CADWALADER

Happy Valentine's Day

February 12, 2021 | Issue No. 113

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It’s My Equity, and I’ll Pledge If I Want To

February 12, 2021 | Issue No. 113

By Tim Hicks
Partner | Fund Finance

Most limited partners (“Investors”) in a private equity fund (“Fund”) understand the basics of the collateral package in connection with a subscription credit facility, which typically involves a pledge by a Fund and its general partner or other managing entity of:

- the right in and to the unfunded capital commitments of the Investors;
- the right to make capital calls and to enforce the obligations of the Investors to contribute capital; and
- the deposit account into which the Investors are required to fund its capital contributions.

Furthermore, most Investors recognize that their unfunded capital commitment can be excluded from the calculation of the borrowing base as a result of an Investor’s actions (or inaction) in respect of certain events. An Investor encumbering its equity interest in a Fund is a commonly included exclusion event in a subscription credit agreement. Despite the regularity of encountering this exclusion event, it presents a number of considerations for the Investor, the Fund, and the subscription lender (“Lender”).

From an Investor’s perspective, its equity interest in a Fund is not generally collateral under a typical subscription facility, and depending on the Fund’s underlying value, this equity interest presents an asset that an Investor may seek to pledge in order to obtain its own leverage. This is all the more relevant to growing sector of secondaries funds. An Investor’s desire to pledge its equity interest can create a natural tension between the Investor and the Fund. The Fund is seeking to maximize its availability under the subscription credit facility by maintaining the inclusion of the Investor in the borrowing base, yet the Investor is seeking to use its equity in the Fund to attract is own lenders. If the pledge of equity occurs, the Investor’s uncalled capital commitment provides the Fund with no borrowing base credit under the subscription credit facility.

This exclusion event requires the Fund to take note of the potential consequences as well. All subscription credit agreements require the Fund to inform the Lender upon becoming aware of the occurrence of an exclusion event. The Fund is tasked with maintaining awareness of an Investor’s actions, which may or may not be taken with advance notice to the Fund. The Fund is often subject to a negative covenant that it will not permit any Investor to pledge or otherwise grant a security interest or otherwise create a lien on such Investor’s right, title and interest in the Fund without the prior written consent of the Lender. Thus, the Fund is not only placed in a position of having to honor its contractual obligations of reporting and avoiding permissive unauthorized actions but also must attempt to maintain its investor relationships and accommodate requests from its source of committed capital.

The Lender is also in the fray and is faced with the conundrum of working with the Fund while maintaining the integrity of its underwriting. The Lender obviously wants the Investor to be incentivized in every way to fund all capital calls. If the Investor is over-levered and/or its equity interest in a Fund will be completely consumed as collateral to service the Investor's debt, the fear is that the Investor will succumb to the temptation to stop funding additional capital to the Fund (or the Lender upon its exercise of remedies).

So how does the trilogy of diverging interests reach an amicable outcome? This is often only reached through compromise and a balancing of the risks. The covenant preventing the Fund from permitting an Investor from pledging its equity interest in the Fund is occasionally modified to provide some flexibility or the inclusion of a small, predetermined basket of the amount of equity interests that may be pledged to a third-party creditor. The exclusion event is often modified similar to the below:

> "such Investor encumbers its interest in any Fund and a creditor of such Investor has commenced the exercise of remedies in respect of such interest."

Under this scenario, the Investor is able to obtain the leverage it seeks, the Fund is in a position to grant the Investor's request to incur leverage while maximizing availability under its borrowing base, and the Lender has some advance warning that an issue may have arisen with respect to the Investor and can resize the borrowing base to exclude the Investor upon the commencement (but prior to the completion) of the exercise of remedies by a third-party creditor.

Certainly, every subscription facility is different and the composition of the pool of Investors dictates the negotiations related to this point. However, in the end, the competing interests of the parties involved can only be reconciled through a willingness to understand each party's respective concerns.

‘Fund Finance Friday: Industry Conversations’ – EQT Discuss Their ESG Capital Call Facilities

