C A D W A L A D E R

FUND FINANCE FRIDAY

Subscription Finance Loan Agreement Series, Part 10: Considerations, Limits and Exclusions

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An essential part of any facility (many would say, the fundamental part) is the question of what utilisations under the facility are actually going to be utilised for. In facility documentation, this is always addressed in the "purpose" clause, and versions of this clause are common across all types of facilities. Also common are certain caveats or exclusions related to this. In terms of what all facilities have in common in dealing with the facility's "purpose," this will in almost all cases be, first, a summary (either in general or more specific terms) of the purpose or purposes for which utilisations under the facility can be employed and, second, a general statement to the effect that while the purpose may be specifically stated, no lender is bound to monitor or verify that the facilities are actually utilised for the stated purpose.

It's probably helpful to deal with the second part of the above first (as this is a feature of any subscription/capital call facility in exactly the same way as it is of other facilities). Lenders will, of course, be extremely interested in the way in which utilisations are applied by their borrowers, for all sorts of good reasons. But the primary intention of this statement is to ensure that the lenders do not themselves incur any liability (or be held in any way to be contributing to) any use of the facilities that does not comply with the purpose or purposes set out. The statement is relatively effective in helping to achieve that objective, but note that Lenders will also look for additional protections around sanctions and other regulatory or other matters relating to the use of the facilities. So this statement alone is not the whole story.

Turning now to the first part, namely, the summary of the purpose or purposes for which the facilities can be utilised. In a subscription/capital call facility, the stated purpose will consist of one or more of the following. First (and this will almost without exception be at least one of the purposes, as it is the fundamental *raison d'etre* of a subscription/capital call facility), utilisations may be applied to fund investments (or follow-on investments) of the fund. Second, utilisations may be applied to pay fees, costs and expenses incurred by the fund as they arise. Often these will include management or similar fees (more on this below). Third, utilisations may be made to pay interest (and perhaps other ongoing expenses) in relation to the facilities themselves. And, finally (often expressed in a more general reference to "other purposes" or to "working capital purposes"), utilisations may be made to fund other purposes (not specifically identified) permitted by the fund documents. Although not always specifically referenced, this may, for example, include collateral or other expenses payable in respect of hedging arrangements entered into by the fund. It's important to note also that in any "purpose" clause for a subscription/capital call facility, all the stated purposes (whether specific or general) should be required to be compliant with the fund documentation of the borrower.

All of the above, you will be thinking (rightly), will give the fund borrower considerable flexibility in the purposes for which it may use the facilities, and it does. However, there will also be specific uses that are not permitted (even if allowed under the fund documentation). For subscription/capital call facilities, the standard restriction (or prohibition, in some cases) will be on using the facilities to benefit the fund's investors directly (whether by repaying or paying their subscriptions or otherwise providing loans or other financial benefits to them). There may also be (depending on the terms of the fund documentation) limitations on the amount of or proportion of the facilities that can be utilised for certain specific purposes. For example, payment of management fees is often treated slightly differently in terms of investor commitments in fund documentation to funding investments, and the facilities will reflect that.

A couple of final comments. First, management or similar fees have been mentioned a number of times above, and it is very common to see payment of these being one of the permitted purposes for which subscription/capital call facilities can be used. There are good reasons for these to be included, but lenders should at least consider whether funding management fees in isolation from investments may lead to different impacts on investor commitments. Second, in a subscription/capital call facility, the purposes for which the fund actually utilises the facilities (and, particularly, that the utilisation is in compliance with the fund documentation) is probably even more important than in many other sectors. In most other sectors (particularly where facilities are made available to corporates – for example, for leveraged acquisitions or in the real estate sectors), if the corporate does go outside its stated purposes in utilising the facilities, this will generally leave the lenders' recourse to any security provided for those facilities intact, and that security (whether over shares in a corporate entity or corporate or real estate assets) will generally remain enforceable. In the subscription/capital call context, however, utilisations outside the purposes authorised by the fund documents can impact adversely on the security, because the security is over investor commitments and those commitments may be less "sure" if the terms of the fund documents have been breached.

So, as with almost everything else we are covering in this series of articles, even where certain terms of facilities seem relatively standard and uncontroversial, there are issues which need to be considered and carefully addressed in the subscription/capital call environment.