Mexican Capital Call Facilities

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In honor of Cinco de Mayo, we decided to go south of the border this week and give a brief overview of Mexican facilities.

While nearly all of the current bank lending and investor base is local, this market has the potential to make a spicy impact on the U.S. market soon. In fact, U.S.-based sponsors Blackstone, BlackRock, KKR and Lexington, to name a few, have already publicly registered Mexican trusts.

Why the recent interest? Think large amounts of institutional and pension money looking to invest cross-border in private funds. Mexican pension fund managers (*administradora de fondos para el retiro* – AFOREs) reportedly have more than $240 billion in assets under management. AFOREs are actively deploying pension capital to invest in infrastructure projects, energy, real estate, private equity and private debt via investment in Mexican trust co-investment vehicles called CDKs (*certificados bursátiles fiduciarios de desarrollo*) and CERPIs (*certificados bursátiles fiduciarios de proyectos de inversión*).

While each vehicle is a publicly registered and regulated trust that permits AFOREs and other institutional investors to invest in a manner akin to traditional private equity investment, the CERPIs have become more the vehicle of choice over the last couple of years. CERPIs provide more discretion to the investment manager and also permit foreign investment in non-Mexican projects (so long as at least 10% of commitments are invested locally in Mexico). As you can imagine, this distinction has been attractive for U.S.-based sponsors.

Our direct experience in the Mexican subscription finance market is limited, but we understand that, as available funds have grown, the market has become quite established and sophisticated over the last decade. To date, most of the per se Mexican subscription lending has been completed solely by local banks in Mexico. Now given the growing popularity of the CERPIs, we are seeing some material cross-over via the joinder of such vehicles to U.S.-based facilities.

While the CERPIs make great sense to AFOREs and the fund managers attracting capital, they present some unique challenges to lenders. Even though prefunded commitments are technically possible with a CERPI, they have all been structured via capital call mechanics that are governed by Mexican law and regulated by the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores* – the CNBV). Per CNBV rules, investors are required to initially fund 20% of their commitment amount. Funding of the remaining amount is then subject to traditional call mechanics on a five-to-ten day basis but on a "soft" commitment basis given that regulated pension funds in Mexico cannot legally acquire liabilities.

Lenders are certainly able to give credit and underwrite prefunded cash held in a controlled account, but how does one get comfortable with a "soft" commitment to fund the remainder? Punitive dilution and skin-in-the-game: the funded portion coupled with draconian dilution penalties (*e.g.*, 50% of an investor's interest that can be taken from defaulting investors and allocated to non-defaulting investors) are the key. While this is a far leap from the enforceable commitment structure that U.S. lenders rely upon, we are told by our friends in Mexico that track record is another compelling reason – there have been no known defaults. Presumably also, the local banks are comfortable taking local public fund risk.

So, as you enjoy your next margarita, ponder whether lending to these vehicles will continue to gain traction as sponsors raise more Mexican pension money. Will U.S. lenders ever gain enough comfort to provide borrowing base credit? Only time will tell.

Happy Cinco de Mayo from all of us at Cadwalader, and special thanks to our colleague Gabriel del Valle at the Mexico City law firm of Ritch Mueller for his assistance with this article.

“Nothing to see here...move along” or “Something’s happened...let’s stop and look”

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A common area of focus in LMA-based fund finance (and other) facilities in Europe is on the trigger point for acceleration of a facility and/or enforcement of security following the occurrence of an event of default. The borrower will generally want an opportunity to “cure” or “remedy” events that would be events of default when they occur, and will equally not want to be subject to acceleration or enforcement action if an event that is an event of default no longer applies. The lenders, at the same time, will want to ensure that these rights are not abused and, in particular, that the borrower cannot just repeatedly commit then “cure” events that are events of default, particularly where these are significant—at least not without the lenders expressly choosing to waive that event of default.

The problem is that, in the LMA documentation on which most funds finance and many other European facilities are based, the question of when and how to deal with events of default is addressed in two different places and the two provisions are not consistent with each other.

