

A - Z of Fund Finance

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MEET THE AUTHORS



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Abraaj

In 2018, the fund finance world was rocked by the collapse of Dubai's Abraaj Group. The private equity firm's misuse of debt finance to cover expenses and fees contributed to this collapse, with accusations of fraudulent mismanagement and comingling of funds at management level which led to Abraaj's founder Arif Naqvi being charged with criminal offences.

In the wake of Abraaj, many lenders have been looking at what they can do to protect themselves if such a situation were to occur again. Lenders in the European market are moving towards taking a stricter approach when perfecting call right security, insisting that notice be served on investors on the same day

in order to ensure that investors cannot withdraw from the fund before security is perfected. There has also been a move towards tighter restrictions on investors transferring out of the fund being included in the finance documents, with most lenders requiring their prior written consent to the transfer of any investors included in the borrowing base (and in some instances such a consent right extending to non-included investors as well). Greater attention should also be paid at the due diligence stage as to whether the general partner (the "GP") (or manager) has the right to release investors of their obligations to fund commitments.

Brexit

As the possibility of a no-deal Brexit looms, there is still uncertainty of what leaving the EU will mean for the financial services industry.

If the UK leaves the EU without any withdrawal agreement in place, it will impact on certain boilerplate clauses that are commonly accepted as market standard in capital call facilities. These include, but are not limited to:

1. *Exclusive jurisdiction clause:* The current LMA standard clause is a "one-sided" jurisdiction clause which allows lenders to start proceedings against obligors in any court of competent jurisdiction, but which restricts obligors to starting proceedings in English courts only (due to the high regard that the market has for the English court system). This currently works as England (being a current member of the EU) has the benefit of Brussels I Regulation, which would allow for a judgment made in an English court to be enforceable in another EU member state. If the U.K. were to leave the EU in the event of a no-deal Brexit, the Brussels I Regulation would cease to apply to England and parties would be required to use "two-way" exclusive jurisdiction clauses (meaning both

lender and obligors would be restricted to starting proceedings in a specified jurisdiction only); and

2. *Bail-In wording:* The current LMA recommended form of bail-in clause aims to put all parties on notice that, where a lender is situated in an EEA country, such lender is the subject of the write-down and conversion powers of EEA regulators in the event that such lender enters into financial difficulty. Such a clause should be included in a finance document where the document is governed by the law of a non-EEA country and under which a lender which is situated in an EEA country has a liability. As the U.K. is currently an EEA country, such a clause is not strictly required to be included, but is often included if the borrower is situated outside the EEA to prevent the need to include the bail-in clause in all non-English law governed security documents etc. (for example, where the borrower is a Cayman fund). It is not clear whether the U.K. will remain in the EEA in the event of a no-deal Brexit, and as such the prudent approach is to include the bail-in clause in English law governed facility agreements going forwards.

Capital Call Facilities



A capital call secured facility (also known as a ‘subscription line facility’) is a facility provided to a fund which is secured against the uncalled commitments of the fund’s investors. These facilities are typically used to provide the fund with more liquidity and to ‘bridge’ the gap between calling down from investors and making investments. Most constitutional documents stipulate that investors must be given 10 business days’ notice of any call down request, meaning that the fund will have to receive the monies before it can make what could be a very time sensitive investment. Under a capital call secured facility, the borrower will be able to utilise the facility in a much shorter timescale. Due to the bridging nature of these types of facilities, they were typically provided on a short term tenor, however now we often see facilities with a tenor of up to 3 years and sometimes longer. Certain funds require that debt drawn is not outstanding after a certain period of time (say no more than 12 months), thereby requiring the borrower to clean down the particular loan by issuing a call down notice to investors and using the proceeds to pay off any indebtedness in respect of the relevant loan.

Historically, these facilities have been unsecured (especially in the European market), but in the current market the typical capital call facility will be secured by a security assignment of the contractual right that the GP/manager and fund have to issue call down notices to the investors, as well as an account charge over any collateral account into which contributions are paid.

The size of the commitment that a lender provides will be based upon the value of the uncalled commitments left in the fund. The lenders will due diligence all investors and for those that they deem credit worthy, it is their uncalled commitments that are included in the borrowing base of the facility. For this reason, capital call secured facilities are usually provided to a fund at the beginning of its life, before there have been many (if any) call downs from investors and when the value of uncalled capital is at its highest.

