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Writing to Reach You – Investor Letters and Subscription Facilities

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While Chris van Heerden's recent **article** gave some cause for optimism over the fundraising environment for 2024, for now on the ground we are continuing to see significantly longer lead times before funds hit their target size, even for top-tier sponsors.

In many cases that is resulting in the implementation of subscription facilities being delayed entirely, while in others sponsors are coming to the financing market with a much more concentrated LP-base than they typically would have done in the past. In response, we are experiencing something of a resurgence in lenders requiring investor letters by way of a credit mitigant to the heightened risk of lending against a single or small pool of investor(s).

What is an investor letter?

This is not as simple a question as it may seem. The term "investor letter" is used very broadly in the market but the things it can encompass, as explored in more detail below, cover a wide spectrum. This can range from the investor simply acknowledging that the right to call their undrawn commitment has been pledged to a lender (and nothing more), all the way up to an all-singing, all-dancing contract between the investor and the lender, whereby the investor gives a number of direct representations and undertakings that, if breached, give the lender a direct cause of action against the investor alongside a security enforcement process.

Although its name generally suggests that it is the direct-investing entity in the fund that enters into the letter, where that entity is only an SPV a lender may look for a parent further up the investor's corporate chain to give it instead (or in addition); the objective being to contract with the entity "of substance" within the group that will ultimately be the purse from which capital calls are funded and on which the lender's credit analysis is likely to be based. In those circumstances the content of the letter will focus on the linkage between the SPV and the parent by including things like representations as to ownership structure and an undertaking to put the SPV in funds to meet capital calls. Such letters are sometimes referred to as "comfort letters", as distinct from investor letters provided by a direct-investing entity.

In either case, the letter should be addressed directly to the facility and/or security agent.

Clearly it is well worth having these conversations at the early stage of a transaction so as to set expectations as to what the lender is looking for such a letter to include, and what the sponsor is prepared to ask their investor to agree to.

Typical Provisions

Set out below is a summary of the provisions we typically see in these letters. There will, of course, be a degree of variance between one transaction and another, and the intention here is not to suggest that the below represents everything a lender may ask for on a particular deal, nor that a lender will insist on including all of these provisions every time. That said, hopefully this list serves as a useful guide to what are broadly considered market terms in the current climate, as well as the rationale for including them.

For context, these are provisions we would expect to see agreed to by the entity investing directly in the fund, rather than a parent.

- **Confirmation of commitment**. The investor will confirm that it has made an investment in the fund and the levels of its total and undrawn commitment. Reference will also be made to the relevant partnership documents, subscription

agreement, side letter, etc., in order for the investor to acknowledge directly to the lender that it has entered into them so as to create a binding commitment.

- **Acknowledgment of the facility and security**. While not technically required for perfection of security, at least in the vast majority of jurisdictions we encounter on these transactions, the investor will acknowledge that the facility has been put in place and that security has been granted over their undrawn commitment and the fund bank account. Express confirmation that the investor has knowledge of both is key to avoiding equitable defences being raised should it come to an enforcement, while clearly it is of commercial comfort to the lender to know the investor is aware of what is happening from the outset.
- **Further acknowledgments and undertakings**. The investor will be asked to give a variety of undertakings and acknowledge various provisions of the finance documents. Some of these will be primarily to give added comfort to the lender – for example, express confirmation that the facility constitutes a “Subscription Facility”, or similar, as defined in the Limited Partnership Agreement ("LPA"), and therefore that it benefits from the related lender-friendly provisions in the LPA. Others will have more legal import, such as to make binding on the investor certain restrictions in the finance documents that otherwise would only bite on the fund/GP. Some examples of these undertakings are set out below.
- The investor will honor capital calls made in accordance with the fund documents, including those made by the lender on an enforcement, without defence, set-off or counterclaim. This should include overcalls, although clearly that will be less relevant where there is and will remain only one investor.
- All capital calls will be paid into the fund’s collateral account (details of which will be set out in the letter), or another account of the fund specified by both the GP and lender, and any payment made by the investor to a different account shall not discharge its obligation to the fund.
- There shall be no amendments or waivers in respect of the fund documents to the extent not permitted under the finance documents. This is a key protection from a lender’s perspective, as (depending on the fund jurisdiction) it will effectively legally defeat a purported amendment or waiver made by the GP in breach of the equivalent undertakings it has given in the facility agreement by depriving the investor of the ability to rely on that amendment or waiver as a defence to funding.
- An investor letter can also be used to “fix” specific issues with the LPA or side letter between the fund and the investor. For example, similar to the point above, where the LPA includes a unilateral right of the GP to release the investor’s commitment, the GP’s undertaking in the facility agreement not to exercise such right can be made binding on the investor as well by repeating it in the investor letter.
- There may be other transaction-specific requirements that a lender will wish to achieve by way of a direct arrangement with the investor, such as the investor agreeing to deliver financial statements directly to the lender.
- **Representations**. These will consist of fairly standard confirmations that: (a) the investor has due power and authority to enter into the letter and the relevant fund documents; (b) that its obligations under the same are valid and binding; and (c) it has no knowledge of any actions or defaults that would be prejudicial to those obligations.
- **Fund documents prevail**. The terms of the investor letter are usually expressly made subject to the terms of the fund documents, which prevail in the case of a conflict between the two. From an investor’s perspective, they may have limited visibility on the finance documents and so be reluctant to override what they have specifically negotiated and agreed in their fund documents. In any event, by definition the fund/GP is only able to grant security over the rights they have under the LPA and other fund documents, so any exercise of those rights by the lender on an enforcement would have to be subject to the terms of those documents, anyway.
- **Immunity**. If the investor has sought to preserve its immunity in its side letter with the fund, it may wish to restate that wording in the investor letter. This should not pose an issue from the lender’s perspective, of course provided that immunity wording is acceptable in the first place.
- **Confidentiality**. Another investor ask may be for the lender to assume obligations of confidentiality directly to the investor in the letter. Again, this should not be problematic for a lender, given that its confidentiality obligations in the finance documents will already extend to investor information; however it would be prudent to ensure that the obligations, permitted disclosures, etc., are the same in all documents to avoid foot-faults by virtue of inconsistencies.
- **Governing law**. The governing law of the investor letter should generally be the same as that of the LPA, as well as the jurisdiction for claims, although again, if this is altered by the side letter, then in most cases we would expect the investor letter to follow suit.

When is an investor letter required?

There is no one-size-fits-all answer to this question. As mentioned above, a lender's need for an investor letter will likely increase proportionately with the concentration risk, viewed by reference to the ultimate sponsor, even if that sponsor participates via several different vehicles (all of which would need to be party). In any event, investor letters remain an important risk mitigant that is here to stay.