Lender Considerations Related to an Investment Manager's Rights

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When we think about parties to a subscription credit facility (the "Facility"), all eyes are generally on the fund and the general partner (the "GP"), but the investment manager (the "Manager") is also a party to watch. For the reasons explained here, the role of the Manager can vary from deal to deal, and, depending on the terms of the fund documents, it can create risk for the Facility lender in a subscription deal. Here we will break down those risks and how incorporating certain terms into your credit agreement can mitigate these risks.

In a typical U.S. fund structure, a fund will have a GP and a Manager. The GP is typically delegated broad rights with respect to the fund pursuant to the fund's limited partnership agreement (or such other governing agreement) (the "LPA") to do any and all things deemed necessary or desirable by the GP in furtherance of the powers, objectives and purposes of the fund. Included in those rights is the right to delegate certain of its responsibilities with respect to managing the assets of the fund to the Manager. The relationship between the GP and the Manager regarding the fund is governed by a management agreement or an investment advisory agreement (the "Management Agreement").

The Management Agreement is entered into by and between the fund and the Manager. The rights delegated to the Manager are typically limited to identifying investment opportunities, purchasing, monitoring, evaluating and selling the fund's assets, and exercising any voting or consent rights with respect to such assets, in each case, subject to the terms and conditions set forth by the GP and/or the LPA. In an atypical situation, the rights granted to the Manager in the Management Agreement go beyond these aforementioned rights or the granting language in the Management Agreement is drafted ambiguously. Such ambiguity could lead to the language being interpreted as granting the Manager broader rights, which could potentially have a negative impact on the rights of the Facility lender.

The Facility will typically include covenants in the loan documents that are intended to be protective to the Facility lender's interests by limiting the fund's and GP's rights to take certain actions that could have an adverse effect on the Facility collateral. These include, but are not limited to, the following: (i) prohibition of additional liens on the Facility collateral; (ii) limitations on the amount of other indebtedness the fund can incur; (iii) restrictions on cancelling, reducing, excusing or abating the capital commitment of an investor; (iv) limitations on distributions; (v) prohibition on withdrawing funds from the collateral accounts at certain times; and (vi) restrictions on calling capital during an event of default (the "Covenants"). The Covenants help to mitigate risks with respect to the collateral.

In a typical subscription deal, the Covenants typically apply only to the fund and the GP as a party to the Facility loan documents. In the ordinary course, the Manager is not a party to the Facility except with respect to acknowledging a standard covenant that requires the fund to subordinate any payments or advances of any kind on any debts or liabilities due to the Manager. Since the Manager is not otherwise a party to the Facility loan documents, the Manager is not bound by the Covenants, and the Facility lender does not have any recourse to the Manager pursuant to the Facility loan documents if the Manager were to engage in any actions that conflict with or violate the Covenants. One concern for the Facility lender is: if the Manager is not subject to the Facility loan documents, the Manager can issue a capital call to the investors of the Fund and direct the proceeds of such capital call to an account other than the collateral account pledged to the Facility lender. This is often referred to as collateral leakage.

To help protect against collateral leakage, the Manager can be joined to the credit agreement as a credit party. The Manager would be treated similar to the GP. The Covenants and certain other relevant covenants and representations and warranties would apply to the Manager. The Manager would be subject to recourse in the event of any breach of its contractual obligations under the Facility loan documents or any fraud, willful misrepresentation or willful misappropriation of proceeds from the Facility. In addition to becoming a credit party to the credit agreement, the Manager would also pledge any rights that it has with respect to the collateral to the Facility lender. These are minor changes to the Facility loan documents that can serve to be highly protective of the Facility lender's interests without impacting the day-to-day business of the Manager and its wherewithal to manage the fund.

WSJ Tees Up Asset Manager Earnings

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The Wall Street Journal set the stage well for Q2 private funds manager earnings season with its “Buyout Firms Court Fresh Money” story published on July 19. While fundraising numbers took a beating in 1H 2022, the number of funds in the market and aggregate fundraising targets in the pipeline represents a remarkable increase over last year. The story touches on a number of key themes for the moment, including:

- Fundraising timelines are stretching longer after a period in which the time between successor funds had been shortened significantly.
- Between managers, a haves-and-have-nots story is playing out as LPs are rushing to commit to the flagship funds of top sponsors while taking a wait-and-see approach on the broader market.
- High net worth client growth strategies have taken on increased significance as one of the best ideas in long-term AUM growth.
- Return of capital to investors has slowed, which could weigh on future fundraising.

Read the *WSJ* story **here**. *(Also appeared in the July 19, 2022, print edition with the above title.)* Let us know what you think **here**.

