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FUND FINANCE FRIDAY

Been There, Gonna Do That

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At the outset of every credit agreement negotiation, the implicit goal is to reach an agreement on representations and covenants that allows the Fund to operate as needed while also protecting the lender(s) against current and potential risks. Despite these best laid plans, there are times when the Fund is unable (or will be unable) to comply with the credit agreement. Virtually all credit agreements have a reporting covenant that requires the Fund to provide notice of any potential default or event of default at such time that a covenant has not been complied with or a representation was inaccurate when made. It is at this point that the Fund will inevitably ask for a waiver or a consent. These terms are often used interchangeably, but they have differing uses in different contexts. As one seasoned practitioner once told me, a waiver is for the depravities already committed and a consent is when you need forgiveness for what you are about to do.

When a Fund breaches a covenant or makes a representation that turns out to be inaccurate, the need for a waiver is the appropriate ask. The waiver requires the approval of a prescribed percentage of the lenders depending on the action or inaction in question. That percentage is easy to determine in a bilateral deal, but it may be a majority, a supermajority or all lenders in a club deal or more broadly syndicated transaction. A breach of a negative covenant, a deferment or delay of payments or generally anything collateral related would require all lenders to get on board with the approval. A representation or an affirmative covenant requires a majority of lenders to approve in most circumstances.

On the other hand, a consent is forward-looking and is a request to agree to an action before that event has happened or before an inaction will occur. An example would be a scenario where a Fund desires to prematurely release an investor from its commitment or cancel an investor’s commitment altogether. Such an action would almost always be a breach of a negative covenant; however, if the Fund gets the release or cancellation preapproved via a consent, it can undertake the action without a resulting event of default. Much like the waiver scenario, the percentage of lenders that must approve is determined by the type of action desired to be taken or avoided.

The distinction between waiver and consent is one that is often given little focus, but understanding the difference allows a person to speak the language of the deal in a way that may not materially gain credibility but certainly does avoid potentially losing the audience by using these terms out of context. Being cognizant of the difference also allows for clearer communication with credit officers and in discussing asks with members of a syndicate.

The next time an ask for a waiver is presented, ask yourself if the Fund has already been there and needs a cure for acts already committed. If the ask is for permission to take an action in the future, a consent would be the correct tool to select from the toolbox. Knowing the difference allows a lender to better understand the need and work toward a mutually acceptable solution.