Due Diligence

Due diligence on the obligors’ fund documents should be carried out from the moment of instruction as, depending on the number of investors in the borrower (and any other obligor granting call right security), this could be a very lengthy process and it is better to be aware of any issues from the outset. Documents that the lender’s counsel will typically want to review include the limited partnership agreement (“**LPA**”) of the obligors and any other constitutional documents of the GP and any manager, any side letters of the investors, the investors’ subscription agreements and any investment management agreement, alternative investment fund management agreement, investment advisory agreement, depositary agreement, custodian agreement, administration agreement or any other relevant service agreement in place.

When reviewing the LPA, the lender’s counsel will be concerned with whether the GP has the power to borrow, guarantee and grant security on behalf of the fund. It is also important to pay attention to who has the right to issue call down notices to the investors (is this the GP or a manager?), how many days’ notice is required to give notice of call downs and whether there are any details in particular that need to be included in the call down notice (for example, details of the relevant bank account into which contributions are to be paid). Lenders will also want to know whether call down notices can be issued to investors to repay debt after the end of any investment period, as if this is not the case then the term of the facility will need to be tied to the term of the investment period. Among other provisions that lender’s counsel

will look to flag in their review of the LPA are (i) overcall limitations (limits on the ability of the borrower to call capital from its investors), (ii) excused or excluded investors, (iii) cancellation, transfer, withdrawal, reduction, redemption or other similar rights in relation to undrawn commitments, (iv) flexibility for and consequences of alternative investment vehicles, and (v) subordination of investors' and fund parties' claims to those of the lender.

The lender's counsel will be looking for any provisions in the side letters which could prevent an investor from meeting a call down. Provisions with implications

for lenders could include (i) 'most favoured nation' provisions, (ii) investment restrictions, (iii) placement agent provisions, (iv) sovereign immunity provisions, (v) provisions restricting the jurisdiction for the bringing of claims under the fund documents, and (vii) confidentiality obligations.

When reviewing the investors' subscription agreements, lender's counsel should check that the amount and currency of the investor's commitment accords with the lender's records and whether the investor has made certain representations, for example that it is an ERISA investor (see "ERISA" below).

ERISA

If an investor is a pension or retirement fund, it may be classed as an 'ERISA investor' pursuant to the United States Employee Retirement Income Security Act of 1974, as amended ("ERISA"). If a facility agreement is determined to create contractual privity between the lender and ERISA investors, this could result in a 'prohibited transaction' under ERISA.

A fund borrower may be considered to be a 'plan asset vehicle' if 25% or more of the borrower's interests are held by ERISA investors, and as such, lending to such a borrower could be a prohibited transaction (as the plan asset vehicle would be deemed to be 'looked through'), unless an exemption applies. A borrower may be exempt from the prohibited transaction rule if it qualifies as a 'venture capital operating company' ("VCOC"). A VCOC will not be considered to be a plan asset vehicle provided that all of the interests in the VCOC are not held by one ERISA investor or a group of ERISA investors controlled or sponsored by the same employer.

In addition, failure to comply with ERISA could expose the investor and the fund to significant liability and could trigger excuse rights that would permit an ERISA investor to avoid funding capital commitments. Whether an investor is an ERISA investor or not should be flagged and considered at the due diligence stage.

As further protection for ERISA investors, funds will often require ERISA investors to be investors in a feeder fund that will then feed into the main borrower fund. In this instance, a 'cascading collateral structure' is put in place whereby the feeder fund will pledge to the main borrower fund its and its GP's rights to call capital on its investors, and the main borrower fund will then on-pledge to the lender its rights under the security documents between the main borrower fund and the feeder fund, so as to avoid contractual privity between the lender and the ERISA investors in the feeder fund.



Feeder Vehicles

Where feeder vehicles are used in the structuring of a fund, due diligence will need to be carried out on the borrower's fund documents as well as those of any feeder funds. The security package should capture the uncalled commitments of the feeder fund to the fund, as well as the uncalled commitments of the investors in the feeder fund to that feeder fund. In the event that a feeder fund has admitted ERISA investors, it may be necessary for that feeder fund to enter into a

cascading pledge rather than entering into a direct contractual relationship with a lender (see 'ERISA' above).

Lenders will often require any feeder funds to be obligors under the facility agreement, and as such the feeder funds will have to grant cross-guarantees and cross-collateralisation in relation to the fund's borrowing (albeit often capped up to its relevant percentage allocation in the borrower).

