CADWALADER

Code Update: Get Ready

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New UCC Article 12 Matters to More than Just Cryptocurrency

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After being approved by its drafting committees last summer, a new article to the Uniform Commercial Code is now making its way through state legislatures for enactment. Because the new Article 12 and its related code amendments address digital assets, it may be tempting to assume the changes are irrelevant to fund finance. That would be a mistake.

We think these UCC amendments carry significant implications for fund finance attorneys, lenders and borrowers.[1] Here are the main points:

- New Article 12 establishes new asset categories with new rules on perfection and priority. While we explain these in detail below, the upshot is that everyone involved in a fund financing transaction will need to consider whether the new types of assets are included as collateral and, if so, how the concept of control should apply. Broad collateral grants, such as those used in GP lines and management fee facilities, will need particular attention.
- While few and far between in fund finance today, loans secured by digital assets such as cryptocurrencies fall squarely within the ambit of the new provisions and will need to be structured accordingly.
- For transactions that do not rely on the new asset categories, opinion standards may need to adapt to provide lenders with the assurance that existing perfection and priority steps are adequate in the context of the code revisions.
- Enactment timing will vary by state and will likely be followed by a grace period in each state during which an Article 9 security interest perfected prior to the enactment will continue to be perfected. Attorneys will need to follow the progress on this front and be alert to perfection and priority risks.
- The new terms are broad and untested. Their impact may well reach into financing structures in unanticipated ways. Legal practitioners will need to pay close attention to court interpretations that emerge once Article 12 has been released into the wild. And don’t assume that Article 12 will not affect you because your deal doesn’t include crypto.

New Article 12 to the Uniform Commercial Code was approved by the Uniform Law Commission and the American Law Institute in July 2022.[2] Most practitioners are aware that new Article 12 is an addition to the UCC to improve the statute’s coverage of certain digital assets, such as cryptocurrency and NFTs. There has been plenty of commentary in the legal press about new Article 12; there have been excellent summaries and explainers about the general provisions contained in the new article. Get ready, we’re told, change is coming.

Somewhat less frequent in the press coverage to date, however, have been attempts to tease out the potential effects and implications of new Article 12 in specific cases. Despite new Article 12 itself only consisting of seven sections (including the one called “*Title*”), the new Article also comes bundled together with a raft of further amendments to most of the other Articles of the UCC (collectively, with new Article 12, the “2022 Amendments”). How these pieces may fit together, and what effects they may have on commercial financing transactions, is too broad a topic to tackle all at once. But, we thought it would be a useful project to begin thinking about narrower topics related to new Article 12, one at a time. In this piece, we propose to take a quick look at the impact of new Article 12 and the other 2022 Amendments on accounts and payment intangibles[3].

But to get to that particular topic, it is necessary to take a step back and more broadly review what Article 12 is. One thing that it is not – at least not yet – is law. The Uniform Law Commission and the American Law Institute have recommended Article 12 and the 2022 Amendments for enactment in the states, and the 2022 Amendments have been introduced in the legislatures of 21 states and the District of Columbia as of this writing, but they have not yet been enacted in any of those jurisdictions.[4] That, presumably, will change in due course.

More substantively, the 2022 Amendments are an attempt to reduce risks that are perceived to be posed by two trends in electronic commerce. The first trend is the attribution of economic value to some electronic records separate from any

relationship with extrinsic rights and interests. The poster child for this trend is cryptocurrency − pure electronic records that have a value solely in themselves. The second trend is the accelerating use of the creation or transfer of electronic records as a means to transfer rights to receive payment, rights to receive performance of other obligations (*e.g.*, services or the delivery of goods) and other rights and interests in personal and real property.[5] To try to mitigate the risk of disputes arising as these trends continue to develop in commercial markets, the drafters of the 2022 Amendments constructed a regime to specify certain legal rights and attributes of what they termed "controllable electronic records" ("CERs").

