

CADWALDER

# Side Letters: A Round-Up of Common Issues for Lenders

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A side letter is an agreement between an investor and a fund that alters the terms of the investor's investment in the fund (i) by superseding some of the applicable terms in the partnership agreement or subscription agreement or (ii) by adding additional terms to the agreements and commitments between the fund and the investor.

Given the popularity of side letters in fund finance transactions today, we thought it would be useful to highlight frequent issues that arise and that are important for lenders to look out for. This guide is not an exhaustive list; it is important to also keep in mind the nature of the collateral and the credit facility and anything that impedes on those concepts.

**Cease Funding Rights/Withdrawal Rights** - Investor's right to withdraw from the fund/cease funding its obligations.

Often seen relating to placement agent or political contribution regulations; typical with state pension plans but also found in other state side letters. It is a well-known public policy of the State of Michigan that investors will not honor capital calls from third-party lenders.

**Overcall Limitations** - Limitations on a non-defaulting investor's obligation to make up any shortfall in funding caused by other Investors defaulting.

Common overcall limitations include: (i) management fee overcall limitations, whereby overcalls cannot be made to cover a defaulting investor's share of management fees; (ii) overcalls limited to a percentage of the related capital commitment or a percentage of the initial call; and (iii) overcalls based on diversification standards (i.e., investment-linked concentration limits), whereby overcalls are subject to limits on the percentage that can be called from any investor for a particular investment.

**Most Favored Nation (MFN) clauses** - Agreement to give the investor the best terms it makes available to any other investor.

If MFN provision is *not* narrowly drafted (for example, limiting regulatory and tax concessions to investors that are in the same jurisdiction or affected by the applicable provision and limiting MFN treatment to investors with equal or larger capital commitments), problem provisions specific to one investor may spread.

**Reservation of Sovereign Immunity** - If an investor has explicitly reserved sovereign immunity.

Government entities, such as public pensions and sovereign wealth funds, may have immunity from contract claims and other lawsuits unless they waive their immunity. Sovereign immunity provisions may provide for a waiver or may reserve the rights of such investors to waive their immunity. Some jurisdictions may not permit waivers of sovereign immunity except through legislation. Other jurisdictions waive sovereign immunity if an investor is engaging in "commercial acts." Lenders should be mindful of different jurisdictions' sovereign immunity laws and how they may affect an investor's obligations to contribute capital to a fund.

Certain jurisdictions to pay close attention to include: (1) Texas entities, (2) California counties, (3) Arizona entities, (4) super-national organizations (e.g., UN), and (5) foreign governments/sovereign wealth funds, as the analysis for these entities is different.

**Fluctuating Commitments/ Commitment Caps** - If the investor's commitment fluctuates or is capped.

An example of this would be if the investor's commitment can't exceed 20% of aggregate capital commitments.

**Capital Call Formalities**

Examples include: (i) the investor can restrict who can send a capital call (e.g., only officers of the general partner) and (ii) capital calls must come from a specific email or be posted to a specific data site.

### **Delivery of Investor Letters, Confirmations of Uncalled Commitments, Financials**

This issue arises if the side letter limits the ability to require the investor to deliver investor letters (if it is an investor letter transaction), confirmations of commitments or the investor's financials (e.g., only publicly available financials).

### **Conditions Precedent**

If there are any conditions precedent for the capital commitment to be effective (e.g., delivery of an opinion to the investor).

### **Investment Exclusion Rights**

If the investor has any atypical investment exclusion rights. Common exclusion rights include, but are not limited to, investments in pork, pornography, ammunition, gaming, alcohol, tobacco, firearms, sanctioned countries, regulatory and legal prohibitions (including ERISA and indemnification excuse rights).

### **Debt Limitations**

If debt limitations or caps are included in the side letter that are more restrictive than the Fund's partnership agreement. If the facility goes above the debt limit or cap, this could restrict a lender's expectations that the commitments of all investors are available to repay an extension of credit under a loan facility.

### **Borrowing Clean-downs**

If the side letter contains any repayment timelines relating to borrowings (e.g., 90/180 day "clean downs").

### **Transfer Rights**

If the side letter provides an investor transfer rights that do not permit the timing associated with the mandatory prepayment provisions to work properly (e.g., "deemed consent" or "pre-consented").

### **Fund without setoff, counterclaim or defense**

If the investor does *not* agree to fund without setoff, counterclaim or defense. Sometimes seen in connection with a state entity or sovereign immunity. Lender does not want the investor's commitment to be offset against other obligations of the fund or the general partner to the investor.

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As investor policies and requests are constantly changing, it is important to thoroughly vet side letters and analyze each issue on a case-by-case basis. Not all issues are fatal -- many can be cured via simple language amendments if caught early enough before the letter is finalized and others may be structured around in the facility documents.

## A Future in Fund Finance—FFA Next Gen Event in NYC

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The New York chapter of FFA Next Gen recently presented a panel discussion and networking event in New York City focused on the Fund Finance market generally and what it takes to develop a successful career in Fund Finance. The event was well-attended with approximately 85 attendees, most of whom have been in the Fund Finance market for less than 3 years and are eager to hear words of wisdom from those with more experience in the space.