GP Lines

Although not all lenders offer credit lines to GPs for the purpose of funding a GP's fund commitment, there has recently been a slight increase in the number of banks/alternative lenders providing these types of facilities. Certain of those lenders will not, however provide such GP commitment financings on a standalone basis, but may provide them alongside other financings.

The typical security package of a GP line financing will consist of an assignment of the contractual right to receive distributions from the underlying fund and/or the contractual rights to receive management fees. Security will also be taken over the bank accounts into which such cash payments are made. Certain lenders also look for personal guarantees from members of the GP team as a starting point as well as security over the shares of the GP. Ultimately, both pricing of these facilities and the required security/guarantee package depends on the profile of cashflows and the LTV coverage ratio.

Such GP commitment financings typically have a term of approximately 5 years with lenders preferring to lend to the corporate GP, rather than directly to the individual members of the GP team. If the borrowers are the individual members, then a number of consumer credit and FSMA (as defined below) issues need to be considered and addressed under the facility agreement, for example the provision of high net worth statements which acknowledge that the borrowers do not have the protection of the Consumer Credit Act 1974 or the Financial Services and Markets Act 2000 ("FSMA").

In addition to credit lines for GP commitment financings, a number of lenders also provide strategic GP lines such as facilities for succession planning (enabling senior partners to realise equity and junior partners to fund their interest) and financing for GPs wishing to purchase secondary interests in their own funds.

Hurdle Investors

When assessing the credit worthiness of investors, a lender may gain more comfort that an investor is likely to meet its future drawdown obligations if it has already part-funded some of its capital commitment. The rationale behind this is that the investor will already have a vested interest and if it were to fail to meet future call downs and become a defaulting investor, it would lose its rights (such as rights to

distributions) attached to the commitment it had already part funded.

In order to include such investors in the borrowing base, a lender will often include an additional class of included investor and require such class to meet certain conditions. One of these conditions will be part-funding a certain percentage of that investor's capital commitment.

ILPA

Since The Institutional Limited Partners Association (“ILPA”) published its paper “Subscription Lines of Credit and Alignment of Interests: Considerations and Best Practices for Limited and General Partners” in June 2017 (see our 2018 edition of this “**A-Z of Fund Finance**” article), ILPA has published revised principles on “**Fostering Transparency, Governance and Alignment of Interests for General and Limited Partners**”. These principles build on Principles 1 (published in 2009) and Principles 2 (published in 2011).

In summary, these 2019 updated principles include:

- The IRR clock should start when the credit is drawn, rather than when capital is ultimately called from the investors
- Reporting to be presented with and without the effect of such facilities
- Greater transparency on the impact of such facilities on management fees, leverage limited and costs
- Carry clawback be gross of tax
- Limited partners to be attentive to GPs costs
- Transparency in any change of the GP’s ownership

Many managers already include many of ILPA’s recommended disclosures in their quarterly reports, but for those that don’t, following ILPA’s recommendations may be time consuming and administratively burdensome. The majority of investors are sophisticated investors who fully understand the use of subscription line facilities and appreciate the benefits they bring.

Jurisdictional Issues

Certain elements of a fund finance transaction will be determined by which jurisdiction the borrowers (and other obligors) are domiciled in. The most obvious elements that will be affected by local jurisdictions are the fund structure, nature of security and the conditions precedent. There are a variety of potential fund structures across jurisdictions, such as regulated or unregulated structures, limited partnership or investment company structures as well as trust arrangements. It makes sense to engage local counsel from the offset to ensure that any potential issues are flagged early in order to avoid any last minute delays to completion.

A non-exhaustive list of potential jurisdictional differences are as follows:

1. *Security* - how is security granted in that particular jurisdiction? Are there any specific perfection or filing requirements in relation to the proposed security and if so, who is responsible for ensuring these are complied with?
2. *Legal opinions* - lenders typically require capacity and authority opinions in relation to the fund parties’ entry into of the finance documents, as well as opinions in respect of the enforceability of the finance documents and any security, but the jurisdiction of the borrower will dictate who is responsible for providing the opinions. In the U.S., it is market standard for the borrower’s counsel to provide all legal opinions, whereas in the European market, it is generally accepted that on fund finance transactions, borrower’s counsel will provide the capacity and authority opinions and lender’s counsel will provide any enforceability opinions.
3. *Corporate authorisations* - are board, shareholder or investor approvals required? It is important that all parties understand the form of corporate authorisations that will be provided so as to include as granular a description as possible in the conditions precedent. Consider whether

constitutional documents will also need to be amended, and if so the process for doing that.

