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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.