Equity Commitment Letters – A Refresher

May 10, 2024

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We have recently seen a notable uptick in the usage of equity commitment letters (ECLs) in fund finance transactions and have been spending an increasing amount of time discussing their merits with our clients' credit teams. So, even though *Fund Finance Friday* has done overviews of various types of credit support in the past (see links at the end of article), we thought it was time for a refresh on ECLs, how they are deployed in fund finance transactions and what lenders should look for when relying on them as credit support.

What Is an ECL

An ECL in the fund finance landscape is typically structured as a commitment by a parent fund to contribute capital in favor of a subsidiary that is an obligor under the relevant financing transaction. Similar in purpose to a guaranty, an ECL is a type of credit support that lenders in fund finance transactions may rely on to add another source for repayment of their loans (*i.e.*, by providing a lender with indirect access to the ECL provider's balance sheet). However, unlike a guaranty where the lenders are a direct beneficiary of the guarantor's obligations, an ECL is an agreement by the parent that only directly runs in favor of the subsidiary obligor as the direct recipient of the parent's commitment. Thus, ECLs are used to bolster the subsidiary obligor's credit and liquidity profile to demonstrate to a lender that it has additional assets available to meet its obligations in connection with the credit facility.

Below are a couple of common examples of use cases for ECLs in fund finance transactions.

1. *Subscription Facilities* – ECLs may be used in single (or concentrated) investor subscription facilities where a parent fund provides support to a thinly capitalized holding vehicle that is an investor in the fund. The purpose of the ECL is to persuade a lender to underwrite the LP's uncalled capital commitment to the fund notwithstanding that it is thinly capitalized given the availability of the parent's funding commitments under the ECL.
2. *NAV Facilities* – In fund finance, we most frequently see ECLs employed in NAV facilities. An ECL may be provided by a creditworthy parent fund to support a subsidiary holding company that is the borrower under the relevant facility. Where the borrower in such a facility may only hold a relatively concentrated portfolio of investments (*g.*, equity interests in a small number of portfolio companies), the ECL in this context may be necessary to reduce the risk profile of the facility either to (a) entice a lender to enter into the facility in the first place or (b) allow the borrower to obtain financing at a more attractive interest rate than would typically otherwise be available for a NAV facility underwritten against such a concentrated portfolio.

Why Use an ECL

ECLs serve as useful tools where a parent fund is unwilling to assume a primary obligation in respect of a particular transaction (*i.e.*, unwilling to assume a direct debt or guaranty obligation). We see this particularly with funds in jurisdictions where the incurrence of a financing at the fund level may result in adverse tax consequences for the fund (and/or its investors) and where the fund has reached its borrowing/guarantee limits in its fund documentation. Nonetheless, with proper structuring and documentation, an ECL can both address the fund's particular legal/tax/indebtedness requirements and provide additional recourse for a lender relying on the ECL for credit support.

Factors to Consider When Structuring an ECL

There are a number of considerations that lenders should be mindful of when negotiating ECLs in order to make sure that (i) the obligations of the ECL provider are clearly defined, (ii) the lender is able to monitor the ECL provider's credit profile and (iii) the lender is able to exercise remedies directly against the ECL provider in a default scenario.

Defining the Commitment. ECLs should be carefully drafted to quantify the amount of the ECL provider's funding commitment. In the subscription finance example above, this quantum would typically be tied to the amount of the beneficiary's unfunded capital commitment to the borrower/fund that is pledging the beneficiary's uncalled capital commitment. In contrast, in the NAV scenario described above, the amount of the ECL provider's funding commitment would likely be tied directly to the loan obligations (or a portion thereof).

Parent Creditworthiness. Lenders should also consider what requirements or covenants should be included in the loan documentation with respect to the ECL provider. Examples of these may include minimum net asset value and/or liquidity tests and various exclusion criteria for certain credit events pertaining to the ECL provider (*e.g.*, material judgments, insolvency proceedings, default on other indebtedness, etc.). The loan documents should similarly include reporting and disclosure requirements so a lender can directly monitor the ECL provider's creditworthiness and compliance with these provisions.

