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FUND FINANCE FRIDAY

Home Delivery Is Great, Unless It’s Oil

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Diligence Considerations for GP Facilities

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Previous *FFF* articles have discussed an increase in demand for GP and co-invest facilities over recent years. In light of current circumstances, some market participants are already predicting an increase in the popularity of these products, with GPs, managers and co-invest participants wanting to ensure they have an available source of liquidity to meet their obligations to provide capital to their funds. Anecdotally, and in line with these predictions, we have seen a healthy uptick in work around existing GPPS facilities (increases, additional borrower accessions) over recent months.

In light of this, it seems timely to build on our previous pieces about GP facilities by discussing some of the key points to bear in mind when considering the due diligence (and structuring) for a GP facility.

GP support facilities rely on GP profit share (or "GPPS") as the source of funds for repayment of the facility, with security generally being taken over the entitlement of the GP to the GPPS and/or the account into which the GPPS is paid. This gives rise to a very different set of due diligence considerations to a standard subscription facility (although, in some ways, as discussed below, the subscription facility due diligence remains a sub-set of due diligence for a GPPS facility).

Depending on the structure of the fund, entitlement to the GPPS may rest with another fund entity – most likely the manager, if not the GP. Or the GP may have an entitlement to the GPPS under the LPA but may be contractually required to pay on the GPPS to other advisors or managers in the fund for their own account. In these circumstances, the due diligence will need to follow the GPPS through to the ultimate fund party beneficiary. This is discussed further below, but in the interests of keeping the list below digestible, we have assumed for present purposes that the GPPS is payable to (and retained by) the GP.

Increasingly, a GPPS facility may be coupled with a co-invest facility and, in some cases, the GPPS (or a portion of it) may be used as collateral for a co-invest facility. Co-invest facility due diligence is beyond the scope of the considerations below (and will be discussed in a later article). If you would like to discuss co-invest due diligence prior to the publication of that article, then please feel free to contact me or another member of the Cadwalader team.

Key Considerations:

1. Entitlement to GPPS

   It is important to understand from the LPA which fund entity has the entitlement to the GPPS. Depending on the fund structure, the GPPS entitlement may sit with the manager rather than the GP (in which case, the manager will participate in the financing in place of or as well as the GP). Particularly in European transactions it shouldn't be assumed that the profit share entitlement is with the GP.

The entity with the entitlement to the GPPS (as mentioned above, we assume for present purposes this is the GP) will be party to the facility either as the borrower or a guarantor (with an SPV as borrower). As the GPPS is the primary, if not only source of funds to repay the facility, the capacity of the GP to borrower (or guarantee) the full amount of the facility under its formation documents is key.

2. Obligations to pay GPPS on to other fund entities

Depending on the structure of the fund, the GP may be required to pay on the GPPS to other fund entities (usually the manager and any advisors). This is increasingly common in Europe where a separate AIFM is required. Depending on the terms of the facility, it will likely be necessary to track the GPPS through to these entities and ensure that they are granting security over their entitlement to receive the GPPS and the bank account into which it is paid.

For example, if only part of the GPPS is required to be applied in mandatory prepayment of the facility (with the fund being entitled to retain the remaining part of the GPPS to pay costs such as salaries), then on enforcement GPPS amounts already paid could sit with any of the fund entities through which it passes. Practically, the final entity in the GPPS waterfall may well be the entity with employees and costs and consequently contractually entitled to a significant share of the GPPS to allow it to meet these costs. The GPPS is generally paid either quarterly or semi-annually. This means that, at any time, a significant part of the GPPS already paid could be held by an entity other than the GP pending its application to monthly or periodic expenses. Therefore, bringing these entities within the scope of the security package (and ideally having them as guarantors) is important to realising value of past GPPS on enforcement.

The obligation to pay on the GPPS will typically arise in the management or advisory agreements and constitute a percentage of the GPPS (up to 100%) depending on the extent to which the GP has delegated its rights and responsibilities to the manager or other adviser. These documents (and any other instruments of appointment as well as formation documents) will need to be reviewed for the same issues raised in this list with respect to the GP. Ultimately, these documents will be "fund documents" for the purposes of the facility and compliance with their covenants will need to be regulated.

