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FUND FINANCE FRIDAY

Subscription Finance Loan Agreement Series, Part 11: Mandatory/Voluntary Prepayments and Cancellations

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A regime for a mix of events which require mandatory prepayment and options for borrowers to make voluntary prepayments, as well as mandatory or voluntary cancellations, are a common feature of all LMA-based loan documents, and a subscription/capital call facility is no exception. Considerations around the circumstances in which (and how much and subject to what periods of notice) a voluntary prepayment or cancellation can be made are similar in a subscription/capital call facility context to any other loan document. However, those around mandatory prepayments and cancellations have certain characteristics and nuances that are more specific to subscription/capital call financing. In this article, we will cover this as well as provide a brief summary of the more common features of voluntary prepayment and cancellation provisions.

As background, here is a brief reminder of why these provisions are included in the first place. Mandatory prepayment/cancellation events are generally aimed at dealing with circumstances in which events have occurred in respect of the fund borrower that significantly change the lender's view of the credit but which are, in effect, "no default" type events. In other words, they are not events which the fund borrower itself has caused or allowed to happen. In some types of facilities (although not generally in subscription/capital call facilities), they may also be there to effect cash sweeps. Voluntary prepayment or cancellation options are, in contrast, there primarily to assist the fund borrower in adapting the outstanding debt or commitments available under the facility to changes in the fund borrower's ability to pay down the facility or its need for the facility commitments.

So in a subscription/capital call facility, one often sees typical "mandatory prepayment" provisions common to a number of facility types. There will always be a requirement for a mandatory prepayment on illegality (and this will be almost identical to the triggers for mandatory prepayment in any other facility). "Change of Control" mandatory prepayment events are also pretty much universal. In subscription/capital call facilities, these tend to be triggered by a mix of (a) changes in the ownership of the general partner or manager and (b) more directly, the general partner or manager ceasing to be the general partner or manager of the relevant fund borrower.

After that, the options in terms of mandatory prepayment will vary depending on the particular credit criteria and the constitution of the fund. It was (and sometimes still is) the case that the occurrence of a “key person” event (*i.e.,* departure of one or more of the “key” individuals in a fund as defined in its LPA), or a failure to resolve that event within a certain time, would trigger a mandatory prepayment. Other mandatory prepayment events may include the end of an investment period (if that is likely to impact on the financing or security) and, in the case of an amortising facility, a requirement to repay down to the revised facility limits as the amortisation kicks in. With a nod to the circumstances reportedly surrounding the Abraaj case, lenders may also consider whether to include other events in the mandatory prepayment provisions.

It will often be a matter left to negotiation whether some (or all of the above) additional options as to mandatory prepayment triggers (if they are included) are left as “mandatory prepayment” events or are moved into events of default. In making decisions on this, it is always worth bearing in mind that the underlying rationale for most “mandatory prepayment” events is that they do not themselves involve “default” by the fund or other obligors.

Turning now to voluntary prepayments and cancellation, the provisions in subscription/capital call facilities on these are similar in most respects to those in any other LMA-based facilities. There will be provisions allowing voluntary prepayment (and usually cancellation) in whole or in part on notice (and in minimum amounts and multiples) pro rata for all the lenders. In addition, there will be an ability to prepay or cancel facilities or commitments of an individual lender if there are tax gross-ups or tax indemnity payments required by that lender, or if the fund is required to pay increased costs to that lender. Where the facilities are revolving facilities (as they often are in the subscription/capital call world), a specific prepayment or cancellation option may also be included for “defaulting” lenders.

A few final comments. In subscription/capital call facilities, the line between what should be a “mandatory prepayment/cancellation” event and what should be an “event of default” can be blurred, in particular in relation to the various additional mandatory prepayment/cancellation options. For voluntary prepayments/cancellations, it is worth considering how often these options are likely to be exercised and in what circumstances. Subscription/capital call facilities are generally made available before investments are realised, so the opportunities for prepayment may be limited. Also, whereas the facilities are revolving facilities, funds will generally want to ensure that a voluntary prepayment can be reborrowed (so it does not permanently cancel that part of the facility repaid). And, finally, as some subscription/capital call facilities are offered in the market on an uncommitted basis, in these cases the option to “pre-cancel” may not be one that the fund has any particular incentive to exercise, and it is always good to retain the option.