Considerations for Administrative Agents 'Fronting' Funds

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When a borrower submits a request for borrowing in a syndicated credit facility, each lender in the lending group is generally obligated to make its pro rata share of the borrowing available to the administrative agent by a certain date and time. The administrative agent then deposits such proceeds in immediately available funds in the borrower's account. However, it's not always this straightforward.

The process to wire funds can be time-consuming. It can take hours for a transfer to make its way through the system and hours more for the administrative agent to confirm receipt. If the administrative agent waited to confirm receipt of funds from each lender, then the borrower may not receive its loan until very late in the day, or even the following day. To avoid this scenario and accommodate the borrower, administrative agents have commonly "fronted" funds to the borrower on behalf of the lending group in advance of it actually confirming and/or receiving funds from the lenders.

Is Fronting Permitted Under the Credit Agreement?

Market-standard subscription credit agreements expressly permit (but do not require) the administrative agent to front on behalf of the lenders based on the assumption that the lenders will fund (unless notice to the contrary has been provided). Typical language provides that unless the administrative agent has received *notice* from a lender prior to the proposed date of a borrowing that such lender will not make available such lender's share of such borrowing, then the administrative agent may *assume* that such lender has made such share available and may, in reliance upon such assumption, make available to the borrower a corresponding amount.

Clawback Clauses: Who Is Responsible for Repaying the Agent?

If the administrative agent is permitted to front on behalf of the lenders under the terms of the credit agreement, who is responsible for repaying fronted funds in the event such lender(s) fail to timely make their pro rata share of the borrowing available? Clawback clauses attempt to address this risk.

Clawback clauses, as drafted in the Loan Syndications and Trading Association ("LSTA") model and other market-standard subscription credit agreements, provide that the applicable lender(s) and the borrower severally agree to pay to the administrative agent, on demand, such corresponding amount with interest thereon. Such clawback clauses are commonly structured to first require the applicable lender(s) to repay the administrative agent, and failing such repayment, then require the borrower to repay. Typically, different rates will apply depending on whether it is the lender or the borrower being repaid. Lenders will usually be charged at the federal funds rate or other rate "customary" for interbank compensation, and borrowers will usually be charged at the rate applicable to base rate loans.

In recent months, we have seen a trend to strengthen clawback clauses and provide the administrative agent with recourse to the other lenders in the lending group who have timely funded their pro rata share. This means that such other lenders who have *not* defaulted will be contractually obligated to fund their pro rata share of the non-repaid fronted amount (so long as such payment would not result in a lender's loan allocation exceeding their commitment). Such non-defaulting lenders then have recourse for repayment from such lender(s) who initially failed to fund.

Other Possible Solutions?

In some situations, the borrower or in fact the lenders may not wish to rely on a clawback provision, and may instead wish to ensure that all lenders have pre-funded the full amount prior to the proposed borrowing date. In practice, this isn't common; however, it is an alternative solution in situations where the parties cannot agree to the relevant clawback provisions or if the borrower or lenders need extra assurance that all funds are ready for remittance by the agent. Typically, such pre-funding is effected pursuant to a "prefunding agreement" between the agent and the borrower, whereby the borrower agrees to pay to the lenders an amount equal to the interest that they would have earned if the loans had been made on the prefunding date. The borrower would typically also agree to pay any break-funding if the closing doesn't happen on the expected borrowing date.

Consequences for Lenders Failing to Fund

Subject to certain cure periods, failing to fund a loan or pay other amounts due from such lender to the administrative agent (or due to another lender) could classify a lender as a "defaulting lender" under the credit agreement. Such designation typically allows the administrative agent to withhold payments of principal and interest to such defaulting lender and apply them through a "defaulting lender waterfall," which prioritizes repayments of any amounts owed to the administrative agent. Click **here** to read a detailed summary.

Conclusion

We recommend that administrative agents examine the fronting mechanisms and clawback clauses provided in the credit agreement to ensure, among other things, that adequate protections are in place to get repaid. It is important to note that the ability to front is not always expressly provided for in credit agreements. And perhaps even more importantly, provisions detailing recourse and consequences are not always as clear and robust as an administrative agent may like.

Kirschner Case Update: The SEC Declines to Weigh In

July 21, 2023

By **Leah Edelboim**
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We have been following the litigation over the question of whether certain syndicated loans are securities. *Kirschner v. JPMorgan Chase Bank, N.A.*, which has been before New York federal courts for years, is now before the United States Court of Appeals for the Second Circuit.

In this case, the Court is considering an appeal of a 2020 decision by the U.S. District Court for the Southern District of New York which held that the syndicated term loan in question was not a security and therefore not subject to state and federal securities laws and regulations.

Earlier this year, following a hearing, the Second Circuit entered an order asking the U.S. Securities and Exchange Commission ("SEC") to submit "any views it wishes to share" on whether the loans in the Kirschner case are securities.