3. Calculation and timing of GPPS

Calculation of the GPPS needs to be modelled by the fund to show that it will support the facility. The due diligence should outline the manner by which the GPPS is calculated, and the lender needs to ensure that this description aligns with the parameters by which the model has been prepared.

The GPPS calculation will vary over the life of a fund, often moving from a percentage of investor commitment to a percentage of unrealised acquisition costs. Payment of the GPPS is generally quarterly or semi-annually.

The GP may be entitled to certain placement or other fees which may either be retained by the GP (in which case these fees should also ideally form part of the GPPS concept for the purposes of the facility) or paid into the fund (in which case set-off should not be required). If the placement or other fees in a period exceed the GPPS, then the due diligence should be clear as to whether the GP is required to pay that amount or can carry forward the set-off into subsequent periods.

Understanding the timing of the payment of GPPS is also important in terms of establishing the repayment profile (albeit via mandatory prepayments rather than scheduled amortisation) and monitoring this post-closing.

4. Reduction, suspension, forfeiture and clawback of GPPS

The LPA may well provide for circumstances in which GPPS is reduced, suspended or forfeited. For example, this may occur with respect to an investor's share of GPPS where that investor's interests are themselves forfeited. Practically, it may also be limited by a key person event to the extent that it leads to an inability to call capital to pay GPPS.

These events will need to be identified and appropriate protections (such as drawstops or mandatory prepayments) included in the facility documentation.

The LPA may also create circumstances in which GPPS can be clawed back. Where this is the case, the management and advisory agreements under which the GPPS is paid on to other fund entities should ideally reflect a similar contractual clawback (to ensure that the money returns to the GP, allowing it to meet its obligations under the LPA so as not to jeopardise later GPPS payments).

5. Removal of the GP and consequence to GPPS

Removal of the GP will, logically, also lead to a termination of the GPPS entitlement of the GP. Often there may be a termination fee payable where removal is without cause and care should be taken to ensure that the termination amount is within the scope of GPPS concept for the purposes of the facility. Care should also be taken to ensure that the scope of the security extends to the rights to receive any termination fee.

It is important to understand the timings and notice requirements for removal of the GP (whether for cause or not) so that suitable notification barriers can be built into the facility agreement.

6. Capital calls to pay GPPS

Capital calls for the purpose of paying GPPS will generally be possible and, therefore, the due diligence applicable to a subscription line facility becomes a subset of the due diligence for a GP facility. Particular attention should be paid to periods during which the right to call capital is curtailed; the LPA may well provide that capital calls for GPPS are not permitted during a suspension period (or only during the initial part of any suspension period) or when the investment period is terminated early.

In addition, LP side letters will often contain provisions which adjust (or prohibit) capital calls to pay GPPS (either by reducing the GPPS percentage rate from that stated in the

LPA – which is also relevant to point 3 above – or prescribing times when such calls cannot be made).

7. Ranking of GPPS and impact of insolvency

The ability to pay GPPS under the LPA distributions waterfall needs to be clearly understood so that any pre-agreed contractual subordination with respect to GPPS is understood.

The position under the LPA will not necessarily be applicable on insolvency of the fund and so local law advice should be obtained as to the ranking of the GP's entitlement to GPPS relative to the LP's on insolvency. For example, will local law give effect to the ranking set out in the LPA between the various partners?

8. Restrictions on creation of security

The GP may well be restricted from assigning its rights to the GPPS under the LPA. This may be a "by-product" of the general assignments prohibition in the LPA and not purposefully aimed at preventing creation of security over the entitlement to receive the GPPS – but it may, regardless, either limit the effectiveness of the security or mean that the security cannot be granted absent LP consent.

The GP is, however, unlikely to be restricted from creating security over its bank accounts and, as a commercial matter, it may be sufficient that there be a contractual agreement to pay the GPPS into that account (with the security agent having control over any release from the account).