Lender Protections. To provide comfort that ECLs can be reliably called to pay lenders, and to address the risk that an ECL provider may try to avoid funding its commitments via the ECL in a default scenario, lenders should structure ECLs to include the following protections:

1. *Equity not debt* – specifying that the ECL provider's funding commitment is an equity obligation (*e.*, and not debt a commitment);

2. *Irrevocable and lender consent* – specifying that such equity commitments are irrevocable and any amendments to the ECL require lender consent;

3. *Waiver of defenses* – requiring the ECL provider to waive all defenses (including bankruptcy defenses) and all rights of set-off and counterclaims in connection with its funding obligations;

4. *Third-party beneficiaries* – making lenders third-party beneficiaries of the ECL;

5. *Reliance* **–** an acknowledgment of the lender's reliance on the parent's funding obligations under the ECL; and

6. *Pledge* **–** explicitly allowing assignment of the beneficiary's rights to enforce the ECL against the ECL provider to the lender.

These protections should be very familiar to much (if not all) of the fund finance community, as they essentially mirror the protections a lender would expect to see in the LPA of a fund pledging the unfunded capital commitments of its investors associated with a typical subscription credit facility collateral package. While there is little case law in the U.S. pertaining to the enforceability of ECLs specifically, investor equity commitments (whether contained in a limited partnership agreement or in an ECL) are assets of a fund, and the obligations thereunder have long been relied upon by lenders as a primary source of repayment from fund obligors.

Conclusion

As private markets continue to evolve and the fund finance industry along with it, we expect the prevalence of tailored fund finance facilities will continue to grow in order to work with different fund structures and meet specific sponsor demands. Given this trend, the recent uptick in ECL deployment and conversations shouldn't be surprising, as ECLs are a useful tool that allow sponsors and lenders flexibility to solve for a number of issues. Industry participants should get used to seeing these agreements (if they are not already) as it seems like they are here to stay.

Further Reading

See below for other *Fund Finance Friday* articles focused on different types of credit support in fund finance transactions:

1. **Can I Get Some (Credit) Support?**

2. **Upstream and Affiliate Guaranties in NAV Loans**

3. **Get Well, Keep Well**

4. **Equity Commitment Letters Under English Law: Beware of the Pitfalls!**

FFA European Fund Finance Symposium Review – Key Themes

May 10, 2024

By **George Pelling**
Partner | Fund Finance

Last week saw almost 1,140 registrants attend the FFA's annual symposium at the Queen Elizabeth II Conference Centre in London. As ever, the event brought together a wide range of market participants from across the industry, providing a unique opportunity to network and learn more about the many exciting developments taking place in fund finance.

The panels at this year's event covered a diverse range of topics including (but not limited to) NAV, securitisation, ratings, CRTs, secondaries as well as the growth of credit funds in the market. The variety of speakers at this year's event reflect how much the fund finance market has grown and matured in recent years. We heard from bankers, sponsors and lawyers but also ratings agencies, insurers, credit funds, administrators and advisors (including our very own Head of European GP Solutions, Mike Hubbard!)

The Cadwalader London team has set out below some of the key themes arising from the panel discussions . . .

Challenges

Attendees at this year's conference will know that it has been a challenging period for the industry. Macroeconomic events have had a big impact on fundraising, with the war in Ukraine exacerbating pre-existing inflationary pressures across European and US economies, and central banks raising interest rates in an effort to tame inflation. Against these economic headwinds, GPs face a slowdown in fundraising, a sub-optimal exit environment for investments and increased LP demand for liquidity. Adding fuel to the fire, and at a time when GPs need liquidity more than ever, fund finance products are under the microscope, facing increased scrutiny from regulators, the press and investors alike.

Despite the challenges, the mood in the conference remained upbeat, with panellists generally taking the view that our collaborative and innovative industry will continue to grow and provide solutions.