4. *Regulatory* - are there any local regulations that need to be adhered to in relation to borrowing, guaranteeing or granting of security? Are any regulatory consents required and if so what is

the likely timeframe to obtain these?

5. *Tax* - is there withholding tax in any of the applicable jurisdictions? A local tax expert should be instructed to review the relevant finance documents.

Key Person Event

When carrying out due diligence on the borrower's LPA and other fund documents, lender's counsel should be aware of when any keyman/key person provisions may be triggered. If certain key persons leave the fund/stop dedicating a certain amount of time to the business of the fund, the investment period of the fund may be suspended. If not reinstated within a certain time period, the investment period of the fund may be terminated. If the investment period of the borrower is suspended or terminated, the lender should consider whether it is still possible to issue call down notices to investors for the repayment of debt (see also '**Due Diligence**'). The occurrence of a 'key person event' is sometimes a drawstop trigger or a trigger for mandatory prepayment under the facility agreement.



Leveraged Facilities

Leveraged facilities (or net-asset value ("NAV") facilities) are facilities that are essentially secured against the underlying cash flow and distributions that flow up from the fund's underlying portfolio investments. The facility is usually provided to the fund itself, or an underlying SPV. Leveraged facilities are typically structured as term loans and have longer tenors than 'bridging' subscription line facilities. A leveraged facility would typically be provided to a more mature fund when its investment period has ended and there are no or few uncalled capital commitments remaining.

It is important that LPAs are properly reviewed to ensure that such leveraged facilities can be provided

to the fund. Often LPAs restrict the fund's borrowings to the investor's remaining unfunded commitments which would prevent asset-backed borrowings in excess of such limit. In addition, leveraged facilities may raise regulatory issues. Whilst the market view is that subscription facilities are not leverage for the purposes of the alternative investment fund managers directive ("AIFMD"), this is not the position for leveraged/NAV facilities to the extent that liabilities thereunder are not fully covered by investor commitments. Such leveraged/NAV financings therefore, need to be counted in AIFMD's leverage thresholds and are subject to the reporting obligations contained in AIFMD.

Leveraged facilities also require the lender and the borrower to pre-agree certain key factors in the facility agreement such as eligibility criteria, valuation methodology, concentration limits and advance rates for the fund's day one investments and those subsequently acquired. This may prove challenging for subsequent investments for some lenders, particularly where assets are not listed or rated, their valuation is reported by the fund manager using discretionary valuation methods, the assets are not liquid, there are a relatively small number of investments and/or where the acquired investments have not yet been fully funded. It is this increased risk profile which drives the higher overall cost of a leveraged facility in contrast to cheaper subscription line financing.

Security packages for leveraged facilities will vary depending on the type of fund, however it is likely that security will allow the lender to control the underlying assets or distributions paid on such assets.

For example:

- *Secondary funds* – lender may take security over the LP interests that a secondary fund holds in other funds (there has however been a shift in the market from direct to indirect security over such collateral)
- *Credit funds* – lender may take security over underlying loan portfolio (again there has been a shift in the market from direct to indirect security over such collateral)
- *Private equity funds* – lender may take security over the shares in the asset holding vehicles

Read a more detailed article on “**NAV Facilities and Hybrid Facilities**” co-authored by Haynes and Boone's partner Ellen McGinnis and associate Deborah Low.

Manager

When carrying out due diligence on the fund documents, lender's counsel should be careful to check the roles of both the GP and any manager as it may be that the manager as well as the GP (or instead of) has the power to carry out certain acts on behalf of the fund, including issuing call down notices to investors. If this is the case, then the call right security will need to be granted by the manager, possibly as well as the GP and the fund. The investment management agreement should also be reviewed for any provisions which could potentially cause an issue for the lender (see also '**Due Diligence**').

The investment manager should also be caught by certain provisions under the facility agreement. For example, it is common for the borrower to provide an undertaking that it will not remove its investment manager without the lender's (or the facility agent's) prior written consent and that any replacement investment manager be acceptable to the lender/facility agent in their sole discretion and provide

similar conditions precedent (including security package) as provided by the outgoing investment manager. Any change to the investment manager, without such prior written consent, would typically trigger an event of default. It is common to also include restrictions on who a fund party can and cannot delegate to.



