

CADWALADER

The ABCs of KYC (accounts)

September 15, 2023



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Subtly pivoting from the topic of collateral accounts, introduced in the August 25, 2023 *Fund Finance Friday* (“FFF”) article by Chad Stackhouse and Katie Clardy titled “[Control or Control Agreement](#)”, we will explore a few of the issues which we have encountered with respect to anti-money laundering (“AML”) accounts operated by third-party fund administrators.

This article aims to provide a high-level overview of some complications which have arisen in the course of our transactional work with respect to AML accounts and does not address the substance of any applicable AML regulations. Each agreement between a fund and a fund administrator is unique, and it remains essential that legal advice is sought on each transaction to ensure that lender(s) benefit from comprehensive security packages tailored to the structure of each fund.

The Recap

So what are collateral accounts, again? As previewed in the preceding FFF article, the answer in the context of subscription facilities is most commonly the accounts into which investors pay their capital contributions. Please refer to the previous FFF article for the details on how to attach and perfect account pledges in the US.

Okay ... So what's the issue?

Funds may have the in-house capability to perform their own AML checks but often engage third-party fund administrators to outsource these functions.

In such instances, administration agreements are typically put in place empowering a fund administrator to operate an AML account on behalf of a fund, which may result in that fund having limited or no control over the monies in these accounts until such time as all requisite AML checks have been completed.

Therefore, an AML account may in fact be the account into which capital contributions are initially paid and a "collateral account" may be where capital contributions end-up.

This poses a potential issue for lenders given that a third-party may have the power, or be under an obligation, to remit funds away from a secured account, potentially resulting in cash leakage.

So if there is a third-party administrator, how could a lender get comfortable with these arrangements?

The belt-and-suspenders approach would be to take security over both the AML and the collateral accounts, though this is ultimately a commercial point and not always achievable.

If it isn't possible to take security over the AML account, a lender could require that the administrator enter into an "administrator side letter". Such a side letter could provide, for example, that the AML account will be subject to a standing instruction requiring all funds to be swept into a secured collateral account within one business day of the completion all applicable AML checks, and that such instruction could not be altered without the consent of the lender. It could also include an acknowledgment by the administrator that it has no interest in the funds on deposit in the AML account and that the borrower has no ability to exercise any discretion with respect to the transfer of such funds.

The handful of provisions above are examples of some of the potential solutions available to lenders. As previously noted, each situation is unique and requires careful analysis. Negotiating side letters with third-party fund administrators can also be difficult, given that they typically wish to avoid entering into any loan documents or being required to comply with the instructions of anyone other than the fund sponsor.

Are there any other consequences for the loan documents?

Unsurprisingly, yes. It is common to see the inclusion of covenants in credit agreements which oblige credit parties to: maintain collateral accounts, ensure that the proceeds of all capital calls are paid into such accounts and limit withdrawals from such accounts following the occurrence of a cash control event. However, if the proceeds of investor capital calls are actually paid into AML accounts (which are not the subject of security), prior to the funds being remitted to the so-called "collateral accounts", these covenants must be tailored to ensure that adequate carve-outs are included to avoid triggering any day-1 defaults.

Lenders could also seek to include covenants restricting the ability of credit parties to exercise any discretion they may have with respect to the transfer of funds from an AML, without obtaining the consent of the lender(s).

In any case, lenders must be satisfied that in an enforcement scenario the risk of cash leakage is minimized and an administrator side letter may provide comfort on this point but is not a substitute to a perfected account pledge.

The Irish ICAV – Key Features and Finance Considerations

September 15, 2023



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While there has been much industry focus on the re-energised Irish Investment Limited Partnership vehicle, (“ILP”) the ICAV remains the workhorse, or perhaps more accurately the stallion, of Irish Fund structures. We have set out a brief reminder of some of the ICAV’s key features and some points to remember for finance transactions.