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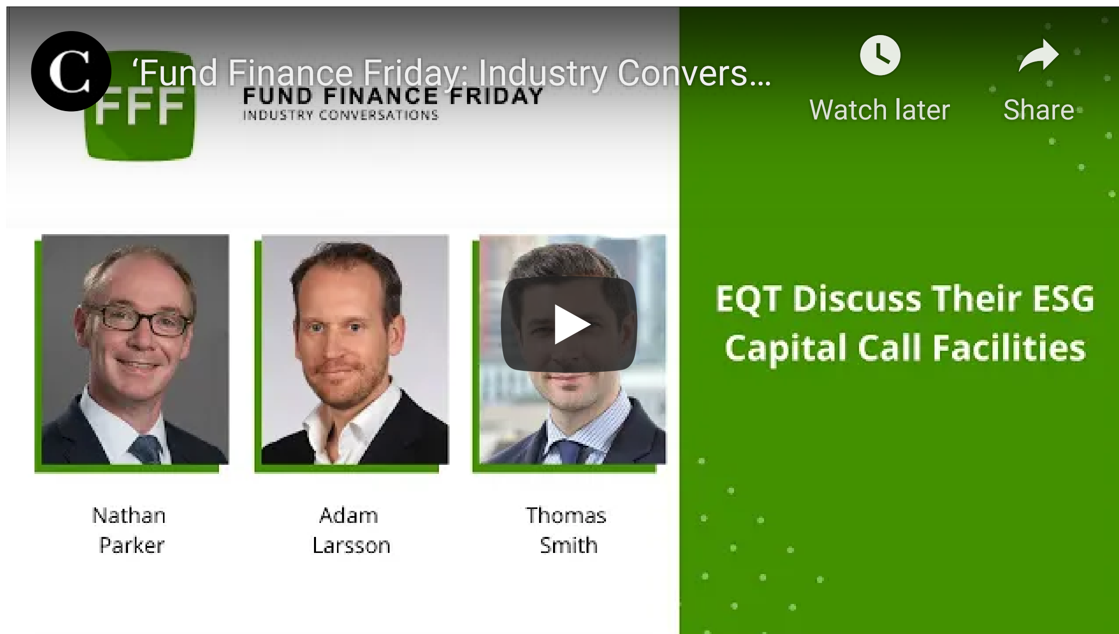
In this episode of *Fund Finance Friday: Industry Conversations,* Cadwalader partner Nathan Parker is joined by EQT Managing Director Adam Larsson and Debevoise & Plimpton partner Thomas Smith to discuss the market-leading, ESG-linked capital call facilities put in place by EQT in the second part of last year.

If you cannot access the video below, please **click here** to watch.



Fund Finance – Positive Developments for Sponsors and Investors under Ireland's Investment Limited Partnership 2.0 Regime

February 12, 2021 | Issue No. 113

By Donal O'Donovan
Partner | Matheson (Dublin)

By Turlough Galvin
Partner | Matheson (Dublin)

By Alan Keating
Partner | Matheson (New York)

Why is this topic suddenly of interest?

Irish Investment Limited Partnerships ("ILPs") have been around since the introduction of the Investment Limited Partnership Act in 1994 (the "1994 Act"). Due to certain requirements imposed under the 1994 Act, they have seldom been used – there were only six in existence as of January 2021 based upon statistics published by the Central Bank of Ireland ("CBI").

However, the 1994 Act has now been revitalised by virtue of the Investment Limited Partnerships (Amendment) Act 2020 (the "2020 Act") to make it fit for modern-day investment purposes and comparable to other fund domiciles. Marking the signing of the Statutory Instrument, the Irish Minister of State at the Department of Finance, said: "The changes will further support Ireland's offering as a top-tier global location of choice for financial services investments."

In addition to the 2020 Act, the CBI has also helpfully updated its Alternative Investment Fund ("AIF") Rulebook for closed-ended qualifying investor AIFs ("QIAIFs") investing in private equity and other illiquid assets, providing clarity in the context of customary features for closed-ended funds, such as capital drawdowns, carried interest, distribution waterfalls and catch-up payments, which are now confirmed as generally permitted for QIAIFs.