A CER is generally defined in the 2022 Amendments as "a record stored in an electronic medium that can be subjected to control under Section 12-105".[6] The idea of "control" under Section 12-105 is the linchpin concept. Section 12-105 specifies that three powers must be granted to a person with respect to an electronic record to establish that person's control: (1) the power of that person to avail itself of all the benefit from the electronic record, (2) the exclusive power of that person to prevent others from availing themselves of substantially all the benefit from the electronic record, and (3) the exclusive power to transfer control of the electronic record to another person (or cause another person to obtain control of another CER as a result of the transfer). In addition, such control also requires that the person, whether through the electronic record itself or a record logically associated with the electronic record or the system in which it is recorded, be enabled to readily identify itself (whether by name, i.d. number, cryptographic key, office or account number) as the person having the above-listed powers.[7]

Control of a CER is relevant under the Article 12 regime for a number of reasons. One of the key reasons is that only a person having control of a CER is eligible to have the rights of a "qualifying purchaser" for purposes of Article 12's "take free" rule. Another key reason is that, under Article 9 as revised by the 2022 Amendments, control of a CER is a new method of perfecting a security interest in the CER, and such control perfection has priority over other methods of perfection (such as filing a financing statement).

The "take free" rule established by Article 12 provides that a "qualified purchaser" − that is, a purchaser[8] of a CER or an interest in a CER that obtains control of the CER for value, in good faith, and without notice of a claim of a property right in the CER − will acquire its rights in the CER free of a competing property right in the CER.[9] This rule is similar to, and derived from,[10] the familiar rights of a holder in due course of a negotiable instrument under UCC Section 3-306. As a result, a qualified purchaser of a CER can take a better property interest in the CER than the person who transferred it to them. Imagine a circumstance in which a hacker hacks the system where a CER is maintained and takes control of the CER − effectively stealing it and depriving its rightful owner of it. Then imagine that the hacker turns around and sells the CER to an innocent buyer who meets the criteria of a qualified purchaser − for value, in good faith, without notice of the competing claim. That qualified purchaser could claim good title to the CER, even though the hacker had no title to the CER at all under general legal principles.[11]

This take-free rule may be a bracing concept, but it is important to appreciate key limitations. Most important, the concept generally applies to the *record* only, in and of itself. Article 12 makes it clear that assets other than the CER *qua* record, such as goods or rights to payment that are carried along with the CER (or, as they are referred to, assets "tethered" to the CER), do not get the benefit of the take-free rule.[12] And further, one of the key elements of the definition of CER in Article 12 not previously mentioned is that it excludes a litany of other UCC assets from the ambit of CERs. Controllable accounts, controllable payment intangibles, deposit accounts, electronic copies of records evidencing chattel paper, electronic documents of title, electronic money, investment property, and transferable records − all of these asset categories (some of which are defined for the first time in the 2022 Amendments) are excluded from the definition of CER.[13]

Note the references to "controllable accounts" and "controllable payment intangibles" in that litany of exclusions above. The 2022 Amendments change Article 9 to add those terms as new definitions, generally defining each as an account (or payment intangible) evidenced by a CER that provides that the account debtor undertakes to pay the person that has control under Section 12-105 of the CER.[14] In view of the discussion immediately above, it may seem natural that such controllable accounts and controllable payment intangibles are excluded from the CER definition; they are payment rights, not records *per se*, and therefore just another species of tethered asset. You might assume that, consistent with Article 12's treatment of such tethered assets, law other than Article 12 would deal with those tethered accounts and payment intangibles.

It is here that the 2022 Amendments make a significant adjustment to the concept of tethered assets. Section 12-104(a) provides that Section 12-104 applies to the acquisition and purchase of rights in controllable accounts and controllable payment intangibles in the same manner the section applies to CERs − including the take-free rule in clause (e) of Section 12-104. Furthermore, to determine whether a purchaser is a qualified purchaser of a controllable account or controllable payment intangible, the purchaser obtains control of the controllable account or controllable payment intangible when that purchaser obtains control of the CER which evidences it.[15]

Article 9 as modified by the 2022 Amendments also provides special rules for controllable accounts and controllable payment intangibles. Currently, perfection of a security interest in accounts and payment intangibles is generally by filing (with a few exceptions[16]). Under the 2022 Amendments, however, control (as defined in Section 12-105[17]) is a new additional means of perfection,[18] and similar to the take-free rule under Section 12-104, control perfection of a controllable account or controllable payment intangible is established by taking control of the CER which evidences it.[19] Such control perfection of controllable accounts and controllable payment intangibles would have priority over other methods of perfection (including perfection by filing).[20]

