Legal Update[1]

By Isabella Shaw and Lindsey Hughes

The "Legal Update" panel discussed lessons learned with respect to last year's banking crisis as well as jurisdictional legal updates from 2023 that will carry forward into 2024. The panel addressed the following questions:

How were NDAs and confidentiality provisions in credit agreements treated during the banking crisis last year?

In the early stages of the bank failure and receivership process, investors and funds were heavily focused on what steps they could take to preserve the confidentiality of their information. One of the frustrations for funds throughout the receivership process was that most funds specifically negotiate non-disclosure agreements ("***NDAs***") and confidentiality provisions throughout the process of putting a subscription facility in place. However, the FDIC did not take any of these confidentiality provisions into account when uploading data for potential buyers to review, and lenders were forced to disclose information. As a result, data rooms included significant amounts of information that funds and investors considered confidential and did not want to be shared. Notwithstanding these disclosures, NDAs and confidentiality provisions are not viewed as a futile endeavor – despite their ineffectiveness in this particular situation, they are still an important tool to broadly protect funds' and investors' confidential information.

What can funds do to protect themselves from the risk of bank failure?

"Defaulting Lender" provisions in loan documents came under intense scrutiny during the recent bank failures. Most definitions of "Defaulting Lender" in credit agreements contemplate a lender for whom a receiver has been appointed. However, once the FDIC became the receiver for the defunct banks, a 90-day stay was imposed, and agents and borrowers were unable to enforce the Defaulting Lender provisions they had negotiated. Ultimately, a major lesson learned is that once the FDIC gets involved, the other parties' ability to act is significantly curtailed. This inability to act also came into play when the failed bank was acting as the account bank – funds were unable to withdraw their cash (or have it applied to their outstanding loans) without the FDIC's involvement. However, as with the confidentiality provisions discussed above, thoughtfully drafting the "Defaulting Lender" language in loan documents remains important, as these provisions could be instrumental in a different future scenario.

What was the impact of the bank failures on security documents?

Following the bank failures last March, hundreds of loans were assigned from the bridge banks created by the FDIC to the various banks that purchased the outstanding loans. A large part of the assignment process involved ensuring that the security documents were adequately assigned to the new lenders. This included filing UCC-3

[1] The panelists were Adeola Adeyemi, Partner in the Cayman Islands office of Walkers; Michael Conners, Director at Golub Capital; Richard Facundo, Senior Counsel at Loeb & Loeb; Maude Royer, Partner at Loyens & Loeff; and Maria Strickland, Partner at Morrison & Foerster LLP. The panel was moderated by Jad Nader, Partner at the Luxembourg office of Ogier.

financing statements assigning the security interest to the new lenders, as well as control agreement assignments whereby the account bank was put on notice that the rights under the control agreement had been assigned to a new lender. In many instances where the account was held with the agent bank, the lenders may have relied on perfection by control and not required a control agreement. In these cases, the funds had to open new accounts and negotiate control agreements as part of the assignment process.

What are the investor notification requirements in the Cayman Islands with respect to a lender assignment?

In the Cayman Islands, priority of liens is fixed by sending investor notices to the investors of a Cayman Islands fund notifying them of the security assignment. These notices are typically sent within the first few days of closing a new facility. Following a lender assignment, some assignee lenders request that the fund send a second round of investor notices notifying investors of the assignment. This request developed into a point of controversy on many transactions. Lenders feared that without the new investor notices, investors might fund their capital contributions to the wrong account or might even refuse to fund a capital call from a lender they did not recognize. Funds argued that capital calls would include the account information and that the waiver of defenses language in the limited partnership agreement or investor letter would prevent investors from refusing to fund. The driving factor behind the pushback was the administrative burden involved – investors pay close attention to these notices, and particularly in light of the bank failures, such a notice could result in dozens if not hundreds of inquiries from investors. Ultimately, this was a business point that funds and lenders had to negotiate on each transaction.

Are new Luxembourg investor notices required after an assignment?

Investor notices in Luxembourg do not perfect a security interest or confer priority, but they do give a lender the right to challenge investors for failing to fund a capital call. However, it is rare for funds to send a secondary notice to investors notifying them of a lender assignment.

What were the major legal updates for 2023 in the U.S., the Cayman Islands, and Luxembourg?

United States: The Corporate Transparency Act went into effect on January 1, 2024.[2] The Act will require increased transparency and disclosures on the part of both large and small businesses, including private equity funds, in order to further anti-money laundering and anti-terrorism goals. The rules are complex, and funds will have to work with their compliance teams and attorneys to ensure they are complying with all applicable requirements.

Cayman Islands: The Cayman Islands are celebrating being removed from the Financial Action Task Force's Grey List – a list of countries under increased monitoring by the Financial Action Task Force which are working to address any deficiencies in their AML or anti-terrorism regimes. After being added to the Grey List in March

[2] Note: This panel was held several days before the issuance of an opinion by the U.S. District Court for the Northern District of Alabama (Northeastern Division) that the Corporate Transparency Act is unconstitutional. As such, the panelists did not discuss the ramifications of such judgment.

2022, the Cayman Islands implemented stricter sanctions and AML rules and regulations, resulting in removal from the Grey List in October 2023.

Luxembourg: On August 7, 2023, Luxembourg passed a law relating to business preservation and bankruptcy modernization as a measure to help distressed companies avoid bankruptcy. The good news is that under this new law, the Luxembourg security interest in capital call facilities remains fully enforceable in the event of a restructuring. However, credit facilities will almost always include the initiation of insolvency or reorganization procedures as an event of default, and under this new law, the right to terminate the loan or accelerate the debt may be restricted. Enforcement of the security interest hinges on the occurrence of a trigger event, and if the trigger event is the acceleration of the underlying debt, the restrictions of the new law may apply, and the security interest may not be enforceable until the restructuring proceedings are complete. Luxembourg lawyers can avoid this pitfall by drafting the security documents to provide that filing for reorganization proceedings under the new law is an enforcement trigger.