Asset Manager Earnings Should Provide a Timely Fundraising Check-In

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Earnings season for alternative asset managers is underway and should provide a window into the private market outlook for the second half. Earnings, of course, shine the spotlight on the large diversified platforms, a group that generally proves more resilient to challenging market conditions.

The first data point came in yesterday when Blackstone reported Q2 fundraising, deployment, and realization totals that defied the broader industry slowdown. AUM posted a meaningful gain. The capital raising numbers underscored an industry trend in which the largest asset managers are able to attract a greater share of capital. Coming into July, nine funds were in the market with fundraising targets $20 billion or more.

For fund finance lenders, the fundraising, deployment and realization numbers are the most significant inputs in forecasting long-term borrowing demand, and the publicly traded private asset managers are likely to continue outperforming the broad market on these metrics, although some moderation is possible. Stock jockeys have turned their attention to investment performance numbers, which are showing signs of a challenging environment. If sustained, weak performance could potentially slow capital allocations to private strategies in the long term, but this risk needs to be assessed relative to public market performance. Also, in evaluating the quarter’s investment performance numbers, compared with their equity market counterparts, fund finance lenders will be much more in tune with how much significance to attach to a single quarter out of the approximate 40 quarters that make up a typical closed-end fund life.

The FFF Primer Navigator: New and Improved

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New to fund finance or know someone who is? Here's an updated guide to primers we've previously published in *Fund Finance Friday*.

Capital Commitments, LPA Terms, and Related Investor Considerations

A Waiting Game…
Annual limits on capital calls in the LPA.

Cross-Referenced Debt Limits
LPA leverage limits that may be revised by advisory committee consent.

Not All Commitments Are Treated Equal
Investor commitments structured as both a loan commitment and equity commitment.

(Over) Call Me, Maybe
Types of overcall limits and their prevalence.

LP Sanctions Risk in Fund Finance: Issues for Lenders to Consider
Issues that arise once an LP has been identified as subject to sanctions.

European Financing Structures Involving UHNWIs and Family Offices
An overview of financing ultra-high net worth individual private fund interests in Europe.

Renewals: Commitment Period and Key Person Event Considerations
Reviewing commitment period and key person event capital call limitations at facility renewal.

Side Letters

Side Letters: A Round-Up of Common Issues for Lenders
Common side letter terms most relevant to subscription lenders.

Declaration of Sovereign Immunity: Navigating Side Letter Provisions
An overview of most favored nation, sovereign immunity and cease funding rights in side letters and their implications for subscription facilities.

Immunity Unlikely
Sovereign immunity and related concepts.

Political Contributions Cease Funding Rights
Cease funding rights tied to political contributions by a fund or its affiliated personnel.

Credit Agreement Concepts

It's My Equity, and I'll Pledge If I Want To
The exclusion event related to an investor encumbering its equity interest in a fund.

Concentration-Linked Overcall Limitations
Applying a use-of-proceeds limitation to address an investment concentration-linked overcall limit in the LPA.

Letters of Credit – An Increasingly Popular Tool?
Letters of credit in the subscription facility context.

Cash Collateralizing Letters of Credit
The interplay between outstanding letters of credit and credit facility repayment at maturity.

Call Me MAE-Be?
Material adverse effect clauses.

Whose Cash Is It Anyway?
Negotiating the available sources of payment available to service certain required payments by the borrower.

You're Out!
Lender replacement provisions in the credit agreement.

The Involuntary Bankruptcy Exclusion Event
Lender exposure related to an investor's involuntary bankruptcy during the typical cure period.

The Intersection of Overcall Limitations and the Investor Default EOD Trigger
The interrelationship between the cumulative default EOD and a fund's percentage overcall limit.

April Showers Bring … Umbrella Facilities?
Considerations in structuring umbrella facilities.

Umbrella Academy: A Guide to Umbrella Facilities in Fund Finance
An update on applying an umbrella structure in various contexts.

Top 10 Items to Consider When Structuring Your ESG Facility
A top-10 list of structuring considerations for ESG facilities.

SONIA: A Primer
Differences between SONIA and SOFR, plus key terms for loan documents.

Syndication Considerations: Elements, Issues and Hot Topics for Bringing New Lenders into Deals
Borrower and motivations for syndication and a summary of how a loan is syndicated by amendment or joinder.

Minority Lender Considerations
Balancing alignment of interest and control terms for minority lenders in syndicated loans with a cornerstone lender or lenders.

NAV Covenants and Subscription Lines
Making use of NAV covenants in subscription lines when unfunded capital commitments have been largely drawn down.