Regardless of what you might think of Article 12's approaches as policy, you might appreciate the drafters of the 2022 Amendments setting up these principles, including the take-free rules, out of concern for issues respecting digital assets carried in distributed ledger technology. If the blocks in a blockchain are vulnerable to dispute and uncertainty as to property rights, digital commerce may be impeded. But what about the impact of these principles on commercial transactions that were not obviously in the sights of the Article 12 drafters' concerns? Currently, for example, transacting parties in deals involving accounts and payment intangibles do not consider whether they have, or should have, holder in due course-like rights in ordinary accounts and payment intangibles. Further, a UCC search generally suffices to give assurance of a proposed secured party's or purchaser's priority of interest in accounts and payment intangibles.

With the adoption of the 2022 Amendments, it seems that current transactional practice will have to be generally reexamined. Parties will want to examine whether the accounts and payment intangibles they are dealing with are "electronic," and whether they are capable of being "controlled" as described in Section 12-105. If they are, then taking new steps beyond filing to obtain control of those accounts and payment intangibles may be critical to assure a transacting party of the highest priority perfected security interest, and the strongest property interest, in those assets against potential competing claimants.

There may also be situations where the transacting parties strategically determine *not* to have Article 12 apply to their transaction − in which case the inquiry may be an exercise in how to have an asset fail to constitute a CER, a controllable account or controllable payment intangible, or how to have the asset fall into one of the numerous exclusions from the CER definition. And, of course − and perhaps most importantly − new Article 12 may help create opportunities for new financing structures and methodologies which can enhance value and efficiency in ways impossible to imagine today.

If the 2022 Amendments would require commercial transaction practices to adjust for new deals, how would the 2022 Amendments impact existing deals? The 2022 Amendments include transitional rules to aid the implementation of their provisions, but there are important issues practitioners should be alert for. In the first place, unlike the broad amendments to the UCC enacted in 1998, the 2022 Amendments do not require a uniform effective date. The dates of enactment in the states will likely vary, so the landscape for deals with collateral governed by differing state laws may need to encompass both pre- and post-2022 Amendment law.

Second, the 2022 Amendments provide for an "adjustment date," defined to be the date that is the later of July 1, 2025 and the date that is one year following the enactment of the 2022 Amendments in the particular state. The period from enactment until the adjustment date is a grace period during which an Article 9 security interest that was perfected pursuant to the rules in effect prior to the enactment of the 2022 Amendments will continue to be perfected (even if the requirements under the 2022 Amendments are not met), and after which the new rules would have to be complied with. [21]

However, issues of priority are potentially more complicated. The transition provisions provide that, to the extent that the priorities established with respect to CERs, controllable accounts and controllable payment intangibles before enactment of the 2022 Amendments would be modified by the new 2022 Amendment rules, those new priorities would take effect only on the adjustment date.[22] But that one-year protection only applies if the priorities were "established" before the enactment date − and, as discussed above, the 2022 Amendments add the critically important *new* method of perfecting by control over CERs, controllable accounts and controllable payment intangibles, which establishes priority superior to perfection by other methods. Since control would only be available to "establish" such priority *after* the effective date, a security interest in accounts and payment intangibles that is properly perfected by filing prior to the effective date of the 2022 Amendments will be vulnerable to being primed by another creditor taking control, to the extent such accounts and payment intangibles satisfy the definitions of controllable accounts and controllable payment intangibles − and that vulnerability would arise immediately upon the enactment of the 2022 Amendments. Market participants will want to review their collateral pools to determine whether their collateral might fall into the Article 12 categories of controllable accounts and controllable payment intangibles to assess this risk, and determine what control methodologies are afforded by the electronic platforms in question.[23]

Finally, the transition rules as to validity, perfection and priority that are included in the 2022 Amendments may be of limited use in many deals where accounts or payment intangibles are iteratively regenerated and repledged, as with

certain fee-based collateral structures. Such assets generated after the effective date of the 2022 Amendments might be viewed as new transactions which would be assessed under the new rules, regardless of whether the relevant transaction documents were executed prior to the effective date; certainly, the security interests in them could only attach and be perfected after the effective date because those assets would not have existed before. Furthermore, the complex definitional changes in the 2022 Amendments may work unanticipated changes into the granting language in existing deal documentation, changing the effect of it or even punching holes in it.