Regulation

The implementation of Basel 3.1 (commonly referred to as Basel IV or, more ominously, Basel 3 Endgame) next year will have a significant impact on the amount of capital banks are required to hold, predominantly as a result of certain lenders being required to adopt standardised methodologies for the purpose of calculating risk-weighted assets (RWAs) as opposed to using an internal rating based approach. For many lenders, finding solutions to improve their capital treatment will play an essential part of adjusting to the new regulatory landscape and ensuring they have sufficient capacity to meet client funding needs. What those solutions might look like is still very much up for debate; with securitisation structures, rated facilities and capital relief trades (CRTs) all being mooted as possible ways forward (something discussed in detail on the Securitisation, Risk Transfer and Ratings panel). A lack of consistency across institutions in terms of focus on this area and how the rules are interpreted was also noted as a possible roadblock in what is a highly syndicated market. Panellists were also clear on the need for greater dialogue between lenders and the regulators, particularly in response to the letter recently issued by the Prudential Regulation Authority outlining its findings following its 'thematic review of private equity related financing activities'.

Consolidation, relationships and liquidity concerns

Anxieties around liquidity constraints were echoed across panels, with many noting that balance sheets were at risk of drying up quickly in a brave new world of "mega funds" – particularly if fundraising starts to pick up again. Indeed, some were quick to point out that subdued fundraising in 2023/2024 may have even protected some GPs and Lenders from more substantive liquidity issues last year.

Liquidity concerns have forced GPs to focus on developing good relationships with a wider pool of lenders (both bank and non-bank) and to work with lenders on structures that look to unlock institutional capital. GPs are increasingly having to help lenders manage their own liquidity by tailoring their financing demands to what they actually need: speakers noted that this has resulted in smaller commitments being made available under facilities from day-1, with a more significant role for accordions as funds increase commitments through subsequent investor closings. Handling a fund's financing arrangements is no longer a part-time job, with many sponsors bringing in dedicated specialist teams to undertake the role.

The slower fundraising environment has also necessitated greater focus by GPs on high net worth individuals, open-ended structures (with liquidity windows) as well as the need to offer LPs co-investment and SMA opportunities. These structures are more challenging from a traditional fund finance perspective, but in light of their growing importance to GPs there was a significant emphasis on the need for Lenders and their counsel to find innovative solutions to financing these structures.

NAV Facilities

NAV facilities were a hot topic at this year's symposium. The increased use of these products across a range of asset classes illustrates what a versatile and useful source of liquidity they have become for GPs. Panellists were aligned in their view that NAV facilities are now widely considered an established financing tool for funds (much like subscription facilities) and that the use of these products will continue to grow.

Despite the cautious optimism, the use NAV facilities is not for everyone: as has been widely reported in the press, some LPs have raised concerns about the use of these facilities and, in particular, whether such loans might be used fund distributions in a way that erodes value for LPs. Whether panellists agreed with those concerns or not, consensus was reached around the importance of ILPA's impending guidance on the use of NAV loans. Participants expect the guidance to set out a shared set of expectations and recommendations for LPs and GPs around the use of NAV products and to place increased emphasis on education for LPs and transparency. Ultimately, speakers agreed that getting buy-in from LPs should be a prerequisite to putting in place a NAV line and that the ILPA guidance may go some way to alleviating investor concerns in this regard. It was also noted that concerns have been raised around the robustness of valuations and, for this reason, credit analysis of the underlying investments, alongside the negotiation of any eligibility criteria and concentration limits, remains a key area of focus and negotiation for lenders.

The increased presence of non-bank lenders in the fund finance market was widely discussed throughout the conference, particularly in the NAV space where term loan structures are more common (and can therefore attract institutional capital). Indeed, it was hard to find a panel that did not acknowlede the growth of credit funds and their growing influence of fund finance. Credit funds operate not only as lenders of NAV lines but also as borrowers, a topic explored further in the NAV lending to Credit Funds panel. The panel highlighted some of the unique aspects of these transactions (when compared to NAV loans to PE funds for example); in particular, that such transactions necessarily involve greater regulatory analysis on the basis they are invariably treated as securitisations. Panellists expect these kinds of financings to face increased regulatory scrutiny in the years ahead.

Secondaries

Discussions on secondaries transactions were – perhaps rather predictably – optimistic in outlook. In what has been a tough year for fundraising across almost all asset classes, secondaries funds have defied market trends and continued to raise investor capital at pace (albeit with much of that capital being raised by top sponsors via so called "mega funds"). GP-led secondaries have increased in volume as a result of a lack of exit opportunities in a high interest rate environment and this has resulted in the increased use of continuation vehicles ("CVs") by GPs.

