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FUND FINANCE FRIDAY

Navigating the Grey Area

March 14, 2025

Table of Contents:

- Navigating the Grey Area: Financial Covenant Amendments and the Doctrine of Purview
- Irish Law Updates: Key Fund Finance Developments
- 9th Annual Girls in Finance Workshop
- CRT on CRE: Capital Relief Trades on Commercial Real Estate Loans
- Register Now: Cadwalader Capital Call Securitization Conference - April 3
- Fund Finance Hiring

Navigating the Grey Area: Financial Covenant Amendments and the Doctrine of Purview

March 14, 2025

By Bronwen Jones
Partner | Fund Finance

By Carla Pilcher
Associate | Fund Finance

The doctrine of purview under English law plays a critical role in determining whether amendments to a secured facility require reaffirmation or re-execution of guarantees and security. However, when it comes to adjustments in financial covenants, there is often a grey area which invites examination and nuance.

Two differing views emerge when considering whether tightening a financial covenant, by amending a NAV Ratio test, for example, triggers concerns under the doctrine of purview. One perspective argues that such changes do not materially alter the secured obligations and therefore should not necessitate new security arrangements. The opposing view suggests that these changes could introduce new risks, potentially meaning the existing security will not extend to the amended obligations unless reaffirmed.

Exploring both viewpoints not only sharpens our legal analysis but also anticipates pushback from stakeholders who may seek to challenge or defend the necessity of additional security.

Purview: The background

The starting point to remember for thinking about purview is that as a result of the case law evolution of the doctrine in the English courts, it is only applicable to guarantors and third-party security givers: it is not applicable to the security given by a borrower for its own borrowing liabilities. So a borrower's security should generally not be prejudiced by adverse amendments made during the life of the financing. But this is not the case for guarantors and third-party security providers, for whom the question is whether, when originally granting that guarantee or third-party security, they anticipated and agreed that a later amendment made to the finance documents would continue to be covered by that guarantee or security. If the answer is yes, that amendment is within the original "purview" and the original guarantee or original third-party security should continue to guarantee or secure the amended liabilities. If it was outside purview, and is adverse to the guarantor or security grantor, then the original guarantee or security may not cover the amended liability and a new guarantee or security will be required.

So the question really is what were the parties at the time of the original transaction expecting? There is, as yet, no case law directly on point for a complex, bespoke financing transaction such as a fund finance facility. So market practice has cautiously developed to agree that clearly anticipated changes, such as extension or increase mechanics included in a facility agreement as originally signed, are within purview, but material extensions or increases which are not originally included are outside purview. There is then a market acceptance that smaller unanticipated amendments are probably within purview as part of a reasonable expectation that details of the financing may need to change over the life of that financing. And this is where the question comes in of how financial covenant amendments fit in to the purview analysis.

View one: The case for no material change

The first perspective contends that tightening a financial covenant does not, in itself, create new secured obligations. Instead, it merely adjusts the framework for assessing compliance with existing obligations. Key arguments include:

1. No new indebtedness: A financial covenant is a monitoring tool, not a direct financial obligation. Unlike increasing loan principal or introducing new debt instruments, adjusting a financial covenant does not impose additional financial burdens on the borrower (and by extension on a guarantor or third-party security provider) beyond what was originally contemplated.
2. Security scope remains unchanged: Security documents typically define "Secured Liabilities" broadly to cover all obligations under the finance documents. Unless the security explicitly references a specific covenant threshold, modifying the covenant does not alter the fundamental nature of the obligations secured.

3. Market practice often supports flexibility: In practice, lenders frequently amend financial covenants without requiring new security. If every such adjustment triggered a need for security reaffirmation, the administrative burden would be significant, disrupting market efficiency and increasing transaction costs.
4. Enforcement rights vs. fundamental obligations: While tightening a financial covenant may increase the likelihood of a breach (and thus the lender's ability to enforce the security), the underlying secured obligation—the repayment of principal and interest—remains the same. Since enforcement is tied to default rather than the covenant itself, the change does not necessarily affect the validity of the security.

In this view, the doctrine of purview should not be engaged because the amendment does not introduce new obligations; it merely shifts the conditions under which the borrower remains in compliance.

View two: The risk of purview issues and security erosion

The opposing argument is more cautious, asserting that tightening a financial covenant—particularly an amendment to a key financial ratio—could create risks under the doctrine of purview. The reasoning here is that such an amendment could be viewed as a material adverse change that potentially renders the existing security ineffective in relation to the changes.