Many of the provisions which would be added by the 2022 Amendments with respect to CERs, controllable accounts and controllable payment intangibles are intentionally vague. The drafters were candid that they intend Article 12 and related provisions to breathe and grow with changes in technology.[24] But the open-endedness of the language may put lawyers and market participants under an unfamiliar burden of looking inside the workings of computers and software. What does it really mean, after all, when control under Section 12-105 requires an electronic record or a system to give a person powers to avail itself of all the benefit of a record, or to transfer it? What does it mean in the definition of a controllable account that the account is "evidenced by" a CER, and that the CER provides that the account debtor undertake to pay the person that has control? How is the lawyer to know? In old-fashioned, familiar control provisions in the existing UCC, such as control by possession or by entering a control agreement, the tests are determinable with familiar tools that lawyers and businesspeople have directly at their disposal: they can determine if a physical instrument is in possession by reference to the instrument's reality in the physical universe; and they can tell if a control agreement meets the requirements of control by reading it. When the control characteristics are embedded in lines of computer code, how will lawyers and businesspeople assure themselves that the technology, in fact, satisfies the legal tests? Short of all lawyers going to computer coding boot camp, it would seem that the changes wrought by Article 12 may necessitate significant reliance on the work of technology consultants who *do* know how computers and software engineering works − but who may not themselves be lawyers or sensitive to the legal and commercial aspects of the transactions that their work may impact. Lawyers who have rendered or received complex reasoned legal opinions for electronic chattel paper might wonder if similar complexity will be required now for what has previously been a simple and straightforward legal opinion: a filing perfection opinion on accounts.

It may be difficult to reach conclusions about what specific impacts Article 12 may have on transactions, although it seems evident that the effects will be significant. But it is certain that lawyers and finance professionals working with transactions under Article 12 will need to adjust to a world where the convergence of law and technology is growing ever closer.

[1] The implications of these developments go far beyond fund finance, of course. We anticipate that future Cadwalader articles and memos will explore specific applications in other areas of finance, including receivables financing and securitization.

[2] See Uniform Commercial Code Amendments (2022), (2022 Am. Law Inst. & Unif. Law Comm'n) ("2022 Amendments").

[3] The UCC gives "account" a specific definition as a right to payment of a monetary obligation, whether or not earned by performance, for property sold or leased, services rendered or to be rendered, a policy of insurance issued or to be issued, secondary obligations to be incurred, energy provided or to be provided, use of a vessel, use of a credit card, or winnings in a lottery. "Payment intangible" is defined more generally as a general intangible under which the account debtor's principal obligation is a monetary obligation. Both definitions would be modified slightly in the 2022 Amendments. See Section 9-102(a), 2022 Amendments (2022).

In common parlance, "accounts receivable" or "receivables" would encompass both UCC accounts and payment intangibles. In this article we will generally try to stick to UCC terminology when discussing specific UCC applications; otherwise, we may use the terms interchangeably.

[4] Uniform Laws Commission, UCC, 2022 Amendments to, Enactment History, **https://www.uniformlaws.org/committees/community-home?communitykey=1457c422-ddb7-40b0-8c76-39a1991651ac#:~:text=Description,-Description&text=The%202022%20amendments%20to%20the,intelligence%2C%20and%20other%20technological%20developments**. (last visited Mar. 8, 2023).

[5] Article 12, Prefatory Note to Article 12, 1. Introduction to Controllable Electronic Records, 2022 Amendments (2022), 229.