In addition to the points mentioned above, GP facility due diligence will also need to:

- ensure the appointment of the relevant entities under the fund documents or any related management/advisory agreements can be tracked,
- explain the requirements placed on the relevant fund entities to make contributions to the fund (and the consequences of those contributions not being made),
- explain the way the GP (or manager) is structured and if it is itself a fund, then including which entities sign on its behalf and who is responsible for its day-to-day business, and
- ensure there is sufficient capacity and power under the GP (or manager) documents for it to borrow, grant security and give any related guarantee.

The above list is by no means intended to be exhaustive. GPPS is often a bespoke and complicated part of any LPA that is frequently adjusted on a per investor basis through the side letters. However, it serves to demonstrate how intricate these financings can be and that, in the end, the success of the financing will depend on the depth of the due diligence and its effective application in the facility drafting.

'Fund Finance Friday: Industry Conversations' – Podcast with Richard Wheelahan of Fund Finance Partners

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Industry Conversations

Cadwalader's Mike Mascia connects with Richard Wheelahan, founding principal of fund finance debt advisory firm Fund Finance Partners, in this week's podcast edition of *Fund Finance Friday: Industry Conversations*. In the podcast, Rich covers what his fund sponsor clients are seeing in the market, where the current demand for fund finance is the highest and what it is like being a principal in a start-up during challenging times.

Subscribe on **Apple Podcasts**, **Google Podcasts** or **Spotify** to never miss an episode.

FUND FINANCE FRIDAY | INDUSTRY CONVERSATIONS

Addressing Market Stresses, with Fund Finance Partners' Richard Whe...

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Pandemic Perfection: Should You Be Pre-Filing Financing Statements?

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By Chris Montgomery
Associate | Fund Finance

The filing of a UCC-1 financing statement is necessary to perfect the lender's security interest in the collateral supporting a credit facility. In normal times, the lender's counsel will file the appropriate UCC-1s on the closing date of the transaction after confirming the form and content of each UCC-1 with the borrower and checking the information against the certified constituent documents of the filing debtor. As a practical matter, Cadwalader files on behalf of the lender through a service that specializes in such filings in the hours after a deal has closed.

These are not normal times, and Cadwalader has been monitoring our clients' ability to file UCC-1s on a timely basis and without surprises. While most state offices that accept such filings are closed, they remain available to accept electronic filings (subject to a few qualifications noted below). One possible precaution for lenders concerned about their ability to file timely is to pre-file the UCC-1s in advance of the closing date.

While it is not customary to pre-file UCC-1s in fund finance transactions, if the deal team has concerns about the jurisdiction in question, pre-filing may be an appropriate precaution. The only documentary difference is that lenders will need to obtain a pre-filing authorization letter from the debtor. Under Section 9-509 of the Uniform Commercial Code (which is adopted in some form with modifications in every state), the debtor must authorize the filing in an authenticated record (*i.e.*, the authorization letter) or sign a security agreement with respect to the applicable collateral.

However, Cadwalader has not yet seen instances where the lender was unable to file or experienced a delay in filing for the three most common jurisdictions – Delaware, the District of Columbia and New York. In Delaware, it should be no surprise that the Secretary of State is (electronically) open for business as usual and can accommodate all electronic filings. In the District of Columbia, access to filing with the Recorder of Deeds depends on the nature of the filer. Cadwalader has relationships through its service providers that bypass the closed office and can file directly to the Recorder of Deeds. In New York, electronic filing is still accepted, but receiving file-stamped copies has a significant delay – up to six weeks.

In other jurisdictions, some UCC filings services have noted an inability to file multiple pages in an electronic filing (such as Illinois, Indiana and Michigan), which would require a follow-up filing with the appropriate multi-page schedules once such offices reopen. (In fund finance transactions, such filings are nearly always multiple pages, since the collateral is not a simple one-sentence "all assets" pledge but a specific and itemized list of capital commitments and the rights to make capital commitments that must be sufficiently described under the Uniform Commercial Code.)

