

Fund Finance Friday



Subscription Finance Loan Agreement Series, Part 13: Transfers by Investors of Interests in a Fund

November 8, 2019 | Issue No. 53

Back in September, in Part 6 of this series, we touched on the issues surrounding the inclusion (or not) of investors in the leverage or borrowing base calculation in a subscription/capital call facility and the factors which might impact on that. In this article, we look a little more closely at one of those issues – namely, transfers by investors of their interests in a fund. In particular, we focus on the impacts of any such transfer on the level of leverage or borrowing base that a lender will be looking at under the facility and at the extent to which lenders can (or would want to) control transfers between investors. Why is this important? Because, as will have been apparent in a number of the articles in this series, the level of commitments of the investors to the fund (and the investors' ability to make good on those commitments when called) are at the heart of all subscription/capital call financing. These will be assessed by any lender at the outset by reference to the then-current group of investors, and any change in those investors (in particular, by transfer to a different investor) will impact both and may well alter that assessment.

How a transfer is treated in terms of a subscription/capital call facility will often depend at least in part on whether the facility is a leverage-based facility (*i.e.*, where the investor base is viewed as a group based on the lender's own assessment of the investors within that group) or a borrowing base facility (where the investor base is looked at by reference to ratings or an equivalent of the relevant investors). In the former, the inclusion (or otherwise) of any transferee investor and its commitment in the leverage covenant will often (but not always) be left to the discretion of the lender. In the latter, such inclusion (or not) will often be (at least outwardly) more "objectively" based (*i.e.*, on whether the transferee investor meets the relevant ratings or other criteria). In both types of facility, there is likely also to be an overarching "aggregate" limit on the amount of commitments which can be transferred, often set at around 15% or 20% of overall commitments and sometimes lower, before the cumulative transfers trigger a repayment obligation.

Whether the lender retains discretion as to the inclusion of transferee investors or is obliged to include or exclude them depending on their fitting or not within set criteria, the issues are the same. The lender needs to be able to make an accurate assessment of whether the transferee investor can make good on the commitments transferred and adjust its leverage or borrowing base accordingly to take account of this. Other issues that both sides need to consider are (in no particular order of importance):

- whether if the effect of the transfer is to reduce the leverage or borrowing base below the current level of utilisations, a prepayment of the excess will be triggered (and, if so, the period allowed to effect that prepayment);
- related to the above, whether if a transfer is contemplated or in progress, it is possible to effect a prepayment obligation prior to the date of the actual transfer;
- whether the transferee needs to be notified of or acknowledge any security arrangements that may have been put in place in respect of the investor commitments on transfer;
- what "KYC" needs to be completed on any new investor and the level of information required to effect that; and
- the extent of information that the lender will require in respect of the new investor.

In the discussion above, we have focused on the inclusion (or not) of transferee investors within any leverage or borrowing base criteria. The other issue that is usually the subject of some debate in a subscription/capital call facility is the extent to which lenders may have some control over or ability to restrict transfers among investors. As stated above, this may be somewhat less of a concern for lenders who are dealing with a borrowing base than for lenders who are looking at a leverage covenant. For funds and their GPs, there are a couple of considerations here. The first is the extent to which the fund or the GP itself has any control over or ability to restrict those transfers. To the extent it

does have such control, then it is at least legally possible to allow the lender also to have some equivalent element of control, but it will not always have such control. The second is the extent to which it is desirable to allow the lender, in effect, to exercise this control right. This second consideration is not straightforward. One way to look at this is to determine whether the control right is related simply to a voluntary transfer by one investor to another (in which case some element of lender control may be acceptable) or whether it is something that the investor has to do (for example, where for that investor to continue as an investor in the fund would cause legal or regulatory issues either for that investor or for the fund). In the latter case, lender control would generally not be acceptable (and, indeed, a lender would be unlikely to want to restrict transfers given the potential adverse consequences to the fund of doing so).

In any subscription/capital call facility (and whether it is based on an investor leverage or an investor borrowing base), getting the balance right between fund and lender in terms of the level of control over investor transfers and the extent of inclusion of transferee investors in any leverage or borrowing base calculations is crucial for all sides. It is hoped that some of the comments in this article will help to properly assess that desired level of balance.