Panellists reflected that the growth of CVs has created additional financing opportunities for lenders; with loans being provided to these vehicles via a range of financing products, from sublines, to hybrids, to NAV facilities. In light of possible concerns around concentrated LP bases and/or underlying asset portfolios of the newly formed funds, such financing are often structured so as to include some kind of hybrid security/covenant package.

Panellists discussed that perceptions of the use-case for CVs have shifted. What were once regarded as vehicles established for the purpose of housing the tail end of a fund's portfolio (or, so called, "zombie assets") are now seen in a much more favourable light: these are vehicles established to ensure that GPs can hold onto what are often their most prized assets. Assets which present great opportunity for future upside given current exit conditions.

It was also noted that there are various attractive aspects of these kinds of financings for lenders, not least the absence of any blind pool risk. Regardless of whether any security over the underlying assets is provided as part of the financing, lenders will be focused on the quality of the assets and the importance of ensuring they are properly and independently valued – particularly in light of the potential conflicts of interest that can arise in a GP led secondary. Whilst GPs are not necessarily incentivised to sell the asset for the highest price possible (on the basis it will want the value of the asset to continue to rise once acquired by the CV), they will need to ensure that the transaction is appropriately and properly managed so that interests of one group of investors (e.g. the selling investors) is not prioritised over those of another (e.g. the rolling investors). For this reason, secondary investors subscribing to a CV will often be happy to rely on latest NAV reported by the fund, knowing that the tyres have been kicked.

In their conclusions, speakers were generally upbeat about the future growth of the secondaries market and the related financing opportunities, particularly as assets are sold over the next 1-3 years and facilities are repaid.

Final Thoughts

A lot has changed in the world of fund finance in recent years and it feels like the industry is at point of inflection. Yes, there are challenges, but this year’s conference also emphasised the wealth of opportunities for growth and innovation in the sector. In our view, it could not be a more exciting time to be part of the conversation.

Celebrating Food Bank For New York City

May 10, 2024

By **Leah Edelboim**
Partner | Fund Finance

It was an honor to represent our Fund Finance team and join my Cadwalader colleagues this week at the 2024 Gotham Ball on behalf of Food Bank For New York City!

The event marked 41 years of service by Food Bank For New York City. Food Bank traces its history back to 1983 when the late Jack Fritts, our former Firm chairman, helped to incorporate Food Bank on a pro bono basis. Jack served on Food Bank's board for many years. In 2018, Food Bank dedicated its Bronx warehouse in his honor, naming the facility "The Jack Fritts Food Distribution Center."

Joining me at the Gotham Ball were fellow partners Bonnie Neuman, Ivan Loncar, Jamie Frazier and Lary Stromfeld.

Cadwalader's own Financial Services partner Lary Stromfeld is the Board's Executive Vice Chairman and founder of the Justice Served campaign in 2015, which annually brings together more than 20 New York law firms and law departments in a six-week effort that has funded more than five million meals for food-insecure New Yorkers.

As Food Bank reminded us at the event, one out of five New Yorkers experiences food insecurity … which means that four out of five New Yorkers are in a position to help their neighbors in some big or small way. This serves as a great reminder for me about all we can do -- within the Fund Finance industry and as individuals -- to give back to the community and to those who need our help.

DFF Soiree - Networking Evening for the Fund Finance Industry

May 10, 2024

Please join the US Diversity in Fund Finance Committee for the Boundary Breakers Speaker Series event!

The US Diversity committee is pleased to announce our next Boundary Breakers event. This DFF speaker series is aimed at fostering open conversations with senior leaders to give voice to unique issues and perspectives diverse professionals face, and how we can challenge ourselves to think outside established biases and stereotypes.