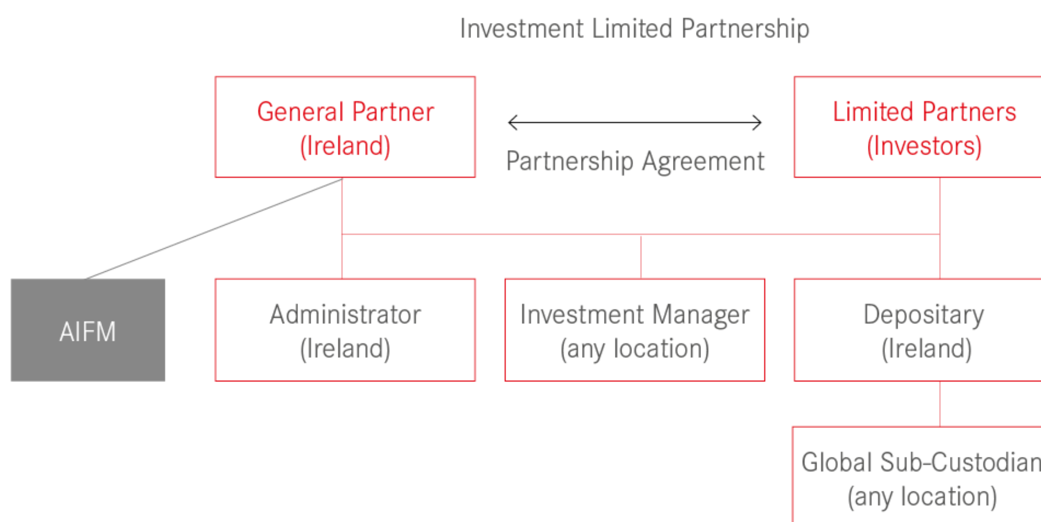
The ILP is now expected to become the fund structure of choice for many international fund sponsors, particularly those in the private equity and real asset sectors. As you will see below, as there are generally no leverage restrictions, the ILP can be a useful component of various structures, with a number of options as to subsidiaries and, accordingly, master/feeder fund arrangements. Much like the highly successful Irish Collective Asset-management Vehicle ("ICAV") that was introduced in 2015, the ILP can be deployed in a number of different types of financing, including NAV or subscription line facilities. We expect that fund finance lenders will begin to see more ILPs appear in borrower groups in the not-too-distant future.

What is an ILP?

An ILP is a partnership that has limited liability for the investors who invest as limited partners ("LPs"). An ILP is not an incorporated entity, so the assets, liabilities and profits belong to the partners in the ILP in accordance with the terms of the limited partnership agreement (the "LPA"), the written document establishing and governing the ILP. As a result, an ILP has no separate legal personality and is treated as tax transparent from an Irish tax perspective.

From an Irish regulatory perspective, an ILP is an AIF which is authorised as a QIAIF. An ILP must be authorised by the CBI and can benefit from the CBI's 24-hour approval process. There are no material investment restrictions or diversification requirements and no borrowing or leverage limits imposed upon ILPs (unless the ILP is engaged in loan origination). In addition, an ILP may be open-ended, have limited liquidity or be closed-ended.

An ILP must have at least one general partner ("GP") which has responsibility for managing the business of the ILP and can be held liable for the debts and obligations of the ILP. An ILP may have one or more LPs. There is no limit on the number of LPs permitted in an ILP. QIAIF ILPs are open to professional or well-informed LPs who: (i) are MiFID "*professional clients*"; (ii) self-certify in writing as being informed investors; or (iii) are appraised by an EU-regulated institution as having an appropriate level of expertise, knowledge and experience. LPs have the benefit of limited liability up to contributed capital (and any outstanding commitments) and the benefit of an extensive and modernised non-exhaustive whitelist of permitted activities which will not cause forfeiture of that liability protection.



The amendments set out in the 2020 Act include the following:

- Umbrella Limited Partnerships. Providing for the establishment of ILPs as umbrella funds with multiple sub-funds and segregated liability between those sub-funds. The ability to establish an umbrella structure, which is already permitted for other types of Irish fund vehicles, will allow managers to establish multiple sub-funds within the same ILP, allowing

for separate investors, separate pools of assets and differing investment strategies without the need for multiple ILPs.

- LPA Amendments. Streamlining the manner in which changes may be made to the LPA.
- Safe Harbours for Limited Partners. Expanding the "whitelist" of activities in which a LP can engage without being deemed to be taking part in the conduct of the business of the ILP. This is a welcome clarification for ILPs in terms of the scope of LP activities which can be undertaken without risk of losing the benefit of limited liability.
- Return of Capital. Simplifying the procedures in respect of the return of capital to LPs.
- Redomiciliation. Permitting the redomiciliation of partnerships from other jurisdictions (such jurisdictions to be specified by ministerial order) and setting out a streamlined process for such redomiciliation. The ability to redomicile funds from offshore jurisdictions was introduced in Irish legislation given the increasing preference among investors for regulated onshore jurisdictions. A redomiciled partnership will be authorised by the CBI as an ILP by way of continuation and may continue to use its track record, and the legislation provides that redomiciliation will not operate so as to impact on any agreement entered into by the partnership prior to redomiciliation.

Comment

The introduction of these reforms to the ILP is a welcome and significant development for the Irish funds industry and reflects an industry which is constantly seeking to develop and grow, building on the positive experiences of the many sponsors who have already established funds in Ireland. The enhanced and rebooted ILP 2.0 will further strengthen Ireland's fund product range, providing an attractive vehicle for promoters seeking to establish private equity, venture capital and "real economy" investment funds in Europe.