1. The amendment creates a more stringent obligation: By changing, for example, an LTV (loan-to-value) ratio to make it a lower percentage, the borrower's ability to comply with the test is directly and adversely affected, which in turn means there is a higher likelihood of the guarantees being called on or the third-party security enforced.
2. Potential for a court to challenge security validity: In an insolvency scenario, a liquidator or third-party creditor may argue that the security does not validly cover the amended obligations. As a result, a court may find that the amendment significantly increases or alters the borrower's liabilities under the finance documents and consequently, the existing third-party security may be deemed ineffective in securing the amended loan.
3. Conservative approach: mitigating legal and enforcement risk: Given these potential risks, the more cautious and market-prevalent approach is to obtain a guarantee and security confirmation from relevant third-party security providers and guarantors for any adverse amendments that were not clearly anticipated in the original finance documents and to retake the relevant transaction security. This should ensure that the amended obligations remain unquestionably within the scope of secured liabilities.
4. Judicial uncertainty and precedent: While there is no absolute precedent confirming that financial covenant adjustments inherently trigger purview concerns, the doctrine remains open to judicial interpretation. Given this uncertainty, lenders and legal advisors may prefer a proactive stance to avoid any argument that security has been compromised.

Ultimately, the determination of whether a financial covenant amendment triggers purview concerns depends on a case-by-case analysis, factoring in the nature of the amendment, the drafting of security documents, and market expectations. As outlined above, the considerations are not as simple as whether the changes affect only core obligations such as increasing the amount of secured debt, but turn on the original expectations of the parties at the time they entered into the deal, including, under the original terms, the likelihood of the guarantees and third-party security being called upon.

While lenders may prefer efficiency and flexibility, courts may scrutinize amendments more rigidly in distressed scenarios. Given this, legal practitioners often default to a cautious approach: if there is any reasonable risk that a financial covenant amendment could impact the security enforceability, reaffirmation and retaking of the security is the safest route.

The debate, however, remains open-ended. In the absence of definitive judicial guidance, the grey area persists—ensuring that legal minds will continue to navigate this issue with curiosity and caution.

Irish Law Updates: Key Fund Finance Developments

March 14, 2025

Just in time for St. Patrick's Day, recent updates in Irish law bring important changes for fund finance participants. Lawyers at Arthur Cox and Mason Hayes & Curran have provided insights on key regulatory and structuring developments that could impact market practices.

Arthur Cox recently published an article, "Irish Central Bank Update: Third Party Guarantees and Cascading Security," summarizing the Central Bank of Ireland's new guidance on third-party guarantees and cascading security under the AIF Rulebook. Read more **here**.

Mason Hayes & Curran has published their fourth installment of *Irish Fund Finance in Five* where they explore key provisions in investor subscription documents and their impact on subscription line facilities. Despite growing interest in NAV-based and hybrid financing, subscription line facilities remain the dominant form of fund finance involving Irish fund vehicles. They highlight critical due diligence considerations for lenders, including security considerations, capital call mechanics, set-off risks and side letters. Read more **here**.

In a separate article, Mason Hayes & Curran partners discuss the recent relaxation of third-party guarantee restrictions for Irish funds. The Central Bank of Ireland's new guidance clarifies that QIAIFs may now provide guarantees under specific conditions, enhancing Ireland's appeal as a jurisdiction for private funds and fund finance transactions.

Read the full article below:

Substantial Relaxation of Third Party Guarantee Restriction Applicable to Irish Funds

Conor Lynch

Partner - Mason Hayes & Curran

Anthony O'Hanlon

Partner - Mason Hayes & Curran

Clarifications from recent helpful guidance by the Central Bank of Ireland is extremely welcome, and signals the removal of the restriction on guarantees applicable to Irish AIFs provided certain conditions are satisfied. Over time, Ireland has proven itself to be a convenient jurisdiction in which to conduct fund finance transactions. With its English-speaking population and its common law legal system, market participants based from other jurisdictions, such as the UK and the US, often find transactions involving an Irish nexus to be convenient and familiar. However, the interpretation of the restriction on third party guarantees had proven itself to be problematic in certain fund finance transactions. The removal of this restriction on third party guarantees further bolsters the attractiveness of Ireland as a jurisdiction of choice for private funds (as well as prospective lenders considering transactions with such vehicles).

On 7 March 2025, Central Bank of Ireland (the "**Central Bank**") released a revised version of its **AIFMD Questions and Answers document** (the "**Revised Q&A**"). This welcome guidance from the Central Bank pursuant to the Revised Q&A has been issued in advance of an expected upcoming consultation process in relation to updates to the AIF Rulebook.