Non-Performing Loans

A non-performing loan (“NPL”) is a loan which is considered to be in default due to non-payment of principal or interest. After the 2008 financial crisis, there was a large number of NPLs on lenders’ books. Due to lenders being keen to rid their books of NPLs, lenders are willing to write down the value of NPLs (see also the bail-in section in ‘Brexit’ above) and offer attractive deals to those willing to invest in NPLs. Such a supply has created a demand, and distressed credit funds have filled this space, with both open-ended and

closed-ended funds offering investment opportunities to investors. Although NPLs are by nature a riskier asset class, due to a strengthening in the global economic market in recent years, investors have seen high returns.

Like many other types of funds, credit funds have been keen to implement the use of subscription line facilities as part of their investment strategy.

Open-Ended Funds

Whether a fund is open-ended or closed-ended largely depends on the nature of the investments to be made. For liquid investments, an open-ended fund is the usual choice. In contrast, closed-ended funds tend to be chosen for illiquid assets.

There are a number of distinguishing factors between open-ended funds and closed-ended funds, however perhaps the most concerning from a lender’s perspective is the flexibility for investors in open-ended funds to redeem their interests. True open-ended funds require investors to fully fund all capital commitments at fund closing and permit redemption of equity at the election of the investor. Subscription line facilities would therefore not be suitable for such a fund, hence why lenders have historically not provided such facilities to those funds.

However, nowadays we sometimes see more flexible open-ended fund structures, with expanded redemption and withdrawal rights for investors and which retain the concept of an unfunded capital commitment. Following careful due diligence of an open-ended fund’s constitutional documentation, particularly around redemption timing and mechanics, and notwithstanding the additional open-ended fund feature of a changing pool of investors, a subscription line facility could be structured with finance



documentation drafted to address lender concerns. Typically, such concerns would be dealt with through additional covenants and events of defaults as well as additional investor exclusion events (tied to requests for redemption) and mandatory prepayment triggers in advance of redemption windows.

Otherwise, from a lender recourse perspective, open-ended facilities tend to be structured to look at the underlying assets and to include net asset value covenants. However, such asset level financings are likely to be more expensive than cheaper subscription line facilities.

Power of Attorney

When taking security over the GP's/manager's and fund's rights to issue call down notices to investors, most security documents will also contain a power of attorney by way of security in order that the lender is able to 'step into the shoes' of the GP/manager and issue call down notices when and if the lender looks to enforce its security. The security documents will typically be governed by the laws of the jurisdiction in which the asset is situated (being the governing law of the LPA in respect of capital call security), and, depending on the jurisdiction, the issue of whether a power of the attorney will survive insolvency should be considered. If a power of attorney does not survive insolvency, then a secured party could be left in the position that it is unable to exercise this power of attorney if the security grantor becomes insolvent and will have to look to the courts in order to enforce its security.

If the security grantor is domiciled in England, then typically a separate power of attorney by way of security will be taken, either in addition to any security agreement or as a stand-alone document if the transaction is unsecured.

If the transaction is secured, then any English law governed security agreement in respect of call down rights will be perfected by the receipt of notice by the

investors. This perfection creates priority in favour of the security agent, and so even if the borrower subsequently breaches the usual negative pledge covenant contained in the facility agreement and/or security agreement (by granting security over the same call rights to another lender), the perfected security will take priority. A power of attorney on its own, however, does not have any priority and rather is a delegation of the GP's rights. If the GP then assigns the right to issue call down notices to another party at a later date, the perfected assignment will take priority over any existing power of attorney, and for this reason, lenders prefer to take security by way of assignment and a separate power of attorney, rather than a power of attorney alone.

The GP's authority and capacity to execute a power of attorney should be checked under the fund documents. Depending on the jurisdiction of the security grantor, there may also be special execution requirements for a power of attorney to be effectively executed (for example, in England and Wales, powers of attorney need to be signed as a deed). It should therefore, always be ensured that any security documents containing a power of attorney and/or any separate power of attorney by way of security are executed correctly.

Quarterly Reports

It is market standard for a lender to request copies of the unaudited quarterly financial statements of the borrower (and any quarterly management reports) for each financial quarter, ideally as soon as they become available. The lender will also want to be provided with the audited financial statements of the borrower for that financial year as soon as they become available, or typically in any event within 120 days after the end of each respective financial year.

