Considerations for Post-IPO NAV Financing

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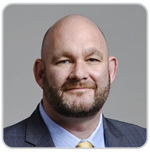

By **Brian Foster**
Partner | Fund Finance

With a surge in asset-based lending to private equity funds since the start of the pandemic and a historic run of IPO fundraising, it is not surprising that we are increasingly seeing post-IPO shares being pledged as collateral in support of asset-based loans. While private equity funds often invest in companies with the goal of later taking those companies public, the occurrence of the initial public offering doesn't necessarily lead to the immediate divestment of a fund's investment in that company. As part of the IPO process, key investors often agree to maintain all or a portion of their investment in a company for a specified period after the occurrence of the IPO. It is not unusual for such investors to monetize their investments during that period by obtaining a loan secured by the investment. The issues that must be addressed in structuring a financing of such post-IPO shares are materially different from the issues that arise for a financing of pre-IPO shares. We highlight certain key considerations below:

- Shares that are listed on a U.S. exchange generally constitute "margin stock." Lending secured by margin stock is subject to regulations under U.S. law that may impose limits on the amount of credit that can be extended relative to the value of such shares.
- Listed shares have real-time pricing based on sales on the stock exchange. Whereas prior to the IPO (where a valuation is only provided once every 3 months), a lender might have focused on issues such as valuation methodology, valuation source and appraisal rights, lenders for post-IPO shares typically focus on issues such as price volatility and daily trading volume, delisting, and exchange and market disruption events generally.
- The borrower's shares in the company may not be covered by the registration statement that was filed by the company in connection with the IPO. In order to sell the shares, a new or amended registration statement must be filed, or the borrower (or lender in the case of a foreclosure) must effect the sale pursuant to an exemption from registration under applicable securities laws.
- The borrower may have entered into a registration rights agreement under which it can cause the company to file a registration statement to facilitate a public sale of the borrower's shares. Where possible, the lender will want to receive a pledge of the borrower's rights under the registration rights agreement.
- If the borrower provides or appoints officers or directors to the company, or owns a material portion of the shares (10% or more), it may be deemed an affiliate of the company and may be subject to certain requirements and limitations under securities laws, such as ownership disclosure requirements and short-swing profits limitations under Section 13 and Section 16 of the Securities Exchange Act of 1934. The lender will want to structure its rights under the loan documentation and exercise its remedies in a way that it will not itself be deemed an affiliate of the company.
- The borrower may have entered into a lock-up agreement with the company, the principal underwriter for the IPO and other key investors that prohibits the borrower from pledging and/or selling its shares for a specified period after the IPO. It is critical that the lender review and understand the restrictions contained in the lock-up agreements, including under what circumstances (if any) a sale of the borrower's shares may be permitted prior to the end of the lock-up period. It is not uncommon for investors to negotiate flexibility within the terms of the lock-up, and some lock-up agreements will have carveouts for margin loans. Others may permit a sale of shares during the lock-up period as long as the purchaser agrees to receive the shares subject to the terms of the lock-up.
- In order to discourage illegal insider trading, the company will likely have a detailed policy regarding trading of the company's stock by its directors, officers, employees and entities (including investment funds) affiliated with such persons. The lender will want to review the insider trading policy of the company to ensure that the margin loan (and any resulting foreclosure on the shares) is not prohibited under the insider trading policy, and to determine whether additional consents or approvals should be obtained as a condition to providing the margin loan.
- The lender will be sensitive to receipt of material non-public information about the company from the borrower. The loan documentation will typically include a covenant for the borrower to identify any information as material non-public information prior to disclosure to the lender, and shall allow the lender to decline to receive such information. If the lender is in possession of material non-public information at the time of a foreclosure, it may need to disclose that information prior to effecting a foreclosure sale.

- The borrower’s shares may be held in the form of physical certificates that bear restrictive legends. Prior to a public sale of the shares, the legends will need to be removed and the shares may be converted to electronic form. This will require the cooperation of the company and/or its transfer agent.
- It is not uncommon for the lender to enter into an agreement with the company addressing the issues above, including confirming that the margin loan complies with the insider trading policy, that there are no restrictions on transfers of the borrower’s shares (other than the lock-up agreement and securities laws), that the company will cooperate with the lender to de-legend the certificated shares, and that the company will not treat the lender as an affiliate of the company in connection with a foreclosure on the shares. The purpose of this letter is to provide the lender comfort that if a default occurs under the margin loan, it will be able to effect a timely sale of the shares in order to repay the loan.

