

Selecting a depositary bank and collateral agent for your project finance needs

Over the years, project finance has taken on a multifaceted structure. In the past, the purpose of the financing may have been to simply build a facility. Today, however, it is not uncommon for a single project to be divided into multiple phases or involve building multiple facilities to meet the project's long-range goals. In addition, project financing can come from multiple secured parties/investors through an array of transactions with varying time frames.

Organizations use project finance to develop infrastructure, sports venues, power and energy facilities, electrical transmission lines, pipelines, and more. The complexity of project finance makes it incumbent upon the organization initiating the project to choose wisely in selecting a depositary bank (also known as the "account bank") and collateral agent (or "collateral trustee").

THE ROLE OF THE DEPOSITARY BANK

All funds, including loan or revenue proceeds, equity contributions, letter of credit draws, and swap payments are held and administered by the depositary bank. The institution in this role administers accounts to ensure the project progresses in accordance with the transaction's governing agreements. This entails opening and maintaining all collateral accounts and crediting funds to the appropriate account(s).

The depositary bank must understand all phases of the project and the corresponding funds flow for each phase. There's a difference between processing payments during the construction phase of the project and processing funds during the revenue-generating phase.

In addition, the depositary bank must navigate the timing and mechanics of processing transfers from reserve accounts and/or draws on letters of credit to meet any deficiencies connected with certain payment obligations. Additional duties include, but are not limited to:

- Confirming all investments selected by the organization initiating the project, or other authorized parties, match the guidelines for permitted investments, and that the available funds criteria are satisfied
- Ensuring all disbursement requests are presented in the approved format and manner with the designated authorized signature(s)
- Processing all withdrawals, transfers, and payments — whether related to construction costs, debt obligations, operating expenses, or restricted payments
- Transferring funds among the various collateral and company accounts in a timely manner and in accordance with the direction of the authorized party
- Providing the checks and balances the parties need and want in their agreements

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Furthermore, the depository bank must read, understand, and be able to act on a variety of different agreement types, including: collateral agreements, depository agreements, credit/loan agreements, and security/pledge agreements. An experienced, professional depository bank will be able to identify flaws in the flow of funds, collateral, or other contractual terms and resolve them before the documents are signed.

THE ROLE OF THE COLLATERAL AGENT

The collateral agent/trustee is tasked with monitoring and administering the collateral security on behalf of the secured party.

Your collateral agent should understand the schematics of your transaction and contribute to improving efficiency by offering suggestions on streamlining the flow of funds and minimizing timing gaps for your specific project type. In addition, your collateral agent should be actively involved in the negotiation process, diligently performing essential tasks, including:

- Requiring that the timing and disbursement provisions follow a logical pattern
- Incorporating the process and methodology for satisfying insufficient funds in order to eliminate any gaps between funding and processing payments
- Providing a vital neutral viewpoint as one of the few parties without a vested interest in a specific outcome other than making sure your documents work
- Reviewing descriptions of all assigned and/or pledged collateral and mechanics for exercising applicable liens
- Reviewing the formats for various disbursements, withdrawal certificates, requests, and countersignatures of the administrative agent, if applicable

The collateral agent should be able to provide a focused technical review during document drafting without causing any delays or interrupting documentation deadlines.

In order to effectively administer a project finance transaction, the collateral agent must review a variety of agreements to understand the immediate and potential impact on the project of each one. While most parties in a project finance transaction have a specific area of expertise and role such as independent engineer or sponsor, the collateral agent needs to have a broader level of expertise. In addition to understanding the duties and responsibilities assigned to the depository bank, the collateral agent is charged with:

- Exercising rights and remedies on behalf of the secured party in the event of a default or trigger event as directed by the administrative agent, required lenders, or other authorized party

- Initiating draws on guarantees, letters of credit, promissory notes, and other supporting documents in the event of a deficiency or other event as defined in the governing agreement
- Monitoring milestones, satisfaction of reserve requirements, and the document provisions related to each
- Understanding the assets as well as the form of assets pledged

Should a trigger event or event of default occur and be declared through a notice, the collateral agent will play an active role, in coordination with other transaction participants, in protecting the secured party's interests. Upon receipt of a notice of default or a trigger event notice, the collateral agent must stop taking direction from the organization initiating the project, seize control of the company account(s), and monitor any transactions posted against the account(s) so the assets are not inappropriately released.