The financial statements to be provided pursuant to the information undertakings in a facility agreement may be a much negotiated point. The reports that the

borrower is willing to provide will depend on the reporting obligations the borrower/GP has to its investors under the borrower's LPA as the borrower is unlikely to be willing to prepare additional reports for a lender.

The borrower may also be required to provide a 'compliance certificate' to the facility agent within a certain time period after the end of each financial quarter. This 'compliance certificate' is for the purposes of confirming that no event of default has occurred, no event has occurred which would result in an investor being excluded from the borrowing base,

and that the borrower is in compliance with any financial covenants contained in the facility agreement.

If there is a borrowing base mechanic incorporated in a subscription line or NAV facility agreement, then it is likely that the lenders will also request a 'borrowing base certificate' to be provided following certain

trigger events (such as each utilisation request, upon the occurrence of exclusion events, transfers of commitments and/or investments (as applicable), distributions and investment default events). This certificate will confirm which investors or assets are included in the borrowing base and that no event has occurred which would exclude such investors or assets from the borrowing base.

Risk Analysis

When conducting due diligence on a subscription line deal (see also '**Due Diligence**'), lenders will look at what type of entity each investor is (for example, is the investor a sovereign wealth fund, a family office and a pension fund, etc.) and will ultimately decide how reliable that investor is in respect of meeting its commitment obligations and what advance rate should be applied against it.

When determining the creditworthiness of an investor, a lender will need to be aware of any potential issues which could restrict it from being able to recover money from such an investor. Potential issues will vary depending on the type of investor and the jurisdiction in which that investor is based.

In the event of a payment default, whether a lender can recover money from investors will depend upon a lender's ability to enforce against the investors. Sovereign immunity is one such issue which may

restrict a lender from being able to enforce against an investor. Lenders should be aware of types of investor which may have sovereign immunity, such as sovereign wealth funds and super-national organisations, and jurisdictions which may provide for sovereign immunity to certain entities, such as Texas (see '**Texan State Investors**') and California.

In order to provide comfort that an investor is creditworthy, a lender may request that an investor provide a letter directly to the lender confirming that that investor agrees to fund any call downs made by that lender. A lender may also request that an investor provide additional documentation evidencing that the investor is funded by a credible parent (i.e. 'credit provider'). In some instances, the parent entity of an investor may be required to guarantee the investor's commitment. The more creditworthy an investor is deemed to be, the higher the advance rate that will be applied against it.



Separately Managed Accounts

Separately managed accounts (“SMAs”) may be used by large institutional or high net-worth investors and provide an opportunity to the investor to make investments in accordance with its specific policy or strategy. Such a structure allows the individual investor to hold its portfolio of assets separately, rather than in comingled funds.

A facility provided to an SMA is a more bespoke product and may not be one that all lenders are willing to offer. The lack of diversification in the borrowing

base and the collateral pool makes this product riskier than a standard capital call facility in the eyes of most lenders. For this reason, lenders may require additional comfort in the form of credit linkage and an investor letter (which is easier to negotiate when there is only one investor in the fund). The finance documentation is also likely to provide stricter protections for the lender, for example shorter cure periods, additional pre-payment triggers and greater reporting obligations. It goes without saying that transfer provisions will also be extremely tight.

Texan State Investors

When conducting due diligence on investors, lenders should be aware of bespoke enforceability issues which vary depending on the laws of the jurisdiction in which the investor is domiciled. One such issue is that of investors which are Texan governmental bodies. Under Texas law, governmental bodies have sovereign immunity status. Even if a side letter includes typical comfort wording (such as “*nothing in this letter shall relieve the investor of any enforceable obligation to contribute capital...*” etc), sovereign immunity status

cannot be waived contractually under Texas law and would have to be waived at legislature level to allow enforcement against an investor which is a state entity.

If a lender is keen to work out a way of how to include such an investor in its borrowing base, such investor may be included as a hurdle investor (see “**Hurdle Investors**”).

Umbrella Facilities

Umbrella facilities have become increasingly more popular with fund managers as they allow multiple funds with different investment strategies (and often their related parallel funds, feeder funds or alternative investment vehicles) to accede into pre-agreed facility structures as borrowers (and guarantors) as and when such fund groups are established. Having one facility agreement in place rather than separate facility agreements for each fund group means that fewer set-up costs are incurred by the manager, consistency

is ensured across different fund groups, and that fund managers are able to put fund financings in place for their managed funds quickly and efficiently.

