

CADWALDER

Cash Control Event: Lender and Borrower Considerations

March 15, 2024



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Our readers have been blessed with wonderful *Fund Finance Friday* articles dealing with the maintenance of collateral accounts in '[When Deposits Don't Travel with Loans](#)', control over collateral accounts in '[Control or Control Agreement](#)' and lastly, events of default in '[Common Events of Default in Subscription Credit Facilities: How Parties End Up Here, and Recommendations for Avoiding Preventable EODs](#)'. In this article we explore the circumstances under which lender may take action with respect to collateral accounts, often called Cash Control Events.

Background

As explained by Chad Stackhouse and Katie Clardy [here](#), subscription credit facilities are generally secured by (1) the right to call capital and receive capital contributions from the fund's limited partners and (2) the collateral account into which those capital contribution proceeds are deposited by such limited partners. The security interest over such collateral account is perfected by control, either by the account being maintained with the lender or by entry into a control agreement with the account bank that maintains the collateral account.

Although the lender may have "control" over a collateral account for perfection purposes, provided no Cash Control Event has occurred, the borrower is permitted to withdraw funds from its collateral account. If an event that triggers a Cash Control Event does occur, the borrower's ability to withdraw funds from the collateral account is suspended and the lender would be able to take effective control over the collateral account and access the funds on deposit in such collateral account. Thus, understanding when a Cash Control Event could occur and its consequences is of paramount importance to borrowers, limited partners, fund managers, and lenders alike.

What is a Cash Control Event?

Generally, a Cash Control Event is triggered if (1) an Event of Default has occurred and is continuing, (2) a potential default has occurred and is continuing, or (3) a mandatory prepayment is required. Events of Default are covered by Brian Kettmer in great detail [here](#).

A potential default usually includes any condition, act or event which, with the giving of notice or lapse of time or both, would become an Event of Default. A mandatory prepayment is typically triggered when the outstanding principal amount of the loans exceeds the amount that the borrower can borrow under the subscription credit facility.

While the above is a typical construct, the scope of what may be covered under the potential default prong can depend on the borrower-lender relationship, the composition and robustness of the borrowing base (and credit support), the reputation of the fund sponsor and the track record of the fund. The borrower may seek to limit potential defaults to more serious or incurable events such as payment and insolvency Events of Default. At the same time a lender may wish to have a wider list of potential defaults to ensure that it would be able to prevent the withdrawal of funds from the collateral account promptly if any Event of Default is likely to arise.

Thus, a Cash Control Event is the first layer of protection available to the lender. On the one hand, a lender wants to be able to access funds in the collateral account as soon as possible upon any indication that an Event of Default would or could occur and on the other hand, the borrower wants to maintain access to liquidity and is very focused on not triggering a Cash Control Event. The Cash Control Event construct is beneficial to both lender and borrower in that it provides certainty to the borrower regarding the scope of events that could trigger a Cash Control Event while the lender has some comfort that it has the ability to prevent withdrawals of cash from the collateral account and can gain access to the funds in the collateral account.

Cash Control Event consequences vs enforcement under an Event of Default

One of the main takeaways here is timing. A Cash Control Event can be triggered before an Event of Default actually occurs. There is an important distinction between the consequences of a Cash Control Event and enforcement of security interests pursuant to an Event of Default. Triggering a Cash Control Event does not necessarily mean that the lender would immediately be able to make a capital call pursuant to an Event of Default. The immediate consequences

of a Cash Control Event is that (1) the lender would have the authority to take control of the borrower's collateral account and (2) withdrawal of funds by the borrower from the collateral account is prohibited. Depending on the business agreement between the parties, the consequences of a Cash Control Event could also include that (1) the borrower would not be able to borrow, (2) credit party payments or advances on any debts and liabilities to any other credit party, the limited partners and the investment manager would be prohibited (the rights to payments or advances of such other credit parties, limited partners and the investment manager (together with any liens thereon) would be subordinated to the obligations due to the lender), and (3) payments of distributions to limited partners would be prohibited. Thus, the consequences of a Cash Control Event are serious and immediate and can arise well before a potential default ripens into an Event of Default.

Documentation and Taking Control

When crafting the credit agreement and other loan documents it is important to distinguish between situations that trigger a Cash Control Event and situations that trigger an Event of Default. The collateral account pledge trigger is typically a Cash Control Event, to allow a lender control over the collateral account i.e. access to the funds in the collateral account. However, the trigger under the security agreement is generally an Event of Default. This is because a lender would require access to funds in the collateral account at an early stage, while a lender is generally only be able to step in to make a capital call pursuant to the security agreements once an Event of Default has occurred.

Generally, if a Cash Control Event occurs and the lender decides to act thereon pursuant to the control agreement, it will send a notice to the account bank (or the division of the lender administering the account) and notify such that a Cash Control Event (sometimes called an event of default in the control agreement) has occurred under the subscription credit facility. Upon receipt of the notice, the account bank would be required to cease taking instruction from the borrower with respect to the collateral account and will hence forth only act upon the lender's instruction. This is a crucial consideration for the lender, because such action memorializes the event that triggered the Cash Control Event and subjects the borrower and the fund to much higher levels of scrutiny than what would be the case if the issue that triggered the Cash Control Event was anticipated, communicated and discussed by the parties (and possibly resolved) prior to such escalating to the level where the lender has to send a notice to the account bank.