The Central Bank is expected to commence a consultation process on proposed updates to its AIF Rulebook shortly, in preparation for the implementation of AIFMD II by the April 2026 European deadline.

By way of background, the Central Bank's AIF Rulebook prohibits Irish qualifying investor alternative investment fund ("**QIAIFs**") from granting loans or acting as a guarantor on behalf of a third party. This prohibition has been interpreted very widely since its inception and construed as a complete prohibition of the giving of guarantees by a QIAIF in respect of any obligations of any other party (other than wholly owned subsidiaries). This prohibition had previously proved problematic in Irish fund financing transactions where it was expected that an upstream or other entity within the structure would guarantee the borrowing of another entity within the structure.

This prohibition regularly arises in the context of subscription line facilities where the QIAIF is a feeder fund (and not the underlying borrower). In those circumstances, a workaround has been available whereby a "cascading security" arrangement is implemented. Some readers may be familiar with this approach in non-Irish structures, for example in the context of restrictions on granting security under ERISA. An example of a "cascading security" arrangement is as follows:

- The non-borrowing feeder fund granting a charge and security assignment in favour of the master fund over both (i) the feeder fund's uncalled commitments from its investors and (ii) the bank accounts which those capital calls are to be paid into (the "**Feeder Security Document**"), as security for its obligation to fund capital commitments to the master fund; and
- The master fund in turn granting a charge and security assignment in favour of the lender over (i) its uncalled commitments from the feeder fund (and any other investors), (ii) the bank accounts which those capital calls are paid into and (iii) its rights under the Feeder Security Document, as security for its borrowings from the lender.

Where a cascading security structure such as this is implemented, the lender can enforce directly against the feeder fund. This is done by enforcing the security granted by the master fund under the Feeder Security Document.

Irish QIAFs acting as guarantors

In a significant development, the Central Bank has clarified that QIAIFs may provide a guarantee in respect of investments and/or intermediate vehicles for such investments in which that QIAIF has a direct or indirect economic interest provided:

1. such arrangements are determined by the QIAIFs alternative investment fund manager (the "**AIFM**") to be in the best interests of both the QIAIF and its investors and are ancillary to the QIAIF's predominant investment strategy;
2. the AIFM (or in the case of a non-Irish AIFM or registered AIFM, the authorised QIAIF) and the QIAIF's depositary confirm that the proposed transaction is at arm's length and in the best interest of investors;
3. the prospectus discloses to investors that the QIAIF can provide a guarantee in respect of investments and/or intermediate vehicles for such investments in which the QIAIF has a direct or indirect economic interest, along with any associated material risks;
4. the liability of investors in the QIAIF under such arrangements (above the value of their current holdings of shares or other interests in the QIAIF) shall be limited to the amount, if any, unpaid on the shares or other interests held by them which shall include, in the case of a QIAIF that raises capital under a formally agreed capital commitment basis, the amount of the undrawn capital commitments in accordance with the prospectus and the constitutional document of the QIAIF;
5. the Qualifying Investor AIF complies with provisions of Central Bank ID 1159 of a previous version of the Q&A[1]; and
6. the AIFM must comply with the relevant requirements under AIFMD as applicable in relation to leverage and its risk management, including regularly conducting stress tests in accordance with Article 48 and other applicable requirements of AIFMD which shall cover market risks and any resulting impact, including on margin calls, collateral requirements and credit lines.

Key takeaways

This development is certainly welcome and is a positive indicator of the Central Bank's commitment to further enhancing and streamlining Ireland's private funds offering. However, as readers will note there are still a number of factors above which market participants need to be aware of prior to any QIAIF giving a guarantee. Ultimately, each transaction will need to be reviewed on a case-by-case basis to ensure it is appropriate for the guarantee to be given in the circumstances. Where there is any uncertainty, implementing a cascading security structure will continue to be a neat solution where possible in the transaction structure.

ID 1159 provides as follows:

1. I am a QIAIF/RIAIF that intends to invest through a co-investment vehicle that includes other third party investors and is not a wholly owned subsidiary of the QIAIF / RIAIF. Is that permissible?
2. Yes. The ownership / control of the co-investment vehicle must reflect the actual economic interest that the QIAIF/ RIAIF has in that vehicle and the QIAIF / RIAIF must demonstrate that such arrangements reflect the true economic interests of the parties holding shares in that vehicle. The reasons for use of a co-investment vehicle, rather than a wholly owned subsidiary, must be documented by the Board of the AIFM and approved by the depositary in writing and be available to the Central Bank on request. The arrangement should not be structured in such a way as to circumvent the policy objectives of this QA

9th Annual Girls in Finance Workshop

March 14, 2025

As part of our Women's History Month and International Women's Day Celebrations, Cadwalader's Women's Leadership Initiative hosted its 9th Annual Girls in Finance Workshop in our New York and London offices.