Michael O’Connor’s Promotion

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By Michael Mascia
FFA Board Member

I was so happy to see Conyers Dill & Pearman announce this week that Michael O’Connor has been elevated to Partner. I’m always happy to see fund finance professionals get promoted; for too long, it felt like those of us in fund finance were a little underappreciated compared to professionals in more long-standing and higher profile sectors like leveraged finance. But that is clearly changing: LinkedIn has been overflowing with fund finance promotion announcements over the last year, which is awesome. But Michael’s elevation, from my vantage point, is a little different.

Lawyers seem to have a business development playbook. Even when extremely successful lawyers teach biz dev to aspiring partners, the focus is always the same: content creation, social media branding, speaking engagements, industry association involvement and client events. These tactics are all important and entirely appropriate for the enterprising young lawyer to have in his or her toolkit. I don’t want to minimize their relevance in building a professional brand and in attracting clients. But their impact is far overvalued and actually limited to the margins; they influence less than 10% of any good lawyer’s ultimate deal flow, at least in my experience.

The fundamental driver of generating future work is providing sensational client service at reasonable value on existing work. Highly responsive, substantively on point, clear, informed, and commercial counsel always brings clients back at increased volume. And great work constantly attracts new clients who either observe the superior service or who receive referrals from those that did. It is elite service that keeps a lawyer’s plate full; elite service is far more relevant than all other tactics combined. This simple and fundamental truth seems to be lost in current biz dev training. But that’s what Michael O’Connor (and his mentor Derek Stenson) have gotten so perfectly right.

Conyers was never on my personal radar in the Cayman Islands. I have been fortunate to work with some of the Caymans’ best lawyers at other firms who have become my great friends, now for long periods of time. But Derek and Michael got in with some of our young partners. And Michael serviced our team with the same level of intensity, turnaround times and all-hours availability that we at Cadwalader aspire to bring to our clients. Time after time, when I would ask our team who was providing great service, Michael’s name came up. He earned his way into the rotation and then earned his way to greater share. And it had all to do with relentless client service and virtually nothing to do with the articles he writes or hosting dinners. Great work is what really matters. Congrats, Michael. Incredibly well-deserved.

Private Debt Investor – Talking Points Report with Allvue

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Private Debt Investor provided a May 2021 Talking Points report with Ryan Crowell and Yuriy Shterk of Allvue Systems. The conversation highlights that the strong performance and increased demand for Fund Finance products during the pandemic is continuing as the pandemic subsides. While the increased adoption is creating new reporting and credit management demands, they note that new technologies are being used and developed to address these challenges. Read more **here.**

New Private Markets Article: ESG-linked Credit Line

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New Private Markets published an article this week that highlighted the ESG-linked credit line to AlpInvest, a subsidiary of Carlyle. The article briefly outlines some of the KPIs included to measure the performance of the fund as well as some of the consequences of not meeting them. Our Cadwalader team has assisted a number of lenders in putting in place significantly sized ESG-linked subscription facilities. We can attest to the fact that ESG-linked subscription facilities have become more than just a trendy classification but are rather well thought out and include increasingly meaningful and ambitious KPIs with real financial consequences depending on them being met (or not).

The article is available **here**.

Avardi Partners Column in The Drawdown

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Sarah Lobbardi of Avardi Partners provided the guest column in this month's *The Drawdown* magazine. The column is on page 34, and the subscription-required magazine is available **here**.

PEI Article Critical of Sublines

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Private Equity International published an article this week outlining the views of Ian Brown, the head of private markets at LGPS (one of the UK's largest public pension funds). In the article, Brown raised concerns about the proliferation of subscription lines among PE funds, stating that the main benefit of such products is to inflate returns for managers at the expense of investors. Brown also notes that, in his view, there is a lack of transparency and, consequently, not enough LP understanding of the connection between subscription line facilities and the ability to artificially inflate IRRs. The article is available **here**. *Fund Finance Friday* notes that ILPA has engaged on subscription lines extensively and that multiple research reports have found that subscription lines have only a modest impact on IRRs (see, for example, this **article** from *Pitchbook*).

Tom Glover Joins BC Partners

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Private Funds CFO this week reported on BC Partners bringing on Tom Glover to lead an NAV lending and pref equity build-out. This subscription-required article is accessible **here**.

Dave Philipp Promoted to Partner

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Co-head of Crestline's thriving fund liquidity solutions group, Dave Philipp was promoted to Partner this week. For more on the news, click **here**.

Fund Finance Hiring

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On the Move | Fund Finance Hiring

The Goldman Sachs Asset Management team in Dallas is hiring an analyst to join its Alternative Capital Markets & Strategy (ACMS) Fund Finance team. For more details or to apply, please check out the GS careers **site**.