Given the uncertainty of what state governments may do going forward with respect to their ability to accept electronic filings, it is important for business teams and their counsel to think through the UCC filing locations early in the transaction. Counsel can investigate any potential problems and delays and, if necessary, advise pre-filing a UCC-1. While we have not seen a situation yet that would require pre-filing, each deal team should consider pre-filing as a possible precaution should counsel identify any potential delays in the filing process.

Intertrust Hosts Webinar on Fund Finance

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Global corporate, capital markets, private equity and private wealth advisory firm Intertrust this week hosted a fund finance webinar titled “Accessing capital and liquidity from a fund finance perspective during the COVID-crisis.” The panel was moderated by Cliff Pearce, Intertrust’s Global Head of Capital Markets, and included James Rock-Perring, Intertrust’s Head of Fund Finance Advisory, Stephen Quinn, Managing Director at 17Capital, and Cadwalader’s Samantha Hutchinson and Mike Mascia. The webinar is available for video replay **here**.

ILPA Draft Proposal on Subscription Facilities

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This week the Institutional Limited Partners Association (ILPA) circulated a draft proposal around subscription facilities. Graham Bippart of *Private Funds CFO* published an extensive article on it yesterday titled "ILPA to recommend boosting disclosure of capital call credit line usage." The subscription-required article is available **here**. ILPA has kindly requested comments on the proposal from the Fund Finance Association, among others. The FFA is reviewing the proposal and plans to provide commentary to ILPA in the coming week.

Force Majeure, COVID-19 and Luxembourg Fund Finance Transactions

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By Michael Mbayi
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The purpose of this article is to envisage whether the current COVID-19 pandemic can be considered as a *force majeure* in Luxembourg and the potential impact on Luxembourg fund finance transactions.

In this respect, a *summa diviso* needs to be established: (i) Luxembourg fund finance transactions with a Luxembourg law credit agreement, and (ii) Luxembourg fund finance transactions with a foreign law credit agreement (generally New York law or UK law).

1. **Luxembourg fund finance transactions with Luxembourg credit agreements**

In these transactions, the main documents are the Luxembourg credit agreement, the Luxembourg pledge over undrawn commitments, and the Luxembourg bank account pledge agreement.

The *force majeure* question may be relevant because this could potentially lead to a release of the obligations of an obligor.

The first step is to determine how the *force majeure* is defined. On the basis of the principle of the freedom of contract (*liberté contractuelle*), if the parties have defined and established the conditions of a *force majeure* event in the credit agreement, then the occurrence of and the consequences of such an event will be determined in accordance with its terms.

It should be noted that, in contrast to common law jurisdictions, *force majeure* exists in law in civil law jurisdictions such as Luxembourg. As such, where the *force majeure* is not defined contractually, it would be determined in accordance with the criteria established by Luxembourg law. However, *force majeure* is not defined in the Luxembourg civil code, and the concept has been shaped by case law. Classically, there are three requirements for the legal qualification of *force majeure* under Luxembourg law: exteriority (*exteriorité*), unpreventability (*irresistibilité*), and unpredictability (*imprévisibilité*).

Exteriority means that the relevant event is external and is not connected to the parties. A pandemic and the exceptional measures taken by the government in this context are indeed external.

Unpreventability means that there is an impossibility to perform the relevant contractual obligations. Furthermore, to be qualified as a *force majeure*, such impossibility must not be partial or temporary but total and final. The unpreventability would be a difficult condition to meet in practice, particularly in presence of a Luxembourg investment fund of a certain degree of sophistication, since it would be complicated to establish that there is totally no means (in particular, in terms of technical means and human resources) to perform the relevant obligations, but of course an analysis on a case-by-case basis must be performed.

Unpredictability means that at the time of the entering into the agreement, the event was not foreseeable. It seems that the pandemic and the governmental measures taken were indeed not foreseeable.

