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FUND FINANCE FRIDAY

Getting Personal – Lending to Fund Executives

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By Nathan Parker
Partner | Fund Finance

Funds in Europe are increasingly calling on their traditional subscription finance lenders for the purpose of providing credit lines to management and executives of the fund. In one form or another, these facilities have existed in the market for some time, but an increase in the size, number and lenders willing to make these facilities available is leading to an increased focus on their (often quite technical) requirements.

Although the structure used to implement executive facilities can vary, their purpose tends to primarily be financing capital calls made against the executives in their capacity as LPs in co-invest funds.

In general terms, these facilities provide financing for the payment of subscription amounts owed by the executives and are supported by security granted by the executives over their entitlement to receive distributions from the fund, often requiring these distributions to be paid directly into a secured account.

Depending on the timing and size of expected distributions, the security package may be enhanced by the executives providing additional collateral (in the form of cash or eligible securities) and, in some circumstances, other fund entities (such as the manager or GP) may be asked to provide security over that entity's entitlement to management or GP fees.

Each borrower will generally be subject to financial covenants – for example, where collateral over cash or securities is granted the executive may be required to ensure compliance with LTV coverage requirements.

The facility may be made available directly to the executives (with security being granted by the executive to the security agent (or lender, where the facility is bilateral)). In other cases, the lender may extend credit to a fund vehicle (often an SPV or limited purpose entity) that then on-lends the proceeds to the executives. In this case, a typical structure would require the executive to grant security to the SPV lender and the SPV lender, in turn, to grant security over its rights under that security to the security agent – effectively creating an upward "cascade."

As the loan is being made to an individual, there are some key considerations and due diligence matters that need to be resolved to ensure the facility is enforceable and that the making of the loans does not result in a breach of law. As you might expect, the covenants, representations and events of default also need to be tailored so as to be applicable to individuals rather than funds or corporates, and consideration will need to be given to executive departure provisions in the LPA – particularly in a "bad leaver" scenario.

In terms of due diligence, a primary concern is the application of consumer credit legislation to the facility, and an analysis of the relevant consumer credit legislation will require an understanding of the borrower and lender location as well as the location of any assets (such as accounts) that are subject to security (as well as any other factors that create a nexus to consumer credit legislation in a particular jurisdiction). It is unusual for a borrower, lender, the collateral and governing law of a facility to all be in the same jurisdiction, and so it may be necessary to consider the consumer credit requirements of more than one jurisdiction in connection with any one borrower or loan.

The consequences of failure to comply with consumer credit legislation vary across the jurisdictions and, for example, breach of the consumer credit requirements may result in the loan and/or security being unenforceable and/or a lender being subject to regulatory or criminal sanction. In some jurisdictions (particularly those regarded as "offshore" jurisdictions in the fund finance market), it may be that there is very limited consumer credit regulation (*e.g.,* Jersey and Guernsey) or that the regime is more permissive than in "onshore" jurisdictions (for example, in our experience, the Luxembourg regime is easier to navigate in the context of these types of facilities than the regime in the UK). However, as mentioned above, the laws of more than one jurisdiction may be applicable to a loan to a borrower.

Structuring the facility as a loan to an SPV (with the SPV on-lending to the individuals) so as to avoid making a loan to an individual does not necessarily remove the need to consider consumer credit legislation as that SPV may, as lender, be subject to consumer credit requirements. Therefore, although it may reduce the risk of regulatory or criminal sanction for the bank lender to the SPV, it does not solve potential unenforceability issues in respect of the loan and security between the SPV and the individual (over which the bank lender would ordinarily look to take cascading security as described above). In this context, lenders should also be mindful of aiding and abetting offences.

Another consideration is the application privacy legislation to the transaction. GDPR can be relevant depending on the nature of the information provided by the individuals (particularly in security documents which may contain address, passport numbers, email and account information) and its anticipated use. It may be necessary for the fund and/or the lender to obtain GDPR consents from the individual borrowers.

In most cases, it is possible to structure the facility so that it is compliant with privacy and consumer credit legislation. Looking back at the last 12 months we have structured transactions for executives in jurisdictions across Europe, including Jersey, Guernsey, Luxembourg, Germany, Poland and the UK, as well as North America, and have seen, for example, reliance on high net worth exceptions and loans being exempt for being in excess of a certain amount. It is also possible that lenders (or affiliates) may have appropriate permissions in place to make consumer loans available.

Available exemptions may require third-party involvement (such as a third-party verification of high net worth status or there may be a requirement that individuals receive independent legal advice). These requirements can add to cost and may also lead to delays in implementing the transaction and so identifying the relevant consumer credit and privacy laws and identifying a structure that complies with these requirements as soon as possible in the life of a transaction is key.