Committee of 100 is a non-profit, non-partisan membership organization of prominent Chinese Americans in business, government, academia, science, technology, and the arts. The organization was formed following the aftermath of Tiananmen Square. Renowned architect I.M. Pei assembled an exceptional group of Chinese Americans to address the critical issues impacting the Chinese community in America and help foster positive relations between the U.S. and Greater China. This group of luminaries — Yo-Yo Ma, I.M. Pei, Henry S. Tang, Oscar Tang, Chien Shiung Wu, and Shirley Young — became the first generation of Committee of 100 members. The name “Committee of 100” derives from a blend of inspirations of ‘We the People’ and an ancient Chinese idiom, 老百姓 (lao bai xing) to reflect both American values and Chinese culture.

Henry Tang, speaker, is a seasoned 30-year investment banking veteran of Wall Street having participated in and observed the global transformation of the capital markets. As a securities management executive, he has been engaged in global investment and banking activities in Europe, Asia and the U.S. for several of the largest Wall Street investment banks. Henry Tang’s business experiences have been enhanced by a broad participation in public and community activities. He has been active in many efforts to help bridge cultural and economic understanding between the China region and the U.S. and between Chinese Americans in the U.S. Henry helped found the Committee of 100, to help create a better understanding of American and Chinese cultural and economic events. Vicky Du, moderator, is the Global Head of Fund Finance at Standard Chartered, managing a globally integrated team responsible for providing financial sponsors with fund level financing solutions. Vicky has extensive knowledge and experience in Leveraged Finance, Structured Finance, and Capital Markets.

Please register and save the date for our next conversation, co-sponsored by Standard Chartered Bank and Haynes Boone, which will feature Henry Tang, Co-Founder of Committee of 100, and Vicky Du Global Head of Fund Finance at Standard Chartered Bank.

Event Details

Date: Wednesday, May 29th, 2024

Registration: 4:30 pm EST

Time: 5:00 pm EST

Location: Standard Chartered Bank, 37th Floor, 3 Bryant Park, New York, NY 10036

Speaker: Henry Tang, Committee of 100

Moderator: Vicky Du, Standard Chartered Bank

Refreshments will be provided. Networking reception to follow the discussion.

Registration is open on a first-come, first-served basis. If this event becomes oversubscribed, FFA reserves the right to limit the number of attendees from each firm, in order to allow for participation from as many of our supporting institutions as possible.

Register **here**.

Evolving Landscape of LP Financing in Asia: Trends, Challenges and Innovations

May 10, 2024

In a recent article from Mourant parnters **Danielle Roman** and **Simon Lawrenson** they explore recent trends, evolving structures, preferred financing instruments, and the impact of economic conditions on LP financing in Asia.Danielle is head of the firm's Asia **Banking and Finance** team, and Simon is the global co-practice leader for the firm’s **Corporate and Finance** team.

Financial challenges from volatile equity markets, a real estate crisis in China and high US$ interest rates have prompted transformations in the landscape of limited partner (LP) financing in Asia. High net worth (HNW) individuals are increasingly exploring ways to leverage existing assets, primarily driven by the need for liquidity, higher margins and a desire to proactively manage and diversify their portfolios amid lacklustre performances in the public markets. Fund managers, meanwhile, increasingly look for financing options to exploit opportunities in the secondaries market or fund their own contributions into continuation funds.

Read the article **here**.

Women in Fund Finance Ladies Poker Night

May 10, 2024

We had a great time attending the first Women in Fund Finance Ladies Poker Night at the Hearst Tower in New York City, cohosted by Fitch Ratings, Deloitte and WFF last week!

We loved the hands-on poker training and the time to network with friends and colleagues. Thanks to all those who joined.

Fund Finance Hiring

May 10, 2024

Fund Finance Hiring

Here is who's hiring in Fund Finance:

Banc of California is looking for a Senior Underwriter/Client Manager to join their Fund Finance team in New York. The VP-level position will be a key member of the Northeast practice and will be responsible for monitoring the quality of assigned borrowers and growing both new and existing relationships in the region. This is an ideal position for a commercial and/or fund finance banking analyst or associate with 3-5 years of experience now looking to take the next step and join a fast growing, dynamic and collaborative team. If you're interested in learning more, the full job description can be found **here** and feel free to reach out directing to **scott.wolfgang@bancofcal.com**, the hiring manager, if you have additional questions.

Apply online: **https://careers-bancofcalifornia.icims.com/jobs/3613/vp%2c-client-manager-fund-finance/job?mode=view**