It's worth noting that the SEC has previously weighed in on the subject and has indicated that, in certain situations and under certain factual scenarios, loans could be securities. The Court set a deadline for the submission by the regulator in April of this year and the SEC requested three separate extensions of time to respond to the Court's request.

After all these extensions, those of us watching the case were a bit surprised when the SEC's response this week was a letter filed with the Court and signed by SEC General Counsel Megan Barbero in which the SEC declined to give its view as to whether certain syndicated loans are securities. The letter said: "Despite diligent efforts to respond to the Court's order and provide the Commission's views, the staff is unfortunately not in a position to file a brief on behalf of the Commission in this matter. We greatly appreciate the Court's indulgence and regret any inconvenience this may have caused the Court or the parties."

Many experts believed that any view expressed by the SEC would be important to the Court's ruling in the case. Without this view, the Court will now move forward in making a determination in this case based on the briefings it has received and the hearings that have taken place. We continue to watch for developments in this case, which could have serious implications for the $1.4 trillion loan market.

WFF Golf Outing an Instant Classic

July 21, 2023

Cadwalader was delighted to co-sponsor yesterday's inaugural Women in Fund Finance golf outing at Dyker Beach Golf Course in Brooklyn, New York. The event was planned and orchestrated by Kristin Castellanos, head of fund finance at TriState Capital Bank, along with Mary Touchstone, partner and head of fund finance at Simpson Thacher, and was sponsored by TriState Capital, Assured Guaranty and Cadwalader.

The event was open to golfers at all experience levels, even those who had never picked up clubs before. The event included an hour of golf instruction, lunch and nine holes of golf. Many of the attendees were beginners and enjoyed the chance to try their hand at golf in a fun, supportive and friendly environment. Kudos to our instructor and the experienced golfers in the group for helping and encouraging the newer golfers in their foursome.

The event was a smashing success and was Women in Fund Finance at its finest. First, it gave an opportunity to women in fund finance to become acquainted with golf – something many women see as a business opportunity but may not be sure how to get involved.

We all know that lots of business gets done on the golf course, and yesterday was no exception. Women (and men) in all areas of fund finance had a chance to connect and share this fun experience. Deals were discussed and connections were forged. It was a great day. Thanks to Kristin for organizing and to our cosponsors for supporting this fun and invaluable event.

Here are some photos from the event!

European Subscription Finance H1 in Review

July 21, 2023

Our UK team tracks data and trends coming out of the European subscription finance market on a quarterly basis, and has just completed the Q2 2023 review and outlook. To arrange a call or meeting to discuss, please reach out to Mike Hubbard or your Cadwalader UK fund finance counsel.

Investec Publishes Annual Report on Secondaries Market

July 21, 2023

Investec has just published its latest annual report on the Secondaries market – and it is well worth a read.

The report found that secondary managers have high expectations for both deal flow and fundraising in 2023 – reflected in the resilient demand for debt that Investec noted, despite rising rates.

The Investec report also offers useful insights into how and why GPs in secondaries are using leverage, and assesses the various financing strategies.

The key insights (along with the full report to download) can be found **here**.

What We're Reading

July 21, 2023

NAV financing, continuation funds, public pension funds and their increased private equity allocations, and the commercial real estate outlook – here's what we're reading.

- NAV financing is filling in the gap left by the year-to-date decline in M&A activity and private deal exits, according to the FT's ***Buyout groups raise debt against portfolios to return cash as dealmaking slows***. Borrowing against portfolio assets allows funds to return capital to investors, which is particularly helpful for sponsors in the process of fundraising. The article highlights some of the most recent NAV financings but overextends itself a bit by venturing into quoting NAV pricing without any reference to asset class, term, structure or leverage.
- Bloomberg's Matt Levine **turned his attention to continuation funds** in Tuesday's edition of Money Stuff. (Be sure to **sign up** if you're not getting the former Goldman Sachs banker and former Wachtell M&A lawyer's free newsletter.) The write-up recaps why continuation funds are controversial among investors and why the alignment of incentives are not quite as straightforward as is sometimes assumed.
- U.S. public pension funds increased private equity allocations to 13% in 2022, up from 11% the prior year and 8% in 2001, according to **research** from the Equable Institute. In dollar terms, pension fund investments in private equity total $620 billion. The authors expect 2023 private equity returns to decelerate further following a decline in 2022.
- The commercial real estate outlook received a fair bit of attention this week as banks reported earnings (**here** and **here**).

Fund Finance Hiring
July 21, 2023

Fund Finance Hiring

Fitch Ratings is seeing strong demand for subscription finance ratings following publication of its **new rating methodology**, and so the company is adding staff to support this initiative. Fitch just posted five new positions in New York and London:

NY - **Analyst/Senior Analyst**
NY - **Associate Director**
London - **Analyst/Senior Analyst**
London - **Associate Director**
London - **Director/Senior Director**