CADWALADER

FUND FINANCE FRIDAY

Subscription Finance Loan Agreement Series — Part 1

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This is Part 1 of a series of articles in which we take a close look at some of the provisions and issues in loan agreements that are specific to subscription finance transactions. The commentary is based on LMA (*i.e.*, UK/European) forms of Capital Call/Subscription Finance Loan Agreements, rather than the LSTA (*i.e.*, U.S.) forms. Much of the commentary will be relevant to both but, where principles or considerations differ, this will be flagged in the relevant article. We hope you will follow the series and, to help you do so, the articles will as far as practical follow the same order as the loan agreement.

So we start with the parties.

The focus here is on the “borrower”/“fund” side parties. There are very few real issues or differences between the finance parties (*i.e.*, the “lender” side) and the issues around those parties in a subscription or capital-call financing or any other more standard “corporate” financing, so the commentary on that side is much more limited.

On the fund side:

This will start with the borrower (or borrowers). It will usually be the fund (or funds) which are making the investments being financed by the facility or an SPV or SPVs of those funds and will include any parallel funds or their SPVs. Just to note that depending on the jurisdiction of any fund borrower, that fund may or may not have a distinct legal “personality” and, in any event, in general it will act either through its general partner or manager and/or will be represented by them.

Then there are the guarantors. Three main issues to consider here. First, if the borrower is an SPV, then the fund owner of that SPV should be a guarantor. Second, if there is more than one borrower (in particular, parallel funds which are all borrowers) then all the funds should be guarantors of each other. If they are not, then their investors cannot all be counted in the same borrowing base or leverage-investor base and would have to be counted separately. This can and does happen, but it is a more difficult credit decision (and requires some further tinkering with the documentation). Third, if there is a feeder fund involved (and the investors in that feeder fund are to be counted in the relevant borrowing or leverage-investor base), ideally that feeder fund should also be a guarantor. One issue to be aware of – and that should always be very carefully checked with both “other” funds and/or feeder funds becoming guarantors – is that these funds have the necessary powers to become guarantors in their LPAs (or equivalent).

Next is the manager and/or the general partner (in their own capacities rather than as representatives of the fund). Occasionally, the necessity to include either of these separately as a party is queried. However, it is standard practice to include whichever of the general partner or the manager is primarily responsible for the operation of the fund or funds which are parties as borrowers or guarantors. Whether this is the general partner or the manager will depend on the particular jurisdiction and constitution of the relevant fund, and sometimes it is both. Their inclusion allows the finance parties to take comfort from the fact (among other things) that representations and covenants are made by the primary legal entity or entities responsible for "running" the underlying funds and, where this is an issue, for these to be coming from an entity which is a legal "personality." Sometimes, the manager or general partner may itself be a fund in which case consideration should be given to whether their own manager or general partner should be added as a party.

As with any other financing, there will usually be further provisions allowing additional parties to accede to the facility in any of the categories above. One point of difference between this type of facility and a standard "corporate" facility is that, in general, while parties can accede, there are usually only very limited circumstances in which parties can "retire" or cease to be parties. Where this is allowed, it is usually only in relation to the manager or general partner and then (if allowed at all) only if a suitable replacement becomes a party in their place. And a word here about "qualified borrowers": More common in U.S.-style documentation, these are entities which are permitted to borrow under a facility which contemplates more than one borrower but which, while they themselves are guaranteed by the other borrowers as guarantors, are not themselves required to become guarantors of the other borrowers. Such entities will accede as borrowers in the normal way (but not become guarantors).

So, that's pretty much it . . . except for two things and a final point below. First, the due diligence on the structure of the fund or funds which are to be parties has to be carefully done so as to ensure that every entity which needs to be a party to the facility is (and can be) a party. Second, the finance parties will need to have carried out and be satisfied with their own KYC, sanctions, credit and other checks on all the "fund side" parties.

And on the finance party side: As stated at the beginning of this article, there is little difference here between a subscription finance/capital-call facility and any other "corporate"-type facility. The only issue we would highlight here is the potential inclusion (or not) of hedge counterparties. Traditionally, funds had organised their hedging requirements outside the direct ambit of subscription finance facilities. But, over the last few years, it has become much more common for finance parties to include hedging in their offering for that to impact the borrowing base/leverage calculations and for such hedging to benefit in terms of pricing from being part of the secured debt. If this is part of the transaction, then the parties would usually want to ensure that the hedge counterparty is either included as a finance party in the facility agreement from the outset (along with the other finance parties) or there are suitable provisions for it to accede as such when the hedging is concluded.