Key Features:

- The ICAV is a regulated fund vehicle established under the Irish Collective Asset-management Vehicles Act 2015 (the “ICAV Act”).
- It can be established as an umbrella fund with segregated liability between sub-funds, allowing for different investment strategies to be established within a single legal entity.
- The ICAV is eligible to elect to be treated as a transparent entity for US federal income tax purposes.
- The ICAV Act has a tried and tested mechanism for fund vehicles established in offshore jurisdictions to migrate or redomicile to Ireland as an ICAV.
- Unlike an ILP, the ICAV is a corporate entity and does not have a GP and its board of directors have management responsibility with delegated authority to key regulated service providers.
- It may amend its constitutional documents without shareholder approval in respect of changes that do not prejudice the interest of shareholders and do not come within certain categories of changes specified by the Irish Central Bank.

Key Considerations for Finance Transactions:

In our work on fund finance transactions for Lenders and Borrowers the following are some of the key points and considerations which arise from an Irish perspective.

Power to borrow and give security:

ICAV's are typically established to have broad powers to borrow and give security. The usual legal due diligence will identify any limitations in this regard. While there are restrictions on an ICAV giving security for the obligations of a third party, which for example could be relevant where the ICAV is a Feeder Fund for a Master Fund Borrower, cascading security can be used as a neat solution. In this example, the ICAV grants security to the Borrower over the relevant secured assets as security for obligations arising under the subscription documents between the ICAV and the Borrower, and in turn the Borrower grants security to the Administrative Agent over the security granted to it by the ICAV.

Segregated Liability / Limited Recourse:

Umbrella ICAV's as a matter of Irish law segregate liability between sub-funds, *i.e.*, one-sub fund cannot be held responsible for another sub-funds liabilities with some limited exceptions. There is standard wording which will need to be inserted into the loan documents to reflect this.

We are also seeing requests from some borrowers' counsel to insert limited recourse/non-petition clauses into loan documents. Such clauses can provide for example, that the lenders recourse to the party creating security is limited to assets over which it has granted security and that once realised that lenders recourse to such party is extinguished and with limited exceptions the lender cannot initiate or otherwise claim in any insolvency of the Fund. The requested language may also seek to restrict recourse to directors and shareholders of the Fund.

This type of language is quite common on securitisation and certain types of structured finance deals. If agreed to be included, it will need to be carefully reviewed and negotiated. For example, restricting recourse to shareholders for a subscription line does not work.

Waiver of Defences

While in the more distant past the inclusion of "waivers of defences" language was not always included by fund counsel in the constitutional/subscription documents it is now rare to see a deal where this is not baked in Day 1. Our review at the due diligence stage will identify any concerns. It can be difficult to get funds and limited partners to agree to necessary changes by way of amendment to signed fund or subscription documents but less difficult to reflect it in a side letter or in the notice/acknowledgment of the creation of security to/with the limited partner.

Service Providers and Side Letters

As with any regulated Irish Fund vehicle it will appoint a Manager/AIFM, an Administrator and a Depository (*i.e.*, a custodian rather than an account bank). What may be recommended to be obtained from such service providers (if anything) will be driven by the type of funding and the output from the due diligence process. For example, for a subscription facility one or more of the Manager/Administrator may have a role in the call process, which may necessitate the Lender obtaining direct covenant coverage from them by way of side letter. Importantly, there should be no need to require them to execute the security. A Depository or other Service Provider may also have signing rights on bank accounts which may need to be controlled and this can be included in side letters and will also be dealt with in the loan documents. For an

asset-level security package more detailed control arrangements may be required (e.g. securities accounts held with the Depositary).

The Future

While we are seeing traction on the uptake of the Irish ILP vehicle, the ICAV remains a vehicle of choice for many sponsors.

The Irish government is currently undertaking a public consultation and review of the Irish funds sector. Arthur Cox are actively contributing to this review with our own insights, on behalf of our clients and as part of our participation in industry bodies. This review is to be welcomed and is an opportunity to take stock, provide feedback on potential enhancements and future-proof Ireland's offering in the funds sector.

