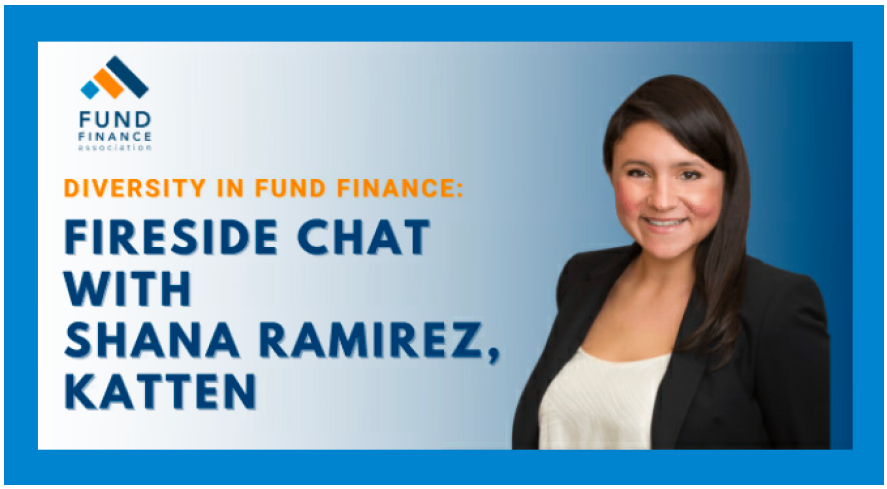
April 7, 2023

Women in Fund Finance US will hold its first Wit and Wisdom event in Charlotte on Tuesday, April 18 from 5:30-8:30 p.m. The evening will be filled with networking and a panel discussion on a range of topics from office politics to feeling stuck. All are welcome to join, but please note that the event is specifically targeted towards junior to mid-level female colleagues with at least two years of experience working in the fund finance industry.

Space is limited. To reserve your spot, please fill out the form **here**.

FFA Diversity Fireside Chat with Shana Ramirez

April 7, 2023



FFA's U.S. Diversity team is hosting a Wednesday, April 12 “fireside chat” between **Shana Ramirez**, Partner and leader of the fund finance practice at Katten, and FFA Diversity in Fund Finance Co-Chair **Anastasia Kaup**. Shana will speak about her career path, trends in fund finance, the realities facing Hispanic/Latinx women in large law firms, and ways to further improve diversity, equity, and inclusion in large law firms and the fund finance industry.

The program (9 a.m. PDT/11 a.m. CDT/12 p.m. EDT) will be part of an in-person event at Katten's Los Angeles and Chicago offices and also available via Zoom.

Registration is open on a first-come, first-served basis. If this event becomes oversubscribed, FFA reserves the right to limit the number of attendees from each firm, in order to allow for participation from as many of its supporting institutions as possible.

Register here for **Los Angeles**, **Chicago** or **Zoom**.

Lloyds Bank Appoints New Head of Financial Sponsors Syndicate

April 7, 2023

Lloyds Bank Corporate & Institutional Banking has appointed William A. Lamain as Managing Director and Head of Financial Sponsors Syndicate, a newly-created role. William will be based in London and report to James Ranger, Managing Director and Head of Structured Finance & Syndicate.

William has more than 18 years' banking experience, having joined from Raiffeisen Bank International AG, where he helped develop and build its fund finance franchise. Prior to this, William worked at Natwest and Bank of America.

William's hire will support the continued material growth of the Lloyds Bank's Private Market capability. In this new role, William will be responsible for supporting the existing Financial Sponsors business by further developing its distribution strategies and coordinating fund finance facilities.

Fund Finance Hiring

April 7, 2023

Fund Finance Hiring

State Street is looking for an Assistant Vice President, Fund Finance in Boston and a Vice President, Credit Services in Boston or Charlotte.

- The Assistant Vice President will be responsible for, among other responsibilities, due diligence process and underwriting of capital call credit facilities to private equity funds; the presentation and defense of credit recommendations; maintenance of up-to-date approvals, risk ratings as well as credit and legal files; addressing requests for information from Enterprise Risk Management, internal audit and bank examiners; and working with Loan Operations and customers as appropriate to facilitate operational aspects of credit relationship. Click **here** for additional information.
- The Vice President role will include, among other responsibilities, growing and managing a portfolio of fund level credit facilities to alternative investments funds; working closely with Alts Sales and Relationship Management teams to identify and develop cross-sell opportunities and ensure client retention; managing due diligence process and underwriting of subscription credit facilities, including legal documentation; presenting and liaising with respective deal committees and stakeholders internally such as operations, legal, risk management, etc.; networking within the fund finance and alternative investment management industries to promote and strengthen State Street's reputation; and providing effective portfolio oversight and management reporting in accordance with State Street risk framework. Click **here** for additional information.

Barclays has an opening for a new Legal Vice President to join its growing Corporate Banking Legal team in New York. Basic qualifications include a minimum of five years' experience working in commercial lending at a law firm and/or in-house. For a more detailed description of the role and information on how to apply, please visit **here**.

Avardi Partners, a leading fund finance advisory practice, is looking to hire multiple candidates in London, from analyst to vice president. If you have up to eight years of experience in fund finance and are interested in joining our fast-growing firm, please get in touch. To apply, please visit **here**.

Intesa Sanpaolo IMI CIB is looking for a VP role to join the Fund Financing desk at Intesa Sanpaolo Bank Luxembourg. The candidate will be responsible for the structuring and execution of FF deals, together with a fast-growing team. Visit **here** for more information and to apply.