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FUND FINANCE FRIDAY

Please Don’t Ignore My (Over)call

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By Amrita Maini
Senior Attorney | Fund Finance

Overcall limitations limit a non-defaulting investor’s obligation to make up for any shortfall in funding caused by other investors defaulting. In the absence of such a limitation, each “non-defaulting” investor would be liable for up to the whole balance of its commitment to make good any such shortfall. Overcall limitations have become increasingly commonplace in fund documentation as investors often want to limit their obligation to compensate for any shortfall in funding caused by a default by a fellow investor.

Lenders need to be aware of the extent of and application of overcall restrictions set in the relevant fund documentation. Such limitations will usually appear in the Limited Partnership Agreement or equivalent partnership document (in which case they will apply to all investor commitments), but they can sometimes apply specifically to individual investors (in which case the limitations will usually be set out in side letters).

Typical limits on the commitments required to be made by an investor to make good a shortfall are set at 20%/30% of the existing commitment already called for the relevant investment or other payment. In some circumstances, overcall limits may be set much lower (or even at zero) for particular items (*e.g.*, management fees).

So what impact does this have on Lenders? Lenders need to consider the correlation between the overcall limitations and the investor base and concentration levels. A Lender can then adequately assess the level at which defaults by investors holding a certain percentage of commitments in conjunction with the overcall limitation would result in the likelihood that there would no longer be sufficient investor commitments to repay a loan (“Default Point”). Lenders should then ensure that the relevant facility agreement contains a mandatory prepayment event or an event of default that would be triggered if investors with commitments just short of the Default Point become defaulting or excused partners, or transfer their commitments to ensure that there is never a scenario where there are insufficient investor commitments to repay outstanding loans.

In addition, Lenders should ensure that the event of default, mandatory prepayment event or transfer threshold should not be limited to "included" or any other group of investors (in the case of a facility that is calculated on the basis of a borrowing base) but rather should include all investors. This is important as the relevant Limited Partnership Agreement will be applicable to the entire investor base and, in case of an enforcement or even a drawdown by a fund to repay a loan, the requirement to treat all investors equally will require that payment is sought from each investor pro rata to their level of commitment.

Where overcall limitations are set at zero (as is increasingly the case for Management Fee payments, for example), Lenders will need to consider carefully how and to what extent they can minimise the impact of this on any loan terms.

We expect that overcall limitations in general and differing levels of limitation for different items of a Fund’s expenditure will become more ubiquitous in Fund documentation. Therefore, the market should be prepared to amend facility documentation so as to ensure that a Lender doesn’t find itself in a situation that (despite a fund having plenty of uncalled investor commitments) by operation of an overcall limitation there would not in fact be sufficient investor commitments available to repay indebtedness owed under a facility.