Please Don’t Ignore My (Over)call

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Overcall limitations limit a non-defaulting investor’s obligation to make up for any shortfall in funding caused by other investors defaulting. In the absence of such a limitation, each “non-defaulting” investor would be liable for up to the whole balance of its commitment to make good any such shortfall. Overcall limitations have become increasingly commonplace in fund documentation as investors often want to limit their obligation to compensate for any shortfall in funding caused by a default by a fellow investor.

Lenders need to be aware of the extent of and application of overcall restrictions set in the relevant fund documentation. Such limitations will usually appear in the Limited Partnership Agreement or equivalent partnership document (in which case they will apply to all investor commitments), but they can sometimes apply specifically to individual investors (in which case the limitations will usually be set out in side letters).

Typical limits on the commitments required to be made by an investor to make good a shortfall are set at 20%/30% of the existing commitment already called for the relevant investment or other payment. In some circumstances, overcall limits may be set much lower (or even at zero) for particular items (*e.g.*, management fees).

So what impact does this have on Lenders? Lenders need to consider the correlation between the overcall limitations and the investor base and concentration levels. A Lender can then adequately assess the level at which defaults by investors holding a certain percentage of commitments in conjunction with the overcall limitation would result in the likelihood that there would no longer be sufficient investor commitments to repay a loan (“Default Point”). Lenders should then ensure that the relevant facility agreement contains a mandatory prepayment event or an event of default that would be triggered if investors with commitments just short of the Default Point become defaulting or excused partners, or transfer their commitments to ensure that there is never a scenario where there are insufficient investor commitments to repay outstanding loans.

In addition, Lenders should ensure that the event of default, mandatory prepayment event or transfer threshold should not be limited to "included" or any other group of investors (in the case of a facility that is calculated on the basis of a borrowing base) but rather should include all investors. This is important as the relevant Limited Partnership Agreement will be applicable to the entire investor base and, in case of an enforcement or even a drawdown by a fund to repay a loan, the requirement to treat all investors equally will require that payment is sought from each investor pro rata to their level of commitment.

Where overcall limitations are set at zero (as is increasingly the case for Management Fee payments, for example), Lenders will need to consider carefully how and to what extent they can minimise the impact of this on any loan terms.

We expect that overcall limitations in general and differing levels of limitation for different items of a Fund’s expenditure will become more ubiquitous in Fund documentation. Therefore, the market should be prepared to amend facility documentation so as to ensure that a Lender doesn’t find itself in a situation that (despite a fund having plenty of uncalled investor commitments) by operation of an overcall limitation there would not in fact be sufficient investor commitments available to repay indebtedness owed under a facility.

BIS Research Provides Further Perspective on LIBOR Replacement

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By **Chris van Heerden**
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The Bank of International Settlements (BIS) this week published a **notable report** on LIBOR replacement. No one can be blamed at this stage for fatigue on the topic, but the BIS report is nonetheless worth a read.

Here's why: The authors show that while a secured transactions-based replacement rate should provide a robust and accurate representation of overnight interest rates, such a rate would largely be untethered from bank funding costs. This rate would be tied instead, at least in part, to the demand-and-supply dynamics of collateral in the repo market.

These points may already be understood, at least in principle. What's helpful in the BIS report are the illustrations of what these traits mean in practice. The authors approximate an estimated SOFR pricing series for the financial crisis era and find that the scarcity of repo collateral during this flight-to-safety period drove overnight repo rates down and, therefore, resulted in a SOFR of at or close to zero precisely during periods when bank funding costs and LIBOR spiked.

More recently, repo market dynamics again drove SOFR pricing when the General Collateral Finance repo rate spiked on December 31, 2018, and SOFR followed higher by more than 50 bps. Quarter-end positioning at banks and a heavy Treasury issuance calendar explained the move up.

Both episodes provide thought-provoking points comparing SOFR and LIBOR. Compared to LIBOR, SOFR removes the credit-pricing component linked to bank wholesale funding costs, and, as a trade-off for referencing a broad set of actual transactions, follows the demand-and-supply dynamics in the repo market.

Fund Finance 2019 Published

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Global Legal Group this week published the third edition of *Fund Finance 2019*, widely referred to in the market as the "Pink Book." The treatise includes 21 product-oriented chapters submitted by the most prominent law firms in fund finance, covering virtually every aspect of the market. It also includes jurisdictional updates for 22 countries, a helpful resource for brushing up on a new jurisdiction or selecting local counsel. Mike Mascia of Cadwalader is again the contributing editor. The treatise can be downloaded **here** and hard copies will be available at the Fund Finance Association's Global Symposium later in the month (use Code GLIFF2019).

Cadwalader Cocktail Event in Miami

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Cadwalader is hosting a cocktail reception at the 9th Annual Global Fund Finance Symposium in Miami. The event is scheduled for 8:00 p.m. (following the FFA's welcome reception) and will be located at Scarpetta within the Fontainebleau Hotel. Significant others may join. To register, click **here**.

Brookfield—Oaktree Tie-Up Creates Top Alternatives ManagerÂ

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Brookfield Asset Management Inc. on Wednesday agreed to buy a majority stake in Oaktree Capital LLC under a tie-up that would result in combined AUM of about $475 billion and create one of the largest alternative managers. Both firms are big consumers of fund finance. The acquisition is structured to preserve the firms’ individual identities—each will continue to be run separately—while capturing the synergies of a combined platform. Data in recent years point to a fundraising advantage for megafunds.

James Rock-Perring joins Intertrust

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James Rock-Perring has joined Intertrust to establish a new fund finance advisory business. James and his team will act as independent advisors to help funds navigate through the process of establishing fund finance facilities or debt lines. Their expertise can add significant value through a fund's lifecycle, having a full overview and understanding of the lender market as well as the wide range of lending structures available across the fund finance spectrum.

James has over 20 years of banking experience within private markets, spanning the areas of fund finance, leveraged finance and sponsor coverage. His most recent position was in the fund finance team at Lloyds Banking Group. James will be in good company at Intertrust as he joins Cliff Pearce, Head of Capital Markets, previously responsible for fund finance in Europe at Bank of America Merrill Lynch, and Andrea Williams, Managing Director, London, formerly responsible for European real estate fund finance facilities at Blackstone.

PERE Article on GFC-style Leverage Use

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PERE published an article on March 7, titled “Warning bells sounded over GFC-style leverage use.” The article discusses Asia private real estate managers using strategies predicated on leverage levels reaching 90 percent loan to value. The article mentions the use of subscription lines, which it lumps in with real estate mezzanine debt. The full *PERE* article is available **here**.