In a nutshell, a pandemic in itself does not qualify automatically as a *force majeure,* and an analysis on a case-by-case basis must be undertaken in light of the terms of the particular agreement. Further elements must be established in order to establish that there was an impossibility *in concreto* to perform the relevant obligations. The principle of good faith (*bonne foi*), which is implied in all agreements, will also serve as a compass for such an analysis.

2. Luxembourg fund finance transactions with foreign law credit agreements

In this type of transaction there is, typically, a New York or UK law credit agreement, a Luxembourg pledge over undrawn commitment, and a Luxembourg bank account pledge.

The legal characterization is to be sought in the law governing the credit agreement. In other words, New York law or UK law would determine, regarding the particular credit agreement, whether there is a *force majeure* event and the consequences of the same.

As to Luxembourg collateral, it would follow the qualification of the foreign credit agreement to establish whether there is a default or not and to determine if enforcement of the collateral is possible.

3. General recommendations

It may be reminded that Luxembourg financial collateral is generally efficient and may be, as a matter of Luxembourg law, quickly enforced in the event of default. In this respect, it would be advised for the funds to reach out to their lenders if they anticipate difficulties concerning their contractual obligations, in light of the current global context, in order to set up constructive solutions upfront.

We are all on this, and the major actors of the industry locally and internationally have shown their engagement to find innovative solutions and overcome the consequences of this COVID-19 pandemic.

The Cayman Islands Private Funds Law – FAQs for Lenders

April 24, 2020 | Issue No. 74

By Derek Stenson
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By Michael O'Connor
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The Cayman Islands Private Funds Law, 2020 (the “PF Law”) has been an increasingly prevalent topic in fund finance transactions since its introduction in February of this year.

As transactions have arisen (new subscription lines or amendments to existing facilities), most lenders have sought to directly address the implications of the PF Law. This has primarily occurred via the addition of affirmative covenants or other contractual provisions to the loan documents in respect of the requirement for private funds to register with the Cayman Islands Monetary Authority (“CIMA”), which is of material significance to lenders to such funds.

As a result of the negotiation of these provisions (primarily in respect of registration timing, evidence of registration and ongoing compliance requirements), we are seeing a number of similar queries related to these points. The below is a summary of the questions we are most frequently receiving from lenders and their legal counsel and our responses to them.

What is required for a private fund to ‘register’ with CIMA?

The CIMA registration process is extremely straightforward. A private fund simply authorizes its Cayman Islands legal counsel to upload the following documents to the CIMA secure online system (known as “REEFS”) along with submitting the required application fee:

- REEFS Application Form;
- Certificate of Incorporation/Registration (as applicable);
- Constitutive Documents (Memorandum & Articles of Association/Trust Deed/Declaration of Partnership, as applicable);
- Offering Memorandum/Summary of Terms/Marketing Material (as applicable);
- Auditor’s letter of consent (if appointment has been finalized by time of registration);
- Administrator’s letter of consent (if applicable); and
- Structure Chart.

What happens next? How long does it take for a private fund to register with CIMA?

The application is reviewed by CIMA and, assuming all of the documents, information and fees required have been provided, the private fund can expect its application to be approved and the private fund to be formally "registered" within a number of days.

Is a private fund automatically registered by making a submission to register as a private fund with CIMA?

No. The *submission* of an application to CIMA does not mean the private fund is automatically registered. The application needs to be processed and approved by CIMA prior to their registration of the private fund. Accordingly, a private fund is not "registered" for the purposes of the PF Law (and able to accept capital contributions for the purposes of investments under section 5(6) of the PF Law) until its registration has been confirmed by CIMA.

In what circumstances might CIMA reject an application?

The most common reason CIMA might reject an application is as a result of the submission being incomplete or inconsistent (*e.g.*, missing documents, missing details in the application form).

CIMA may also delay approval of or reject an application if adverse hits or findings emerge as part of fitness and probity checks or if the sponsor is part of an ongoing criminal or regulatory investigation.

What can be obtained as evidence of registration when a private fund registers with CIMA?