First, it is dealt with in the “definitions” clause, in which an event of default is deemed to be “continuing” if it has not been remedied or waived (the reference to “waiver” here being treated by the LMA as a point to be negotiated). Second, it is dealt with in the events of default clause itself where certain events of default (for example, most covenant breaches) are said to constitute events of default if they are capable of remedy and are not remedied within a defined cure period (usually somewhere between 10 and 20 business days).

So the question is, how do you reconcile one with the other (and how do borrowers and lenders with their somewhat different concerns reach a common position on this)? In summary, the definitions clause (the first clause referenced above) is more where the borrower wants to be (particularly if it can remove the reference to “waiver”), and the second clause is more where the lenders want to be (because it defines exactly which events of default can be cured and the time period during which that can happen, and applies only to events of default that can be remedied in the first place). Lenders will also want to retain the reference to waivers in the first clause, so that they can make a specific decision on whether an event of default has been remedied under that clause.

What resolution is reached often depends on the negotiating stance of the parties and the underlying background of the parties. A common (but not universal) “market” position is for lenders and borrowers to agree that an event of default can be remedied at any time if it is a “minor” event of default but that a “major” event of default would require a specific waiver from the lenders (so the lenders have the option to make the decision).

It remains to be seen whether the LMA form itself will ever be changed to bring the two clauses more in line with each other, but until and unless that happens, the way in which they work together to reflect the underlying borrower and lender concerns will and should continue to be an area of particular focus for the parties in their negotiations.

ARRC Recommends LIBOR Termination Language

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By **Jeffrey Nagle**
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The Alternative Reference Rates Committee ("ARRC") recently **provided** recommended contractual fallback language for U.S. dollar LIBOR-denominated **floating rate notes** and **syndicated loans**. Cadwalader served as drafting counsel for the ARRC working groups.

The recommendation, according to the ARRC, addresses risks in contracts that reference LIBOR and builds on the "**Paced Transition Plan**," which sets forth steps for an efficient shift to the Secured Overnight Financing Rate ("SOFR").

The ARRC's recommended fallback language for floating rate notes "defines the trigger events that start the transition away from LIBOR" and lays out a "waterfall" approach to determine the SOFR-based successor rate and "spread adjustment that would apply to the successor rate."

The ARRC noted that there are two separate alternative fallback language approaches for syndicated loans: the hardwired approach (which follows the trigger event and waterfall patterns of the floating rate notes) and the amendment approach (which has the same trigger events but leaves the selection of the replacement rate to the contract participants).

Incorporating robust LIBOR fallback provisions into new and (if possible) existing contracts is critical for financial market participants, with the end of LIBOR coming into focus over the horizon. The ARRC's publication of final versions of the recommended LIBOR fallback contract language for floating rate notes and syndicated business loans is a meaningful next step in this process. Banking and other institutions will be reviewing the proposed language over the coming weeks and many will be incorporating the language (or modified alternatives) into their standard form floating rate note and syndicated business loan documents. Fallback language for securitization and bilateral business loans are expected in the coming weeks and months.

Fund Finance Hiring

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Fund Finance Hiring

- Signature Bank seeks to add a Relationship Specialist in its Fund Banking Division. Focused on providing personalized banking services to financial institution customers, the position will be based in New York. Candidates should bring a minimum of five years of financial services experience demonstrating high-level client support. Interested applicants can find more information **here**.
- National Australia Bank is seeking an Associate to join its New York-based Fund Finance team. The role will include supporting origination, structuring, credit submissions, and portfolio management across private equity and publicly listed funds. Key products include subscription finance, hybrids/NAVs, redemption facilities and foreign exchange. For further information please contact Alex Bolton (**alex.bolton@nabny.com**) or Nick Woutas (**nicholas.woutas@nabny.com**).
- Cadwalader has opportunities for both associates and staff attorney applicants to join the firm's Fund Finance practice in Charlotte. More about those opportunities and a link to apply are available **here**.

Fund Finance Calendar
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In Case You Missed It–Recently in FFF

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We can pack some serious substance into our Friday publication—not necessarily everyone's peak time for absorbing a nuanced discussion on complex financial products. Here's a recap of original substantive pieces from recent issues for easy reference:

Funds with Benefits? Moving to a Balanced Lender Assignment Approach for Irish 110 Companies
The preservation of a lender's right of assignability is often pitted against perceived tax issues of Irish 110 Companies. We take a deeper look.