An umbrella facility will typically be structured to enable an acceding fund group to establish a sub-facility under the facility agreement. Each sub-facility will typically have its own purpose, availability period, base currency, commitment, termination date, pricing and covenant ratios and may have certain commercial terms that apply to that sub-facility only. The facility

agreement will dictate what information needs to be included in this sub-facility request (typically an agreed form is appended to the facility agreement). Clearly, the amount requested in each sub-facility request cannot exceed the aggregate available commitment under the master facility.

In addition, an umbrella facility will be drafted with a lot of flexibility to allow different types of fund vehicles to accede. There may also be a restriction on the number of sub-facilities that can be in place at any one time, for example the obligors' agent may be prohibited from delivering a sub-facility request if there are already 15 sub-facilities in place that the facility agent has agreed to. In order to utilise a sub-facility, an utilisation request, identifying the sub-facility to be used, will need to be submitted to the facility agent.

The lenders (and/or the facility agent) will almost always have sole discretion as to whether a new fund group can accede to the facility. The request will usually be made by the obligors' agent in the form of an accession letter addressed to the facility agent. By executing the accession letter, the acceding fund

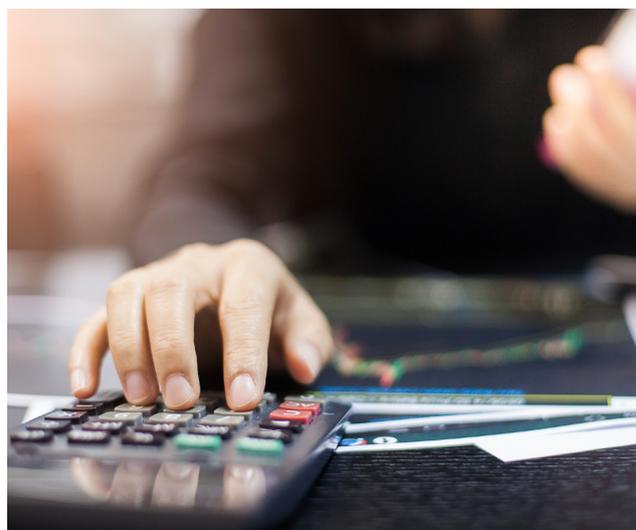
group agrees to be bound by the terms of the original facility agreement (as may be amended by the sub-facility request). Before acceding, the new fund group's fund documents will need to be subjected to the same due diligence as the original borrower. In addition, the fund group will have to satisfy certain conditions precedent, including the granting of additional security over investor call rights (in the case of subscription line facilities) and lender satisfaction with the creditworthiness of the acceding fund group's investors for borrowing base or financial covenant purposes. Other CPs to accession will typically include the provision of corporate authorities, legal opinions in relation to the capacity of the acceding obligors and the enforceability of the new security and accession documentation, officers' certificates, financial information and KYC documentation.

Fund groups will not want any cross collateralisation or cross guarantees between different fund groups, however will typically accept cross collateralisation and cross guarantees between the main fund, parallel fund, feeder funds and alternative investment vehicles in a particular fund group.

VAT

Any VAT or other tax payable in the jurisdiction in which a borrower is domiciled should be considered by a lender. The finance documentation should ensure that any payments made to a finance party pursuant to the finance documents are grossed up in respect of any such payments in order to ensure that the lender does not bear the costs for the borrower's choice of jurisdiction.

Most lenders will also require obligors to provide representations in the facility agreement that it is not overdue on any tax filings, is not currently being investigated by any tax authority and is resident for tax purposes in the jurisdiction under whose laws it is incorporated/established.



Women in Fund Finance

Women in Fund Finance (the “WFF”) is an initiative originally founded and supported by the Fund Finance Association and aims at increasing engagement, recognition and promotion of female leaders within the alternative investment fund finance industry by focusing on connecting women in the fund finance industry, creating a forum in which to educate women about the industry and promoting professional advocacy.

The WFF operates in the U.S., the U.K. and Asia, with the U.K. committee being co-chaired by Haynes and

Boone’s head of finance in London, Emma Russell. To date, the WFF has held networking events in New York, Miami, London, Paris and Hong Kong and is looking to hold events in wider Europe and Boston in the near future. These events typically include both roundtable and panel discussions and focus on a variety of industry and career issues.

For more information on the WFF please visit the **webpage** or contact Emma Russell (contact details at the end of this article).