[6] Section 12-102(a)(1), 2022 Amendments (2022). Also note that the component terms in this definition themselves have defined meanings, which create further opportunity for interpretation. For example, "electronic" is defined as "relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities," 2022 Amendments, Section 1-201(b)(16A), and a "record" (the definition of which is not being amended in the 2022 Amendments) is defined as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form". UCC Section 1-201(31). Does this mean that my old vinyl copy of Bruce Springsteen's album "Born To Run" is an electronic record that can be treated as a CER under Article 12, because it relates to an electrical or electromagnetic technology? What about a Gutenberg Bible, the information recorded in which is perceived by the eye (*i.e.*, optically)? Slightly facetious suggestions, surely. But how far afield from the paradigmatic case of cryptocurrency such broad definitions may take us is an interesting question.

[7] Section 12-105(a), 2022 Amendments (2022). It is notable that the definition of CER in new Article 12 does not specify that, in order to fall within the definition of a CER, the record actually be controlled in the manner specified, but only that it "can be subjected to" such control. This leads to other interesting questions: what is the effect of the potentiality for control on electronic assets that are not in fact subject to, or customarily subjected to, Section 12-105 type control? Will commercial practices need to change because such assets have been drawn into the Article 12 ambit in order to protect the interests of purchasers and lienholders? We briefly consider these questions below.

[8] Note that a "purchaser" under the UCC is defined as a person who takes by purchase, and "purchase" is defined to encompass a variety of transactions, including outright sales, security interests, leases and gifts. For our purposes, keep in mind that a purchase is both a buyer outright and the secured party holding a security interest. UCC 1-201(b)(29), (30).

[9] Section 12-104(e), 2022 Amendments (2022).

[10] Official Comment 7, Section 12-104(e), 2022 Amendments (2022).

[11] See Example 3, Ibid.

[12] Section 12-104(f), 2022 Amendments (2022). It is easy to imagine situations where this record-tethered asset dichotomy might emerge in digitized commercial transactions; for example, a smart contract license agreement which constitutes a CER, tethered to a copyrighted intellectual property such as a motion picture. What the effect of the divergence of property interest between the two elements of the tethered asset pair, resulting from the application of the take-free rule to one element, the CER, and not to the other element, the tethered asset, will be a further fascinating topic to explore.

[13] Section 12-102(a)(1), 2022 Amendments (2022).

[14] Section 9-102(a)(27A), (27B), 2022 Amendments (2022).

[15] Section 12-104(b), 2022 Amendments (2022).

[16] For example, certain security interests in assignments of accounts or sales of payment intangibles are perfected upon attachment. UCC Section 9-309.

[17] See Section 9-107A(a), 2022 Amendments (2022).

[18] Sections 9-314(a), 9-107A(b), 2022 Amendments (2022).

[19] Section 9-107A(b), 2022 Amendments (2022).

[20] Section 9-326A, 2022 Amendments (2022).

[21] Section A-302(b), 2022 Amendments (2022).

[22] Section A-305(c), 2022 Amendments (2022).

[23] See Official Comment 2., Example 3, Section A-305, 2022 Amendments (2022).

[24] "Article 12 creates a legal regime that is meant to apply more broadly than to electronic (intangible) assets that are created using existing technologies.... It also aspires to apply to electronic assets that may be created using technologies that have yet to be developed, or even imagined." Article 12, Prefatory Note to Article 12, 1. Introduction to Controllable Electronic Records, 2022 Amendments (2022), 229.

The MassMutual Transition to Barings: A Conversation with Phillip Titolo and Dadong Yan

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As we reported last week in *Fund Finance Friday*, Massachusetts Mutual Life Insurance Company ("MassMutual") and Barings, one of the world's leading investment managers and subsidiary of MassMutual, announced plans to transition MassMutual's Direct Private Investments ("DPI"), a leading fund finance provider, to Barings.

The announcement noted that the transition, which will occur in the second quarter of 2023, will enable the team to scale their investment strategies with access to additional third-party institutional investors through Barings' global platform, while enabling Barings to provide a broadened set of complementary investment solutions to its clients.

In light of this important announcement, Cadwalader fund finance partner Leah Edelboim reached out to Phil Titolo, Head of Direct Private Investments at MassMutual, and Dadong Yan, Head of Alternative Investment Solutions and Portfolio Manager, DPI at MassMutual, about what this transition means for their business and the opportunities they are seeing in the fund finance market. Phil and Dadong offered us a fresh perspective on the fund finance market more broadly and how they are seeing great business opportunity in providing financing solutions to clients that they believe have been historically underserved.