Side Letters: A Round-Up of Common Issues for Lenders
We identify the considerations for lenders in reviewing side letters.

Economic Substance – Should a Lender Care? A Cayman Perspective
We give an overview of the Cayman Islands economic substance legislation as it applies to fund finance transactions.

Mexican Capital Call Facilities
While most of the per se Mexican subscription lending to date has been completed solely by local banks in Mexico, we are seeing some material crossover via the joinder of such vehicles to U.S.-based facilities. This market has the potential to make an impact on the U.S. market soon.

"Nothing to see here...move along" or "Something's happened...let's stop and look"
We delve into a potential inconsistency in how events of default are addressed in LMA-based fund finance facilities in Europe.

The Intersection of Overcall Limitations and the Investor Default EOD Trigger
We illustrate the link between the Cumulative Default EOD threshold and an overcall limit in the LPA, and how the overcall limit should inform the appropriate Cumulative Default EOD percentage.

Who (When) You Gonna Call?
We review change of control provisions as these relate to indirect entities, such as an investor's holding company.

E-Signatures? E-Sign Me Up!
The enforceability of contacts executed by electronic means is largely addressed by ESIGN and UETA. We touch on e-signature questions that arise in the fund finance context.

Cadwalader Fund Finance Market Review
Highlights the Cadwalader Fund Finance market review as published in the LSTA and GLG's International Comparative Legal Guide for Lending and Secured Finance.

April Showers Bring…Umbrella Facilities?
We refresh on umbrellas with a brief overview of a classic subscription umbrella facility, followed by some pros and cons to lenders.

Who's in Front? Structuring Letters of Credit in Europe
Subscription line lenders are increasingly hesitant to take on the role of fronting issuing bank. Although there are variations on a theme, two main methods of dealing with the letter of credit mechanics are emerging.

Show Me the (Manager) Money
Greater attention is being paid to how the management company is financed in the LP diligence process. Lenders likewise are focusing on any vehicle upon which the GP/manager/affiliated investor relies for funding.

(Over) Call Me, Maybe
We break down the numbers on the prevalence of overcall limits in fund documents based on our representations over the past two years.

Please Don't Ignore My (Over)call
An overview of overcall limitations and the implications for facility structure.

The Irish Collective Asset-Management Vehicle
A review of the ICAV, its use in capital call facilities, and dialing in on its application in an umbrella fund structure.

Political Contributions Cease Funding Rights

A look at cease funding rights tied to political contributions negotiated in side letters by state pensions and other municipal investors in the United States.

Navigating Capital Call Facilities

In the standard capital call facility, uncalled commitments are the lender's primary source of repayment. Fund performance and investor behavior, however, can become interrelated. NAV and asset coverage tests are among the contractual protections that can give comfort to lenders.

Problems with 'Promptly'

We highlight the inherent uncertainties of many terms that are frequently used to describe time periods allowed for performance and summarize guiding principles toward accuracy and certainty.

Spotlight on GP-Led Secondary Transactions

GP-led secondary transactions have become a more frequent approach to unlocking liquidity for both GPs and investors. We review the four most popular types of GP-led transactions and related considerations.

ERISA in Fund Finance

A high-level overview of ERISA and its implications in Fund Finance.

Capital Commitments in the Form of Investor Loans in the U.S.

We review enforceability considerations for investor commitments structured as loan commitments rather than as equity capital commitments.

Joint and Several Liability

The intersection of private equity, cannabis and fund financing appears inevitable. Form credit agreements, however, so far have been limited in considering relevant use of proceeds restrictions or restrictions on qualified borrower joinders.

Waiving Goodbye to Sovereign Immunity in the European Market?

Financial institutions operating in the European fund finance market are increasingly having to familiarize themselves with sovereign or state immunity laws and how these laws interact across multiple jurisdictions. Waivers of sovereign immunity, while helpful, are not always perfect.

Divide and Conquer: New Delaware 'Division' Law Creates Potential Issues for Fund Finance Lenders

Delaware legislation permits an existing LLC to divide into two or more separate and distinct LLCs and allocate assets, rights and liabilities among the new entities. We summarize relevant considerations for loan documents.