ForeX

Where a fund receives subscriptions from investors in one currency and draws down from its subscription line facility in a different currency, it makes sense to hedge the foreign exchange (“FX”) rates due to fluctuations in global currencies to ensure that the fund doesn’t end up with a shortfall when repaying the facility.

A potential loss due to FX rates or any amounts payable by a fund under a FX forward agreement, e.g. fees due to the hedge counterparty, is essentially an ‘indebtedness’ of the fund. However, this indebtedness is arguably not a ‘borrowing’ and so any debt/borrowing restrictions in the fund’s constitutional documents need to be considered carefully in light of potential FX liabilities.

If there is a percentage limit on the fund’s ability to incur indebtedness, will the hedging ‘use up’ a proportion of this allowance? This is something the fund should also consider when drawing down on the facility.

It is often the case that FX hedging is secured; if the fund does grant security for any potential liability incurred under the FX forward agreement, does it specifically have authority under its constitutional

documents to grant security in relation to that hedging (or does the authority only extend to granting security in relation to borrowing)? If security is granted against the uncalled capital commitments of investors, do the constitutional documents specifically authorise call downs from investors for the purposes of repaying hedging liabilities?

If a different team of the same bank lender takes on the role of hedge counterparty, then the hedge counterparty may look to rely on the lender-side of the bank to represent its interest in any security package. If the facility is syndicated, then the hedge counterparty should really think about who will represent its interests if the lender-side of its institution sells down its proportion of the debt at a later date. Conversely, if the fund’s hedging liabilities increase significantly, then this could greatly increase the bank’s overall exposure.

If the hedge counterparty is a non-lender, then any hedging liabilities will need to be subordinated behind the repayment of the credit facility. This may require a separate intercreditor agreement.

Are the hedging liabilities secured and if so, is the hedging counterparty a party to the lenders’ security

package or are the hedging liabilities carved out of any negative pledge by being included in the definition of any 'permitted indebtedness/borrowing'?

The facility agreement may include a 'basket' for the amount of hedging liabilities which will be secured. This secured amount would rank *pari passu* with the amount due to the lenders under the facility agreement and would ultimately be deducted from the borrowing base to ensure that there are always sufficient uncalled capital commitments to satisfy the debt and the hedging exposure.

If the hedge counterparty shares the security package with the lenders then the facility agreement should be drafted to ensure that the hedging liabilities are

included within the definition of 'secured liabilities/obligations' and the hedge counterparty is included within the definition of 'finance parties' on whose behalf the security agent has been appointed. It is often the case that the definition of 'finance parties' will include a carve out in respect of the hedge counterparty to ensure that it is only included when relevant, e.g. when being included as a 'secured party'. Similarly, any hedging agreement will be included within the definition of 'finance document' with the applicable carve out to ensure that the definition only includes any hedging agreement in the applicable circumstances, e.g. non-compliance with a finance document (including any hedging agreement) causing an event of default.

Year Ahead

The size of the fund finance market in each of the U.S., Europe and Asia has grown rapidly over the last few years, with more than 11,000 institutional investors actively investing globally in 2018 and over 50 lenders vying for a place in the fund finance market in London alone.

For the U.K. especially, the areas to watch will be the repercussions of any Brexit (see "**Brexit**") deal (or lack thereof!) and the phase out of LIBOR (see "**Zero Floors**" below).

Zero Floors

An interest rate floor is the agreed upon minimum interest rate in relation to a floating rate loan. It is market standard for the interest rate of a loan to be calculated for each interest period on the basis of margin (i.e. the percentage agreed between principals which represents the lender's return for taking the credit risk of lending to the borrower) plus the applicable LIBOR or EURIBOR rate (or the benchmark rate for another currency).

A 'zero rate' may be implemented as a default rate where the applicable benchmark's interest rate on the relevant quotation day is below zero, thus providing a guaranteed minimum yield to lenders and protecting against currencies with a negative interest rate. This means that, on the basis that the interest rate of the loan is calculated at margin plus the benchmark

interest rate, the interest rate of the loan payable by the borrower will still be the margin (plus the 0% benchmark rate).

The Loan Market Association adopted a zero floor concept for LIBOR in its standard documentation in 2012 and many fund finance lenders are now including zero floors in their facility agreements.

However, LIBOR is no longer thought to be a sustainable interest rate and as such the Bank of England has announced that LIBOR will be phased out by 2021, with SONIA thought to be the likely replacement rate. The LMA has published a "Replacement of Screen Rate" clause which is now widely used and accepted in the market.

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