FFF: Congratulations on the move to Barings. Can you tell us about the transition and what that means for your business?

Phil: Sure, happy to. MassMutual is transitioning DPI in its entirety to Barings. In addition, MassMutual Asset Finance, an equipment finance company, will move to Barings as well. In the move, DPI will still manage its current portfolio and mandate from MassMutual's General Investment Account ("GIA") at Barings. Having our team move to our wholly owned asset manager makes sense and will enable us to continue what we have been doing on the investment grade side of fund finance and also enable us to scale our offerings with access to third-party institutional investors through the Barings global platform.

Dadong: A transition such as this one needs to make sense for all involved. The "why" here is that, on the one hand, this transition allows the DPI team to serve a broader group of investors,

including MassMutual's GIA, while allowing us to continue to deliver tailored financing structures to our asset manager partners. We are effectively creating a one-stop solution: our team is going to connect investors who need high-spread investment grade private debt access with asset managers who have historically been underserved in their financing needs for their various private fund offerings.

FFF: How have these parties been underserved by the fund finance market?

Dadong: In my view, many of the historical products in the fund finance market are somewhat inflexible. Our asset managers want solutions, rather than products, and they want someone who will create a bilateral customized solution. Which is not unlike what their clients in turn are asking of them these days.

Phil: We have clients who refer to the financing solutions we offer as a "luxury good." What they used to get before they had a relationship with us was more rigid and shorter tenor traditional lending products. We take the time to understand the capital needs, and design a more tailored financing solution that is a "win-win" for both parties. We bridge the gap between institutional investor capital that needs a relatively attractive investment grade spread profile and asset managers/borrowers that want customized financing solutions for their fund .

Dadong: Everyone wants to be innovative, but what people forget is that in order to have innovation you need to invest the time to create a team culture that incentivizes innovation. You need to invest in the time with asset manager partners and you need to actually listen to what is needed, rather than pushing a predetermined product. In our view, this is what the industry has been lacking.

FFF: What are you the most proud of in terms of what you have built so far, and where you are going?

Phil: There are three things that I am most proud of. First, we have originated $36 billion of debt and there has been $12 billion that has returned back home safely, showing a great loss-adjusted return for our policyowners. Second is our culture – we have not in the 6 years since our team was formed had any turnover of the folks we directly hired in DPI, which is made up of a group of talented individuals with diverse backgrounds. And, third, we built this business with a single source of capital and the market relationships we have – this is remarkable to me because we don't have a sales team or a marketing deck; it has all been relationship driven. At its core, lending is a relationship business.

On the relationship point, that also extends to our counsel and the importance of having a trusted advisor. Being able to have an open dialogue with our counsel builds that trust and translates well into the longevity of each lending relationship. That's built with continuity and working arm-in-arm to accomplish a win-win outcome. A perfect case in point is our team's longstanding relationship with your great colleague, Angie Batterson. Angie knows our organization, knows what we are trying to deliver, and has been absolutely critical to our success since we started back in 2017.

FFF: You have a bit of a different view of the fund finance market and what you call a "horizontal view." Can you explain what that means?

Phil: Fund finance has become a generic term that actually means a number of things: capital call lines (subscription lines), warehousing facilities, NAV lending, and portfolio lending – these all get roped into fund finance. Similar to how private debt is also a generic term but can encompass many different underlying strategies.

At the higher end of the risk/return continuum, you have preferred equity within a private asset portfolio. This encompasses preferred equity deals done through dedicated funds or as a subset within secondaries PE funds. These have a distinctly different risk-return posture than something that is more debt-like. They are typically more concentrated and they offer a higher LTV. The return is typically comprised of cash coupon and some upside in the form of payment-in-kind ("PIK") or warrants.

Moving up the capital structure, there is the high yield side of the fund finance market, which is based around more concentrated collateral pools, sometimes single PE or strategy funds with 10-20 individual investments, where some are doing well and some may not be. These deals have more structural protections than the last category, with some form of covenants, a stated maturity date, etc. These high yield loans will probably have a rating from an NRSRO, but the key for us is that we independently assign our own probability of default and resulting loss given default for any given loan, regardless of any external rating. Just because another lender or a rating agency may consider a debt facility is investment grade doesn't mean that we will agree, and we will reflect that in the way we allocate capital to that facility.

