Renewed Attention for Defaulting Lender Provisions

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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.

One (Cayman Corporate Governance) Rule to Rule Them All ...

May 5, 2023

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The growth in regulation and oversight of private equity and venture capital funds ("Private Funds") in the Cayman Islands has again taken a step forward with the recent introduction by the Cayman Islands Monetary Authority ("CIMA") of the Statement of Guidance on Corporate Governance for Mutual Funds and Private Funds (the "Corporate Governance Guidance"). To date, only Cayman mutual funds (being open-ended funds or "hedge funds") were in-scope of such guidance and, while Cayman Private Funds were of course subject to the Private Funds Act and the regulations stemming from it, they have not been subject to specific guidance from CIMA in respect of how their funds and structures should operate from a governance perspective.

The introduction and expansion of scope of the Corporate Governance Guidance now creates one rule on corporate governance to govern them all (and by them we mean Cayman Islands funds!) and, while we don't anticipate a three-part Lord of the Rings trilogy to explain the consequences, we thought it would be useful for industry participants to have a quick cheat sheet on its effects (hint: it doesn't make you go crazy with power!).

The short form update – does it matter to lenders?

The inclusion of Private Funds within the scope of the Corporate Governance Guidance will not have a material impact on deal documentation or conditions precedent to the effectiveness of subscription finance facilities (as opposed to the Private Funds Act, which, of course, did move the needle in both of these areas):

- ***From a sponsor's perspective,*** it will of course give cause for most to revisit the governance model of their funds and potentially make changes to fit the size and complexity of a structure, but it is unlikely that much change will be required for many sponsors given that the Cayman market is mostly comprised of vehicles managed by the largest and most sophisticated managers in the world.
- ***From a lender's perspective,*** the regulatory enhancements introduce a modern corporate governance framework for Private Funds that are party to their facilities and so provide some additional comfort (rather than concern) in respect of credit counterparties that are Cayman domiciled.

I'm having a slow Friday – tell me more about what the Corporate Governance Guidance actually requires from Private Funds.

The Corporate Governance Guidance documents various obligations of a fund "Operator," which is defined as the governing body of a Private Fund − the Board of Directors of a corporation; the General Partner of a partnership; the Manager(s) of a limited liability company; and the Trustee where the entity is a trust.

There are seven principal areas on which the Corporate Governance Guidance is focused:

1. **The oversight function of fund Operators.** Operators of Private Funds are responsible for the activities of the fund. The Operators should comprise members with an appropriate diversity of skills, experience and expertise to ensure overall competence of the Operator. The job of the Operator includes taking steps to ensure that the Private Fund is conducting its affairs in accordance with all applicable acts, regulations and regulatory measures of the Cayman Islands.

2. **Conflicts of interest.** The Operators should have a written conflicts of interest policy commensurate with the size, complexity, structure, nature of business and risk profile of the business operations of the fund. The Operator will be expected to identify, disclose, monitor and manage all conflicts of interest. Additionally, all conflicts of interest should be disclosed at least on an annual basis.

3. **Operator meetings.** Operators should convene a meeting at least once per annum. However, the size, complexity structure and risk profile of the fund may dictate that the Operator meets more frequently.

4. **Duties of Operators.** The Corporate Governance Guidance imposes a number of duties on the Operators of Private Funds. The following are an example of some of these duties:

   - Operators should exercise independent judgment whilst always acting in the best interests of the Private Fund;
   - Operators should act honestly and in good faith;
   - Operators need to regularly confirm that the investment manager is operating within their investment strategy, criteria and restrictions;
   - Operators need to keep abreast of the financial position, net asset value and calculation thereof.

5. **Documentation.** The Operator is responsible for ensuring that an accurate written record is kept of all meetings and determinations with respect to the Private Fund.

6. **Relations with CIMA.** The Operator should conduct the affairs of the Private Fund with CIMA in a transparent and honest manner. This would include disclosure of any matters that could materially and adversely affect the financial soundness of the Private Fund as well as any non-compliance with applicable acts, regulations and regulatory measures.

7. **Risk Management.** The Operator should ensure that it provides oversight of the risk management of the Private Fund to ensure that any risks are managed and mitigated.

Conclusion – so it’s all positive news?

The Corporate Governance Guidance provides welcome clarity on CIMA’s position on the governance of Private Funds. While it is unlikely to materially impact many managers or their governance model, the Corporate Governance Guidance provides additional clarity and comfort to international participants, including LPs and lenders, that Cayman continues to enhance its regulatory framework to fit modern standards. For that reason, it can be seen as a positive development in the market.

LMA Publishes Model Provisions for Sustainability-Linked Loans

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Cadwalader ESG Finance and Investment partner Sukhvir Basran collaborated with the Loan Market Association to create the SLL Model Provisions. Sustainability-linked loans ("SLLs") are one of the most important transition tools, and the launch of these provisions will continue to drive the growth of sustainable finance. You can read the LMA's press release **here**.

In addition, Cadwalader recently hosted a breakfast discussion with the LMA and LSTA with the aim of "Unlocking Sustainability-Linked Loans." During the session, Sukhvir was joined by the LMA's Gemma Lawrence-Pardew and the LSTA's Tess Virmani in a conversation addressing some of the most frequently asked questions raised by market participants in respect of SLLs. Click **here** to listen to the discussion. Click **here** to read a detailed summary.

7th Annual European Fund Finance Symposium

May 5, 2023

Registration is still open for the Fund Finance Association's 7th Annual **European Fund Finance Symposium**, which will be held on Monday, June 19, from 9 a.m. to 7:15 p.m., at the QEII Conference Centre in London. For more information or to register, please click **here**.