Intercreditor Arrangements in Fund Finance Transactions
An introduction to taking a second lien on collateral (or consenting to a second lien on collateral) by using an intercreditor agreement.

Fast Cash: Swingline Loans in Fund Finance
A review of how swingline loans are incorporated into a revolving credit facility.

Blockers and Tackling
Constituent document and collateral structure considerations related to blockers.

NAV Facilities

Structuring Security for NAV Loans
Security for NAV loans and related concepts in the lender's disposition of collateral.

Considerations for Post-IPO NAV Financing
Considerations specific to post-IPO shares pledged as collateral.

Blurred Lines
NAV facilities to primary funds.

An Introduction to Secondaries
The private equity secondaries market.

Considerations in NAV Transactions When Collateral Includes Transfer-Restricted Assets
Dealing with transfer restricted assets in structuring NAV financings.

'NAV'igating Cayman Share Security – Lender FAQs
A question-and-answer overview of Cayman pledges of shares.

'NAV'igating Cayman LP Interest Security – Lender FAQs
A question-and-answer overview of taking security over Cayman LP interests.

Asset Valuation Issues for NAV Loans
Focusing on how private company and private fund interests are typically valued in NAV loan facilities.

Other Borrower and Transaction Structures

Top Considerations for Structuring an SMA
Key considerations in lending to an SMA.

One Is the Loneliest Number
Unique issues lenders face in lending to SMAs.

Key Issues for Loans to '40 Act Funds
Common issues that are addressed in loan documentation when the borrower is a registered investment company.

Get To Know Your BDCs
BDC basics and subscription facility considerations.

A Closer Look at Management Fee Facilities
Management fee line collateral, due diligence, credit support and common terms.

Getting Personal — Lending to Fund Executives
Diligence and structuring points related to loans to fund executives in a European context.

Diligence Considerations for Fund Executive Facilities
Due diligence demands with respect to the executives and their rights to receive distributions in their capacity as LPs of the co-invest vehicle.

Diligence Considerations for GP Facilities
Due diligence requirements specific to GP facilities.

Financial Covenant Protection in GP Facilities
Structuring of financial covenants in the context of GP facilities in Europe.

Lending to Venture Capital Funds
Points to keep in mind when structuring credit facilities with venture capital funds.

Open-Ended Funds: A Few SCF Considerations
Distinguishing factors of open-ended funds.

Preferred Equity — The Best of Both Worlds?
Preferred equity, particularly with regard to secondary investors.

ESG Facilities

ESG-Linked Fund Finance: Distinctions From Typical Subscription Facilities and Trends in Adoption (Part One of Two)
Tracing the path of the ESG fund financing market from inception to the current framework for pricing and performance measurement.

ESG-Linked Fund Finance: Two Most Prevalent Structures and Challenges With Use (Part Two of Two)
Understanding and implementing either a use-of-proceeds or a performance-based ESG structure.

Top 10 Items to Consider When Structuring Your ESG Facility
Addressing the credit facility terms that are most relevant in the ESG facility context.

The ABCs of ESG
A summary of the fundamentals of ESG fund finance.

Other Transaction Documents

Payoff Letters – Routine until Rocky
Fundamental legal principles underlying the use of and the market practice of payoff letters.

Investor Letters: Key Provisions
Investor Letters continue as a credit support tool for certain types of facilities.

Get Well, Keep Well
Credit enhancement through guaranties, equity commitment letters and keepwell agreements.

Equity Commitment Letters under English Law: Beware of the Pitfalls!
Key aspects of equity commitment letters and implications for lenders.

It Is OK to Be Noteless
The motivations for requesting a note, considerations that follow, and the alternative of going "noteless."

Other General Topics

Ten Things Every Fund Finance Banker Should Know About the UCC
UCC building blocks relevant to fund finance.

ERISA in Fund Finance
An overview of ERISA and related concepts in fund finance.

A Brief Primer on Cayman Security
An introduction to capital call security interests in the Cayman Islands.

Walkers Podcast on FFA European Symposium

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Walkers this week broadcasted a podcast as part of its “We Talk Banking and Finance Series” hosted by Julia Keppe and Alice Wight on the Fund Finance Association’s European Symposium. To listen, click **here**.

Fund Finance Hiring

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Fund Finance Hiring

NLC, an independent alternative Fund Finance lender, is looking to add a Senior Associate or a VP to its team. If you're a highly motivated and entrepreneurial professional interested in being part of the firm that's looking to shape the future of the fund finance market, **send** a few words on why you're interested in the role and how you'd make a good fit.

Pacific Western Bank is looking for a Vice President to join its Fund Finance Group in the Boston office. If interested, please contact **Chuck Tedeschi** and **Scott Wolfgang**.