Conclusion

A lender can, but is not required to, send a notice to the account bank to take control of the collateral account. This is again why the business relationship between the parties is so important. Ideally, it would be most beneficial to all parties if any Cash Control Event can be addressed before the lender takes formal action to take control of the collateral account. To borrow from Brian Kettmer and reiterating the importance of the business relationship, *"[o]ne of the best ways to avoid EODs is the borrower maintaining open and regular communication with its internal finance and operations teams, external counsel, and the admin agent under a facility to help maintain the mutually beneficial and positive business relationship among the parties."* By understanding the consequences of a Cash Control Event, a borrower and investment manager can proactively manage liquidity and ensure effective communication with limited partners and the lender, to navigate through periods of uncertainty with resilience and agility. As always, a strong relationship and collaboration among all parties involved is essential to maintaining healthy subscription credit facilities.

Liquidity Management, Loan Origination and Credit Funds Under AIFMD II

March 15, 2024

On February 7 2024, the European Union adopted a final text amending the AIFMD and UCITS directives (AIFMD II). In a recent [Client & Friends Memo](#) authored by Michael Newell and Alix Prentice, we focus on loan origination funds and the novel rules applying to them in terms of scope, leverage requirements and liquidity management requirements, as well as important considerations for the grandfathering period as these entirely new rules come into force locally across Europe.

Read more [here](#).

Cadwalader Shortlisted for 'Fund Finance Adviser of the Year' Award

March 15, 2024

The Drawdown has named Cadwalader among its finalists for excellence and innovation within private fund operations!

The Firm has been shortlisted as a “Fund Finance Adviser of the Year” based on the UK publication’s judging process and interviews with leading private capital fund executives. Winners will be announced at *The Drawdown*’s annual awards event in London on June 13. A full list of nominees can be found [here](#).

Congratulations to Sam Hutchinson, Michael Hubbard, Mathan Navaratnam and Nathan Parker on this recognition.

2024 Market Perspectives Talk

March 15, 2024



The Fund Finance Series Webinar held on February 15th organised by the Luxembourg law firm Praxio Law & Tax and hosted by Michael Mbayi on the topic “2024 Market Perspectives” is now available!

The event included:

- A recap of the activity of 2023 in America, EMEA and in the APAC region
- Current global market trends and an outlook for 2024
- Fund Finance in Asia
- ESG and Fund Finance

Learn from industry leaders:

- Aleksandra Cison, Director, HSBC Innovation
- Michael Hubbard, Head of European GP Solutions, Cadwalader
- Sarah Lobbardi, Founder, Avardi Partners
- Don Metheven, Counsel, Freshfields
- Corinne Musa, Partner, Akin

Watch it now [here](#)!

NextGen APAC Networking Receptions

March 15, 2024



The Fund Finance Association NextGen team invites you to join us for an evening of networking!

Please join the FFA for drinks, canapes, and an opportunity to socialize as they wrap up the 2024 FFA U: Asia-Pacific. Networking will be hosted simultaneously on Thursday, March 21st in Hong Kong, Singapore, and Sydney.

This networking opportunity is open to all, whether you're a registered attendee of FFA U: APAC or a member of the FFA community.

Don't miss the in-person networking receptions hosted by the NextGen committee!

Date: 21 March 2024

Time: 06:00 pm - 8:00 pm HKT/SGT/AEDT

Hong Kong - Liberty Exchange Kitchen & Bar: 103, 1/F & 205 - 206 2/F, Two Exchange Square Podium, 8 Connaught Road Central, Hong Kong

Singapore - Brewerkz: 1 Fullerton Road, #01-01 One Fullerton, Singapore 049213

Sydney - Rooftop on Botswana: Shop 8.05 MLC Centre, 19-29 Martin Pl, Sydney, NSW 2000

Register for [Hong Kong](#), [Singapore](#) or [Sydney](#) now.

Fund Finance Hiring

March 15, 2024

Fund Finance Hiring

Here is who's hiring in Fund Finance:

Astorg is looking for an Associate Fund Finance professional in Luxembourg. This is exciting opportunity within the Fund Administration team with closed links to the Capital Markets team. The successful candidate will have primary responsibilities for structuring, managing and negotiating all fund financing instruments (c. €4bn). More details can be found [here](#).

Fund Finance Tidbits – On the Move

March 15, 2024

CADWALADER FUND FINANCE 'ON THE MOVE'

Congratulations to the following individuals who have recently been promoted at Wells Fargo:



Erin Goldstein

Congratulations to **Erin Goldstein** for her promotion from Director to Managing Director - Fund Finance.



Colleen Austin

Congratulations to **Colleen Austin** for her promotion from Associate - Fund Finance to Vice President - Fund Finance.



Ben Jones

Congratulations to **Ben Jones** for his promotion from Associate - Fund Finance to Vice President - Fund Finance.



Belma Porobic

Congratulations to **Belma Porobic** for her promotion from Associate - Fund Finance to Vice President - Fund Finance.



Avery Farm

Congratulations to **Avery Farm** for his promotion to Associate - Fund Finance.



Ray Hiraldo

Congratulations to **Ray Hiraldo** for his promotion to Associate - Fund Finance.



Dagem Kelemework

Congratulations to **Dagem Kelemework** for his promotion to Associate - Fund Finance.



Heidi Leung

Congratulations to **Heidi Leung** for her promotion to Associate - Fund Finance.



Steven Perez

Congratulations to **Steven Perez** for his promotion to Associate - Fund Finance.



Luke Petermann

Congratulations to **Luke Petermann** for his promotion to Associate - Fund Finance.



Ramiro Rodriguez

Congratulations to **Ramiro Rodriguez** for his promotion to Associate - Fund Finance.