The panel, moderated by Jorge Grafal of National Australia Bank, featured: David Wasserman, Managing Director of Morgan Stanley; Eric Schwitzer, Partner at Paul Hastings LLP; Tim Bailey, Director at Fortress Investments; and Tom Delezenski, Managing Member of TRD Advisors.

The panelists provided a brief history of how the Fund Finance market has developed over the last 10-12 years and offered predictions into where they see the market headed in the coming years, noting that we are likely going to see more NAV facilities, co-investment and GP lines, especially with the continued influx of new lenders who are beginning to offer the products. The panelists had great insight and commentary on specific aspects of their respective roles within the market, but the most valuable part of the discussion came at the end, when the panelists offered career advice for the junior professionals in attendance, most notably the following:

- Take note of what your mentors are doing that make them successful and adopt and incorporate those positive traits into your own career;
- Put in the extra effort to be involved in all aspects of a deal to not only get ahead, but to hit the ground running once you are promoted to a more senior role and have oversight of the entire deal;
- Be honest and forthcoming in all of your dealings, which includes maintaining transparency and open lines of communication;
- Figure out what you want out of your career and foster an entrepreneurial spirit;
- Attend networking events to build and develop your personal network and be willing to help your connections; and
- Stay up-to-date on market developments.

Thank you to Morgan Stanley for hosting such a great event, to the panelists for their time and perspective, and to the sponsors who made the event possible.







## Women in Fund Finance NY Hosts Art and Cocktail Networking Reception

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By **Katie McShane**  
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Women in Fund Finance (WFF) recently hosted an evening of modern art, networking and cocktails at the DTR Modern Gallery in the Soho neighborhood of Manhattan. The event provided an opportunity for WFF members and other members of the fund finance community to meet and mingle with two inspiring female artists, Sandra Muss and Jane Manus.

Sandra has been called a “visual alchemist” whose diverse body of work explores her physical and psychological journeys. She also discussed her recent -- and very impressive -- installation at the Belmond Villa San Michele Fiesole Florence, which can be seen [here](#). **Jane** is known for her large-scale, bold geometric abstract sculptures set with brightly colored surfaces and bold forms. She also makes jewelry, and both Jane and her daughter (who also attended the event) were wearing pieces of jewelry that Jane had designed. Copies of Jane’s books were also handed out to the first 20 guests to arrive to the event.

Approximately 80 people attended the event.

















## NAV Takeaways

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Debevoise & Plimpton recently published its Spring 2019 issue of *The Private Equity Report*, available [here](#). This issue included an article on the key takeaways from the NAV and Hybrid Facilities Panel at the Global Fund Finance Symposium this past March. The article discusses the importance of valuations of the underlying assets, whether the acquired assets should automatically be included in the borrowing base, the option of credit funds to raise a hybrid facility or to split NAV and capital call facilities, and more. To read the full article, click [here](#).



## On the Move—Fund Finance Tidbits

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On the Move



BMO Capital Markets Corporate Banking has appointed Michael Orphanides as Head of its Asset & Wealth Management vertical within its Financial Institutions Group (FIG). Michael will be leading a growing team of industry experts to build and develop long-term relationships across Funds & Asset Managers by broadening its financing capabilities and deepening its penetration across its Capital Markets solutions, an area of continued focus for the group, particularly in the U.S.

Prior to joining BMO, Michael spent almost 15 years at Barclays, covering a number of different roles across Coverage and Credit, focused on Bank and Non-Bank Financial Institutions both in London and New York. Michael was responsible for establishing and building the Subscription/Capital Call financing capabilities and coverage of private equity/alternative asset managers in Europe and the U.S. More recently he was the Head of the FIG Americas Corporate Banking team, where he built a strong coverage team covering all verticals within the FIG franchise, delivering global product across the Barclays Corporate & Investment Banking platform.

## Women in Fund Finance Announces London Event

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Women in Fund Finance will host an evening of networking drinks and film screening in the Dive Bar at the Ham Yard Hotel in London on Wednesday, June 19. The event is the evening before the start of the 5<sup>th</sup> Annual European Fund Finance Symposium. To register, click [here](#).

## Fund Finance Hiring

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Fund Finance Hiring

The Cadwalader New York office seeks an associate to join its highly regarded Fund Finance practice for a position specializing in Fund Finance and Derivatives. The ideal candidate will have 2 – 5 years of experience in a corporate transactional practice, such as mergers and acquisitions, corporate finance or secured lending. Familiarity with derivatives is helpful but not necessary. The associate would join a growing practice active in a diverse range of secured lending and derivatives transactions involving leading commercial and investment banks and top-tier hedge funds, private equity funds and registered investment companies. A successful candidate will have strong drafting and client communication skills, as well as a desire to manage client relationships and move transactions forward independently. J.D. and NY Bar admission required. If you are interested in applying for this position, please click [here](#).

