

Fund Finance Friday



Show Me the (Manager) Money

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It is no secret that LPs have been increasingly focused on conducting greater due diligence on the funds they are looking to invest in, and this trend has intensified since the collapse of Abraaj. A lot of the focus of this enhanced LP due diligence focuses, quite rightly, on fund administration and risk controls. However, greater attention is also being given to how the management company is financed, its cash flow situation and who the appointed accountants are.

In the context of subscription lines, lenders do not routinely conduct detailed analysis on the financial position of a manager (i) when assessing whether a fund is bankable for the purpose of a subscription line, or (ii) on an ongoing basis once the subscription line is in place. However, as we have seen with the collapse of Abraaj, the financial health of a manager could severely affect the creditworthiness of a fund and the behavior of the LPs in that fund in the event that a GP, manager, or indeed, an affiliated investor, is unable to meet its obligations to the fund. Nor do subscription line lenders look to the financial condition of any vehicle sitting between the GP/manager/affiliated investor and the ultimate holding company within the structure which finances these entities and allows them to comply with their commitment obligations under the fund documents. Certainly facility agreements will contain an event of default trigger if the GP or manager becomes insolvent (and trigger an exclusion event if the affiliated investor is included within the borrowing base), but what if the GP/manager/affiliated investor's source of funding is cut off because one of its holding companies becomes subject to insolvency procedures? This wouldn't, in and of itself, constitute an event of default or a change of control, so what option would the lender have in these circumstances? Calling an MAE may be an option, but lenders are understandably nervous about calling an event of default based on MAE alone.

On the other hand, many articles in the press recently have referred to indebtedness at the manager or GP level to be "red flags" which is in itself not correct. A manager or general partner may take on debt for a variety of legitimate and necessary reasons. Manager liquidity lines and GP commitment financing lines are very common and serve a necessary purpose for many GPs and managers in the market. What is key is to identify how and to what extent the GP/manager is using this financing.

Going forward, we expect to see lenders in tandem with LPs looking for increased due diligence on funds and looking to capture within the facility documentation triggers in respect of insolvency-type proceedings affecting any vehicle on which the GP/manager/affiliated investor relies upon for funding. To what extent lenders will push for (and GPs/managers will agree to provide) detailed information in relation to the financial position of the GP and management vehicles or their affiliates remains to be seen. Clearly, there needs to be a balance achieved between events which could be materially adverse to the position of the subscription line lenders while recognizing that liquidity/commitment financing lines at the GP/manager level are common and necessary tools used by GPs and managers in the market.