The last category is where DPI was born. This is what we call investment grade fund financings, which is historically what most banks would provide to asset managers on balance sheet. We do not do sublines or capital call lines or warehousing facilities; rather, we look to the underlying private assets and provide senior secured leverage on top of that. Being an insurance company, we are fortunate to be able to do a longer tenor than what a bank would typically be able to provide. If you have a direct lending fund with a 3-year revolving period and a 7-year wind down period, you need up to a 10-year lending facility to meet those asset managers' needs.

As an insurance company, we have had more longevity to our liabilities and can write longer facilities to better match those policy liabilities on the insurance side. Keeping our investor's needs in mind, it is important to underwrite as an investment-grade type exposure with tight structural protections, proper asset diversification, and restricting the type of assets that we will lend against. We also underwrite the manager as if we were going into the fund as an LP. This includes a full deep dive into their track record, process, sourcing, and team expertise.

FFF: Since Phil has talked vertically about the market, perhaps Dadong you can talk horizontally and how you expanded your solutions for GPs.

Dadong: Sure, Leah. We have done it through a simple concept of listening and seeing if there are areas where we can add value where investment-grade risk makes sense for investors.

We are focusing on tailoring solutions, not pushing products. One of the biggest unmet needs in the market for GPs is for financing either at their management company, the GP, or the asset manager. Historically, this has only been met in the private equity markets, like with selling a GP stake to a 3rd party. We have heard from some GPs that they were looking for a non-dilutive debt solution tailored to their needs. This is why we feel traditional lenders have not

excelled in this space: one standardized term sheet might work for one GP but won't work for another GP.

So, our thesis is that there is a huge market opportunity because GPs need this capital, and that need is not going away. Here is where we are typically seeing GP use debt proceeds for:

(1) GP commitments – as funds get bigger, investors are requiring the GP commitment also get larger, making for more capital resources to be devoted to that.

(2) to launch new strategies, which may be organic or inorganic. In terms of inorganic growth, if a GP is looking to buy a 3rd party asset manager with complementary strategies, they can take equity capital, which is more expensive, or they can use debt capital that we can provide. In terms of organic growth, that takes resources in terms of hiring a team and injecting seed capital into a new strategy and raising capital on top of that. Initial seed capital requires capital from GP, which can come from management company financing.

(3) helping GPs to manage succession planning. We can help to come up with innovative strategies to be sure that the next generation is appropriately incentivized to stay and continuing to drive value through a succession transition.

FFF: Ultimately, it sounds like you see yourselves as problem solvers and that drives your relationships with your asset manager partners. Can you expand upon that?

Phil: Usually the calls we get are from clients who say they "want to think through a problem with us." We then listen and suggest a solution, and sometimes a deal can come out of that solution. Sometimes we help them think of a solution that isn't necessarily with us – again, a sign that we are committed to helping in the relationship. We are fortunate to be selective in the loans we execute and our clients are sophisticated professional investors that we typically see eye to eye with. While banks will usually beat us on pricing and advance rate, the asset manager may decide that they would prefer to pay a premium for our more tailored offerings. If a borrower is looking for the maximum leverage at the lowest cost, we probably aren't going to be a fit.

What differentiates us from the other offerings is that, on one side, the client gets the same lending team cradle to maturity – we don't turn over a deal to another team after close to manage. We focus on ease of use for our asset managers during the entire lifetime of the transaction, from having the same contacts to work with daily to streamlining processes like getting managing security over bank accounts.

Dadong: Here is an example of how growth requires listening to our asset manager partners. We started a European DPI team based in London last year. That gave us boots on the ground there, but from a culture perspective, we think about it as still having one integrated team and we utilize deal staff to work together regardless of location. We took a portfolio lending concept we developed in the U.S. for commercial real estate debt financing to our clients in Europe, which in turn broadened our managers' ability to originate CRE debt deals. This was something that we could not have done without an integrated one-team approach.