The primary evidence of registration of a private fund will be the Certificate of Registration, which is electronically generated by CIMA and then made available to the Cayman Islands legal counsel or other service provider who has made the registration submission.

Is there a publicly searchable database of private funds which are registered with CIMA?

Yes. Each private fund that is registered with CIMA will appear on the CIMA online database searchable **here**.

What is required for a private fund to remain registered with CIMA?

A private fund is required to comply with all aspects of the PF Law, including any ongoing obligations, in order to ensure that it remains registered with CIMA, but the most pertinent of these points are that it: (i) pays its annual fees due to CIMA and (ii) attends to the annual filings required to be undertaken with CIMA (filing of its annual audited financial statements etc.).

Are AIVs required to register independently with CIMA?

Each private fund vehicle needs to be considered on its own merits and a determination made as to whether it needs to be registered under the PF Law. Where an AIV (of a Cayman private fund or a US or non-Cayman fund) does not meet the definition of "private fund," it is not required to be independently registered with CIMA.

Details of AIVs of a Cayman private fund will be included in the registration filing of such Cayman private fund but this does not mean the AIV is "registered" as a private fund under the

PF Law (nor does it trigger any requirement for the AIV to register).

Can we obtain a CIMA 'letter of good standing' on closing?

Yes, if the private fund is registered, but: (i) the CIMA letter of good standing is not immediately issued (in the same way a Certificate of Good Standing for an exempted company or exempted limited partnership is by the Registrar of Companies/Partnerships) and so it is expected that it will take three (3) business days for such letter to be issued by CIMA in the normal course; and (ii) the price of obtaining a letter of good standing from CIMA is US$975 per certificate/entity and so is a more material cost than Certificates of Good Standing for entities obtained from the Registrar of Companies/Partnerships.

A CIMA letter of good standing will not mean that the relevant entity is in good standing with the Registrar of Companies/Partnerships and so separate Certificates of Good Standing will still need to be obtained in this regard.

Will the 7 August 2020 registration deadline/implementation date under the PF Law be extended as a result of COVID-19 disruption?

Whilst CIMA has been active in introducing a number of policy extensions and filing concessions in light of the current pandemic to lessen some of the challenges applicants and registered entities may be facing, no announcement has been made in respect of the PF Law registration deadline/implementation date and, therefore, unless industry is notified otherwise, the relevant date remains 7 August 2020.

Private Funds CFO Press Coverage on NAV Lending and Pref Equity

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Private Funds CFO ("*PFCFO*") published and distributed multiple articles this week about the response of preferred equity and concentrated net asset value (NAV) lending markets in the midst of COVID-19's continued presence in the economy. In "**Alternative fund financers ride to the rescue, but is it enough?**", *PFCFO* reports a sudden increase in deal flow in these markets since March and offers insight on how decreased liquidity and cash flows combined with increased caution on traditional bank lending have turned more firms to concentrated NAV lending as their liquidity solution. In "**Is preferred equity the covid-19 crisis's white knight?**", *PFCFO* also highlights two preferred equity players, Whitehorse Liquidity Partners and 17Capital, which are seeing significant success in fundraising and a historic increase in deal flow due to the uncertain market conditions. A deeper dive into Whitehorse Liquidity Partners and its "Genius Strategy" can be found in *PFCFO*'s recent article, "**How Whitehorse became the most envied firm in secondaries**."

Unquote Podcast on Fund Finance with Matt Hansford

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While most of the market noise in fund financing continues to be centered around subscription credit facilities, as liquidity becomes an increasing priority, GPs are looking to lenders for NAV and preferred equity structures. In this *Unquote* podcast, Matt Hansford of Investec unpacks the rationale for such facilities, including efficiency, flexibility of payment and reduced interference with portfolio management. Under the lens of COVID-19, Denise Ko Genevese (*Unquote*) and Oscar Geen (*Debtwire*) discuss the drive toward these pricier facilities as an additional source of capital for funds which are fully deployed, have exhausted other capital sources, or are otherwise seeking additional buffers in these uncertain times. The podcast is accessible **here**.