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Retail Investors: Challenges and Opportunities in Subscription Finance

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The growth of High Net Worth Individual (“HNWI”) allocations to alternative investments is a hot topic in fund finance. In what is widely acknowledged to be a challenging fundraising environment, fund managers have focused their attention on tapping up retail investors for additional capital. Global retail investors account for 50% of global invested AUM but only 16% of alternative asset AUM, according to Bain & Co. research. Top sponsors are now actively investing in infrastructure and marketing to grow retail capital sourcing.

So called “natural persons” have historically obtained access to private markets via closed-end funds but can today invest in an increasing number of evergreen strategies. The proliferation of these perpetual structures is reflective of the growing appetite from the public for access to private markets. According to some sources, recent market volatility has resulted in retail investors increasing their allocations in alternative assets, which are perceived as being less susceptible to market shocks than publicly traded assets. In addition, the rise of secondaries evergreen strategies (across multiple asset classes – including, notably, credit) has increased the range of investment opportunities for HNWIs: offering diversity, lower management fees and immediate access to a mature portfolio of underlying investments. Furthermore, many of the historic barriers to entry for retail investors are now falling away: minimum investment amounts have dramatically reduced whilst new technology and investment platforms have made it easier than ever to invest. This trend shows no signs of slowing down. As a result, lenders in the subscription finance market are seeing increased demand from their sponsor clients to lend against the uncalled capital commitments (“UCCs”) of these investors.

Against this backdrop, this article focuses on some of the considerations for lenders when putting in place subscription finance facilities for funds with HNWI investors and family offices.

Closed-end fund or open-ended fund?

Whether HNWIs are investing through a closed-end fund (that has a fixed lifespan and that restricts investor withdrawals) or an open-ended fund (that permits investor redemptions on a semi-regular basis), will clearly impact whether a capital call facility can be put in place and how it is structured. For closed-end funds, subscription facilities are far more common. However, it is also possible to put in place subscription finance facilities for open-ended vehicles: this can often be achieved where the fund has an initial lock-up period (of, say, 1-3 years) during which time investors are restricted from unilaterally redeeming their interest in the fund. Whether a subscription line facility is feasible for an open-ended fund will also depend upon whether investors are required to advance their entire commitment up-front, or if such amounts can be drawn down throughout the duration of the lock-up period (and, in some cases, beyond). Given the increased appetite from HNWI and family offices for exposure to such open-ended “evergreen” funds, providers of subscription finance are having to think harder about how they treat these investors for financial covenant purposes. We have successfully helped many lenders implement subline facilities to evergreen funds, in both Europe and the US.

How to assess the investor’s creditworthiness?

Historically, some lenders have found it challenging to lend against the UCCs of HNWIs and family offices as opposed to the UCCs of more established institutional investors (such as pension funds, insurance companies and sovereign wealth funds) and rated corporates. Whilst payments defaults from HNWIs are extremely rare, they are known to occur more frequently than is the case for institutional investors. In the absence of a credit rating or any financial statements, it can be difficult for lenders to take a view on the creditworthiness of these investors. Clearly, there may be exceptions to this, particularly where a lender (such as a private bank, for example) has an existing relationship with the relevant investor and may therefore be better placed to evaluate its creditworthiness (particularly where the relevant investor holds accounts with that private bank).

Many subline lenders have not been able to lend against the UCCs of HNWIs, treating them as “Excluded Investors” for the purpose of any financial covenants included in the facility agreement. However, as the investor landscape continues to evolve, we are seeing some lenders take a more nuanced view. We have seen some lenders treat HNWIs as “Included Investors” for borrowing base purposes and apply a low advance rate (relative to other “Included Investors”), sometimes making such inclusion subject to a hurdle rate (i.e. a condition that such investor has advanced a certain proportion of its total commitment to the fund and therefore has “skin in the game”). Lenders will also typically apply a haircut on the total percentage of investor commitments provided by HNWIs or family offices through the application of concentration limits in the borrowing base. In recent years, we have seen a noticeable increase in the aggregate concentration limit lenders are applying to HNWIs.

We have also seen sublines put in place where the fund’s investor base is comprised solely of HNWIs. For these facilities, lenders will typically want to see a large and diversified investor base (often achieved through strict individual concentration limits) and will apply a flat advance rate to all of the investors. Indeed, the diversity offered by a very large pool of HNWIs can be a key mitigant from a credit perspective.

Second-lien subline facilities are also becoming more common. Providers of **second ranking/”Facility B” subscription lines** may be comfortable lending against these HNW UCCs even if some first-lien lenders are not, resulting in a larger aggregate borrowing base. It’s worth noting that the first-ranking lender would be entitled to the first claim on capital contributions from HNWIs, even if the first-ranking lender treats HNWIs as Excluded Investors in the absence of an agreement to the contrary among the parties.

HNW Feeders

In some instances, lenders that might not otherwise include HNWIs in their borrowing base calculations will do so where such investors are subscribing in the borrower fund indirectly via a collective investment vehicle (often described as a “HNW Feeder”). HNW Feeders are typically run by third-party private wealth managers that look to aggregate commitments from multiple HNWIs, sometimes in order to meet minimum investment conditions that a single HNWI may be unable to satisfy on a standalone basis. HNW Feeders can also be established and managed by the sponsor of the borrower fund. Lenders are generally more comfortable with investors on the major private wealth platforms because the manager is known to have good sense of the assets and liquidity of the investor pool.

Some lenders may treat HNW Feeders as “Included Investors” in their own right, often on the basis that their diversified investor base means they carry a lower risk of default. This means that, typically, lenders under a capital call facility will only take security over the UCCs of the HWN Feeder to the main fund and will only be able to call capital from that entity (rather than its underlying investors). Lenders will generally apply concentration limits and/or hurdle rates to such HNW Feeders. In our experience, whether lenders are able to take this approach will often depend on the reputation of the manager of the HNW Feeder and the powers it may have in respect of the underlying HNW investors. Lenders may want to understand whether the private wealth manager has the ability to overcall in circumstances where one of its underlying investors defaults, for example.

When lending against the UCCs of HNW Feeders, lenders will need to consider exactly how they will treat those investors (and their underlying investors) if a payment default occurs. HNW Feeders will often enter into a side letter with the main fund pursuant to which it is agreed that it is not treated as a “Defaulting Investor” in respect of the entirety of its commitment where it is unable to pay as a result of a corresponding payment default from one of its HNW investors. In such circumstances, it is often agreed that the main fund will look through to the HNW investors in the HNW Feeder (such that the HNW Feeder’s interest in the fund is deemed separated into two parts for purposes of exercising any remedies arising under the main fund’s LPA as a result of the payment default). Where this kind of arrangement is agreed, lenders will need to think carefully about how these mechanics may affect their recourse in an enforcement scenario and how they want to address this via the covenants in the facility agreement.

Contractual Protections

In addition to the structuring solutions highlighted above, lenders may seek additional forms of comfort when lending against HNWIs and HNW Feeders and a tailored solution is often required. This might mean including bespoke Exclusion Events which apply to HNW aggregators (where a certain percentage of the underlying HNW investors are in default, for example) or that additional representations and undertakings are required from the sponsor/platform provider in a separate investor letter. We have also seen pricing ratchets applied where concentration thresholds or hurdle conditions are not met.

Final Thoughts

While expanded retail participation in private markets is not a new theme in fund finance, we are seeing lenders actively revise their approach to high net worth ("HNW") investors in 2025. As capital sourcing models evolve, we expect lenders will continue to explore new and innovative ways to keep up with growing demand.