EverBank's Fund Finance Announcement

September 15, 2023

Wes Misson provided insights into EverBank's recent launch of a fund finance division led by Jeff Johnston and Cadwalader alum Mike Mascia to the *American Banker*, which published an article on the development yesterday. You can read it [here](#).

Pitchbook Examines Subscription Facility Interest Rate Impact

September 15, 2023

 PitchBook

Analyst Note

The Changing Landscape of
Capital Call Facilities



One-month term SOFR ramped up from less than 10 bps in the Spring of 2022 to around 5.33% now. Not surprisingly, higher subscription facility cost of funds can affect fund performance metrics. In [The Changing Landscape of Capital Call Facilities](#) published this week, Pitchbook analysts take a look at the IRR and TVPI sensitivities to SOFR levels, concluding that smaller facilities and increased use of hybrid facilities may be possible market adaptations to the current environment.

Register Now - Finance Forum on October 19

September 15, 2023



Our seventh Annual Finance Forum is October 19 at The Ritz-Carlton in Charlotte, and we would love to see you there!

Leaders from over 150 of the world's top financial institutions are registered for an interactive day with the industry's foremost experts. We are going to take deep dives into the wide range of challenges and opportunities that will shape the global financial landscape in 2024 and beyond.

Click [here](#) to view some of the organizations that have registered to attend and [here](#) to meet our moderators!

Current panel topics include:

- Coming of Age: What's Next for a Maturing Fund Finance Industry?
- What's Really Going On: A Close Look at the CRE Market
- Pessimistic or Opportunistic: A Credit Strategy for Volatile Times
- The New Chapter in Fund Finance
- Market Update: Distressed CRE and Workout Trends
- A Conversation with the Chief Credit Officer
- Worlds Collide: Structured Products Meets Fund Finance in CFOs and Rated Feeders
- Sultans of Swing: What (and Who's) Groovin' in CMBS?
- Refocusing on Restructuring: Distressed Credit and Special Situations
- Not-So-Risky Business: Keys to the Effective Structuring of Capital Relief Trades

- Setting the C-PACE in the CMBS Market
- Financing the Financiers: Bank Leverage of Private Credit Originators
- NAVer Fear: New Approaches in the NAV and Secondary Market
- Getting to Yes: Terms and Trends in CRE Lending

For more information about this event, please contact [Cori Niemann](#).

Last Chance to Register for FFA University 1.0

September 15, 2023



FFA University 1.0 is less than a week away! This all-day virtual training session is designed for both bankers and lawyers transacting under U.S. law who are either relatively new to Fund Finance or those who want an in-depth training course. The course will cover everything from understanding fund formation and structures to subscription facility credit documentation and Investor issues.

Registration will officially close on Tuesday, September 19th. Don't miss out on your chance to [register](#) for this event.

Date: September 21st, 2023

Time: 09:00 am - 5:30 PM EST

Networking: 5:30-7 PM EST (Sold Out)

FFA US University 2.0

September 15, 2023



FFA EVENT

FFA US University 2.0

 OCTOBER 05, 2023

 9:00 AM - 5:00 PM EDT

 SIDLEY AUSTIN LLP

The FFA has announced the exciting agenda and stellar lineup of speakers for their upcoming [FFA University 2.0 training program](#). Taking place in New York on October 5, 2023, this full-day, in-person training session is tailor-made for mid-level bankers and lawyers specializing in U.S. law.

Participants can look forward to diving into advanced topics such as subscription facilities, NAV loan structures, Collateralized Fund Obligations, and the intricacies of the PE business model. The event will be held at the offices of Sidley Austin LLP. Following the sessions, attendees will have the opportunity to network at a complimentary reception sponsored by KBRA.

Due to overwhelming demand this event is already SOLD OUT! The FFA asks those anyone who is not already a subscriber to make sure to join the FFA mailing list.

Sign up here: [FFA Mailing List](#)