Over the past few years, we have seen the ICAV form part of the onshore portion of fund structures (parallel funds, master/feeder fund structures, etc.) and whilst this is likely to continue, as a partnership is the vehicle of choice for many sponsors and investors, it is anticipated that the ILP will soon emerge in such fund structures.

This will be of great interest to sponsors who require offshore and onshore coverage/investment opportunities. As we have seen a surge in the provision of debt finance to ICAVs in such structures, it is also anticipated that fund financing (*e.g.*, subscription line or NAV facilities) to analogous structures containing ILPs will become very common. In most respects, similar key legal, regulatory, tax and practical considerations will arise when advising a lender or borrower on financing arrangements that include an ILP. The typical credit support package (and use of cascading pledges where necessary) is likely to be a common feature where structures include an ILP and the due diligence will also be comparable (although with the extra addition of reviewing the LPA).

Upcoming FFA Next Gen NY Event on LIBOR Transition

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The Fund Finance Association Next Gen's New York team will host a virtual panel, *Into the Unknown: A Fund Finance Perspective on "Letting LIBOR Go,"* that will discuss LIBOR transition, a topic that has become a major focus of our industry and the finance world generally. The panel will take place on Thursday, February 25 from 10-11 a.m. EST.

The event's distinguished panelists will include **Jean Lam MacInnes**, Executive Director and Counsel at Mizuho Americas; **Jeff Nagle**, Partner at Cadwalader; and **Tess Virmani**, Associate General Counsel and Executive Vice President for Public Policy at LSTA. **Cassandra Best**, Associate at Cadwalader, will moderate.

The conversation will address:

- LIBOR's current status as the go-to benchmark rate for $350 trillion in financial products and derivatives;
- LIBOR's history and the LIBOR manipulation scandals that took place during the last decade;
- Public and private measures being taken throughout the world to facilitate the transition to new benchmarks; and
- Lenders' current approach towards phasing LIBOR out of loan documentation, with a particular focus on the fund finance market.

Register **here**.

For further information regarding the event, please contact **Michelle Bolingbroke**.

Private Funds CFO Article on Why Fund Finance Is in High Demand

February 12, 2021 | Issue No. 113

According to a *Private Funds CFO* article published on February 8th, there is heightened interest in using subscription lines to ride out some of the ongoing pandemic. Matt Hansford, head of origination and NAV financing at Investec Fund Solutions, points out how subscription finance has allowed borrowers to bridge through fund closes in light of longer fundraising periods and make improvements to the business in the short-term. Beyond the challenges posed by the pandemic, borrowers are expected to turn more heavily towards NAV-based and hybrid facilities; in particular, borrowers have been converting existing subscription facilities into hybrid facilities toward the back end of their investment periods in order to account for net asset value. Click **here** to read the full article.

Brickfield Article on Hiring Market

February 12, 2021 | Issue No. 113

Brickfield Recruitment's latest article focuses on the need for creative thinking and capacity for innovation as a key skill for fund finance professionals looking to build their careers in 2021. The article features comment from Samantha Hutchinson at Cadwalader, Leon Stephenson at Reed Smith, Jeff Maier at First Republic Bank (and FFA Board member) and Jan Sysel at Fried Frank.

Readers looking to receive regular updates on talent acquisition trends in fund finance can **follow Brickfield on LinkedIn**. Law firms, banks and candidates with specific enquiries should contact Rory Smith at Brickfield Recruitment by **email** or by telephone on +44 7800 963 594.

Upcoming: Sixth Installment of Fund Finance Wildgen Webinar – Credit Agreement Negotiation

February 12, 2021 | Issue No. 113

Tune in February 25th as Wildgen's Michael Mbayi hosts the sixth installment of the new "Fund Finance" webinar series. The sixth installment will provide insight and analysis on the process of negotiating and structuring a credit agreement. Panel members for this installment include industry leaders Benjamin Berman (Latham & Watkins), Kathryn Cecil (Fried Frank), Spencer Goss (RBS International), John Oberdorf (Loeb & Loeb) and Shani Unantenne (ANZ). For more information on the sixth installment, **click here**.

PDI Article on Fund Finance Trends for 2021

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Private Debt Investor last week published an article by Richard Wheelahan of Fund Finance Partners titled "The fund finance trends to look out for in 2021." The article summarizes fund finance developments from 2020 and how the private credit market is adapting, and discusses emerging trends and opportunities to expect in the 2021 fund finance market. The full article is available **here.**

Fund Finance Hiring

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Fund Finance Hiring

Citibank has two open fund finance positions, one more **senior** and one more **junior**. If you are interested, contact **Sabin Popescu**.