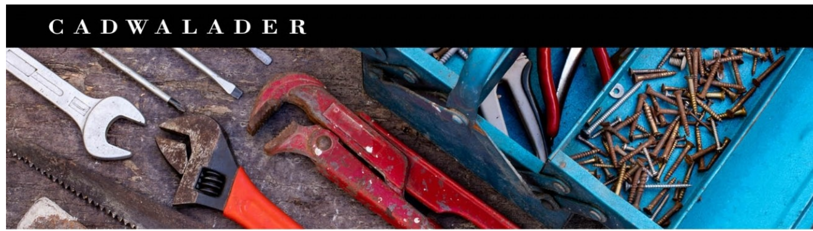
Participants in both cities learned from a fantastic group of finance professionals (business and law) who volunteered to share their insights and experiences.

The Girls in Finance Workshop encourages high school girls to pursue careers in the finance sector by exposing them to elementary finance lessons and introducing them to successful women who have chosen that career path.

Thank you to the panelists who made the program such a success!

CRT on CRE: Capital Relief Trades on Commercial Real Estate Loans

March 14, 2025



Join **Stuart Goldstein**, co-chair of Cadwalader's Capital Markets Practice as he moderates a panel with **Jed Miller**, Head of the CRT practice and **Kahn Hobbs**, CRE structured finance specialist as they explore the intersection of Capital Relief Trades and Commercial Real Estate.

This CLE webinar will provide decision makers with an understanding of credit risk transfer (CRT) transactions and how they can be used for a portfolio of Commercial Real Estate assets.

Download the CRT Handbook.

Thursday, March 20

12:00 PM – 1:00 PM

Zoom Webinar

Register here.

For more information about this event, please contact **Jeneane Zeleznak**.

Register Now: Cadwalader Capital Call Securitization Conference - April 3

March 14, 2025

We are thrilled to announce Cadwalader will be hosting the Capital Call Securitization Conference in our New York office on Thursday, April 3. Space is limited, **RSVP** now to save your spot!

This first of its kind event will bring together industry leaders and experts for an afternoon of insightful discussions on the latest market trends and opportunities in the capital call securitization space. We will dive into the various traditional securitization structures, explore CRTs, CFOs, and other non-cash securitization structures. We will conclude this event with a roundtable discussion featuring market leaders in this space.

Stay tuned for a detailed schedule featuring fantastic speakers and substantive panels. We look forward to welcoming you in April!

Thursday, April 3

1:30 PM - 6:30 PM

Cadwalader, Wickersham & Taft LLP

200 Liberty Street, 2nd Floor

New York, NY

Space is limited, please **RSVP** now to save your spot.

For more information about this event, please contact **Jeneane Zeleznak**.

Fund Finance Hiring

March 14, 2025

Fund Finance Hiring

Here is who's hiring in Fund Finance:

State Street is seeking an Assistant Vice President– Private Equity and Private Debt Funds – Credit Officer in Boston. This role will manage credit risk for a portfolio of Private Equity/Private Debt by conducting credit reviews, performing risk ratings, continuous monitoring, and ad-hoc analyses. They will also maintain data, characteristics, and risk metrics for funds and counterparties in Risk and Dealing systems to ensure control and accurate exposure reporting. Learn more **here**.

Pantheon is seeking an Capital Markets Associate in London to support their global debt and FX operations, ensuring optimal management of financial exposures while delivering value to clients. Learn more **here**.

Standard Chartered is seeking an Executive Director, Fund Finance in New York to maximize customer profitability from FI relationships, originate, lead, structure, execute and distribute fund finance transactions including but not limited to (i) Fund level subscription financing (ii) Fund level NAV financing (iii) GP financing. Learn more **here**.

Barings is seeking an Director, Portfolio Finance. This Director role will be responsible for the evaluation, diligence and investment thesis, and on-going monitoring of a portfolio of fund finance investments, including private debt, made by Barings' Portfolio Finance team. Learn more **here**.

Fitch Ratings is seeking an Director, Business Relationship Manager (BRM) - Fund & Asset Managers Group in New York. This role will be responsible for business development and providing both tactical and strategic support to the Fund & Asset Managers (FAM) Group. Learn more **here**.