The collateral agent will work closely with the appropriate parties so the facility remains operational and productive and the secured party's interests are protected and maintained. It also will follow instructions for cash movement from the administrative agent or other authorized party, according to the terms of the governing agreement(s).

THE DEPOSITORY BANK AND COLLATERAL AGENT COMBINATION

Typically, because the roles of depository bank and collateral agent are so intertwined, the same institution is generally assigned to handle both. This makes strategic sense, since the depository bank and collateral agent are usually parties to the project's agreements, and the ability to understand any cross-references in these agreements plays an essential part in the proper administration of your project finance transaction. Failure to recognize and act on any cross-references could cause serious harm to the project and negatively impact the ability to accomplish project deadlines.

In order to meet the responsibilities of project finance transaction agreement(s), the depository bank and collateral agent must have the ability to translate the legal verbiage of the agreement into layman's terms in order to:

- Comprehend the terms of the financing
- Identify the parties and understand the respective duties and responsibilities of each party in their designated capacity, including how each interacts with the other
- Outline and document on their internal systems the mechanics and procedures for withdrawals and transfers from the various collateral and company accounts as specified by the governing agreement
- Plan and document all specified events, such as commercial operation date and the required actions connected with the satisfaction and declaration of such events

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There are two other expectations you should have of your depositary bank/collateral agent:

First, since project finance transactions lean heavily on the successful receipt and disposition of funds, the institution should provide access to a cash management system. The volume of disbursements adds to the complexity, with most withdrawals and transfers occurring on the first and/or last business day of the month. Access to a single cash management system allowing you to review all account activity is a great asset for managing various collateral accounts, especially on cross-border transactions where you are in one time zone and your depositary bank/collateral agent is in another.

Second, look for your depositary bank and collateral agent to be an ongoing resource. After the deal has been finalized and the agreements executed, the institution should remain available to assist you in navigating the project's various governing agreements. It should also provide guidance on how to access funds, when disbursement requests have to be submitted, and requirements related to delivering compliance items such as insurance certificates and Uniform Commercial Code (UCC) continuation statements. In order to be a knowledgeable resource and best serve your interests, the depositary bank/collateral agent must have an experienced staff dedicated to providing exceptional service.

MAKING YOUR CHOICE

You can't overestimate the importance of the depositary bank and collateral agent in a project financing, as it plays a critical role throughout the entire transaction, including the all-important negotiation and document-drafting stage.

When selecting a bank to serve in this capacity, seek an institution that understands the structure and purpose of your deal over its lifetime. You also need a provider that understands its responsibilities based on the project agreement and any ancillary agreements.

Engage an institution experienced in reviewing and negotiating all agreements, and one that will proactively maintain communication with the active parties in the transaction on various events and issues. Additionally, confirm that the depositary bank/collateral agent will:

- Have an internal automated system within which it can set up the parameters of the transaction in order to track and advise you of defined dates and required actions.
- Provide an online cash management system so investors may independently view account activity
- Maintain a contingency plan to facilitate timely and accurate processing of payments as directed by the investor in accordance with the governing agreement(s) in the event a major event occurs

There are many challenges to any large project/transaction. Knowing what to look for and hiring the right depositary bank and collateral agent to support your project financing can be instrumental to its success.

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Contact us at 800-490-8262 or visit mufgamericas.com/corporatetrust for more information.

The foregoing white paper is intended to provide general information about Corporate Trust Services for Project Finance and is not considered advice from MUFG and MUFG Union Bank, N.A.