FFF: There are a lot of moving parts with a big announcement like this one, so we appreciate you both giving us some insight about this transition and the way you

currently service the market. We wish you all the best with the transition.

Cayman Counsel and Signature Block Comments – What's the Deed?

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Of the comments that Cayman counsel add to transaction documents, one of the points that seems to incur a raised eyebrow by U.S. counsel or lenders now and again is the addition of "*executed as a deed*" in signature blocks of Cayman parties to credit and/or security agreements. What is and what is not a deed is not something that originates in U.S. law, of course, so on occasion we are asked to explain what this is all about and why Cayman counsel are commenting on signature blocks in this way.

What is it that Cayman Counsel add this comment to address?

As part of the standard security and collateral package granted in favour of a lender in a fund finance transaction, in addition and parallel to the grants of security interest over capital call rights and accounts, there will almost always be an irrevocable security power of attorney (PoA) granted in favour of the lender in order that in an event of default it may take actions in the name of the borrower (or its general partner) to enable it to effectively enforce its security. In the fund finance scenario, this PoA would, for example, aid a lender if it wished to send a capital call notice to limited partners on behalf of the general partner. Where a document contains such a PoA to be granted by a Cayman vehicle, this will likely catch the attention of Cayman counsel for the reasons set out below.

So Cayman Law requires it? How do you execute a document "as a deed"?

Execution requirements for PoAs granted by Cayman Islands companies are governed in Cayman by the Powers of Attorney Act (PoA Act) and the Companies Act (Companies Act).

The PoA Act provides that an instrument creating a PoA shall be executed as a deed (or as an instrument under seal – which isn't a route most people want to go down for obvious convenience reasons!). The Companies Act reinforces this for Cayman companies by providing that the appointment of an attorney other than by deed or instrument under seal shall *not* make the attorney a donee (the recipient of a PoA) for the purposes of the POA Act.

The next question we get when someone is exploring this issue is usually: "*Well, how does someone go about executing a document as a deed?*" The answer from a Cayman perspective is simple: you state the document to be executed as a deed. This question most frequently comes from people with experience of UK law or who have dealt with deeds being executed by UK companies, but equivalent formalities do not automatically extend to the Cayman Islands.

But the Credit Agreement/Security Agreement is not Cayman law-governed? Does this point still apply in those circumstances?

Unfortunately, there is no easy answer to this question. The PoA Act was not drafted with subscription finance and cross-border finance transactions in mind, and so neither it nor the Companies Act are specific on whether they intend to extend their requirements regarding execution formalities to foreign law-governed documents. As a result, Cayman attorneys that act for lenders prefer to take a more conservative approach when possible and request that such foreign law-governed documents that include PoAs are executed by Cayman funds "as a deed." This is done to remove any doubt about whether the lender has a validly executed PoA by a Cayman fund in its favour and/or can rely on the security friendly provisions of the PoA Act that arise when an irrevocable PoA is granted in favour of a secured party, being that: (1) the power of attorney will survive the insolvency of the winding-up or insolvency of the donor (the grantor of the power); and (2) the power cannot be revoked by the donor without the consent of the donee.

As mentioned above, lender-side counsel in a transaction with Cayman funds prefer to see these formalities observed, but in some instances, this may not be possible. In these instances, while the lender would not be able to fall back on the protections of the Cayman PoA Act, the fact that Cayman formalities have not been followed does not affect the validity of the PoA from the perspective of its own governing law.

Conclusion: Cayman Firms will continue to comment on my signature blocks, right?

Pretty much! Unless the laws of the Cayman Islands governing PoAs are clarified to specifically address this point (which is not anticipated at present) we don't expect this long-established practise to stop. There are, of course, much more material points in fund finance transactions than the addition of "executed as a deed," but if you have a deal where this comes up you now know why – and who to call with any questions!

Citco Report: Effects of the Pandemic Continue

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Citco says NAV credit facilities have wildly increased in importance compared to the secondary trading of assets as a means of creating liquidity. Read more **here** on how NAV facilities continue to gain momentum, rising from their current size of $100Bn globally to potentially $600Bn globally by 2030.