

CADWALDER

Updates to Fund Finance Friday

May 31, 2019 | Issue No. 31

We are constantly looking for ways to make *FFF* a more relevant part of your weekly routine. This week, we are adding two new recurring columns. The first, *Player Profile*, will spotlight leaders in the fund finance market. Special thanks to Matt Taber of Harneys for sitting with us for a Q&A for our first Player Profile this week. Second is *Outside the Lines*, where one of our teammates will be providing a submission outside of our standard fund finance purview but that may still be of interest to our readers. This week Mike Mascia has provided a short review of *White Shoe: How a New Breed of Wall Street Lawyers Changed Big Business and the American Century*. As always, we welcome your feedback on these new additions and how we can make *FFF* more productive for you.

Funds with Benefits? Moving to a Balanced Lender Assignment Approach for Irish 110 Companies

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By **Kurt Oosterhouse**
Partner | Fund Finance

Lenders typically have a right to assign loans to existing lenders, affiliates or approved funds of existing lenders and, subject to borrower consent, other “eligible assignees.”

The consent right of a borrower over other “eligible assignees” normally exists so long as no event of default has occurred and is continuing. While in some cases, borrowers have been successful negotiating limited qualifications on the “sacred right” of lender free assignability, such as (i) maintaining an approval right outside of only “specified events of default” (*i.e.*, payment, bankruptcy, insolvency, etc.) and (ii) qualifying “eligible assignees” as specifically excluding enumerated “disqualified institutions,” those qualifications and restrictions eventually fall away at some point in a downturn of a credit and lack of compliance with the credit agreement. Stated differently, a lender’s “sacred right” of free assignability may be qualified, but its ability to assign a troubled credit to *any* eligible assignee remains a question of “when” and not “if,” since at some point in a borrower’s downward spiral (following any event of default, or following only a payment default, bankruptcy, insolvency, etc.), a lender will be able to assign all or a portion of a loan to *any* willing eligible assignee.

That “sacred right,” however, may no longer be sacred if you are loaning money into an Irish 110 Company (an “Irish 110”) structure.

In a nutshell, an Irish 110 is an Irish resident special purpose vehicle (SPV) which holds and/or manages “qualifying assets.” Among its various benefits is the ability to qualify under Ireland’s double tax treaty network which can reduce or eliminate taxes on income flows and capital gains in treaty jurisdictions (such as the United States).

As a general U.S. tax matter, the IRS takes the view that funds that originate loans through U.S. managers are engaged in a trade or business in the United States and, as a result, are potentially subject to U.S. federal income tax on income that is “effectively connected” with that U.S. trade or business. However, with respect to an Irish 110 fund, a U.S. manager can originate U.S. loans on behalf of an Irish 110 fund without the fund or its investors being subject to U.S. income tax – so long as the Irish 110 fund qualifies for benefits under the U.S.-Ireland income tax treaty and does not have a “permanent establishment” in the United States.

Very generally, a fund can qualify for benefits under the U.S.-Ireland income tax treaty and avoid a U.S. “permanent establishment” if: (1) it satisfies certain ownership requirements, (2) the amount of deductible expenses that it pays each year to “non-qualified persons” does not exceed 50% of its prior year’s gross income, and (3) its U.S. manager is an “independent agent.”

For an Irish 110 to satisfy the ownership requirements and the cap on deductible expenses (the “Base Erosion Test”) the focus is on the status of “qualified persons” and “non-qualified persons” receiving benefits from the Irish 110. “Qualified Persons” generally include: (1) U.S. individuals, (2) U.S. corporations (including a U.S. tax-exempt entity), (3) a U.S. branch of a foreign bank, or (4) a limited partnership each of whose partners are U.S. individuals or U.S. corporations.

With respect to the Base Erosion Test, deductible payments (including interest payments under profit participating notes and other loans – *i.e.*, subscription facilities) to “non-qualified persons” in any year cannot exceed 50% of the Irish 110’s gross income from the immediately preceding year.

Since the Base Erosion Test picks up interest payments on subscription facilities, Irish 110’s have taken the position that subscription facility lenders cannot assign loans to any non-qualified persons under any circumstance. This, they state, is in order to protect the Irish 110 from becoming subject to U.S. federal income tax as a result of deductible payments to “non-qualified persons” in any year to exceeding 50% of the Irish 100’s gross income from the immediately preceding year.

“*It’s a tax issue.*” Whether one has practiced two years or twenty years, it’s impossible to not have run into “it’s a tax issue” as the trump card to explain an apparently unexplainable issue or result. Thereupon, the parties seemingly give

a nod to the incomprehensible, stop any further analysis and essentially concede that there is nothing further that can be done, since “it’s a tax issue.”

With respect to the position of Irish 110’s that loans cannot be assigned to non-qualified persons under any circumstance –whether or not a payment default, bankruptcy, insolvency, or acceleration shall have occurred – because “it’s a “tax issue” seems to be a position taken more as a matter of convenience than actual necessity. This is especially the case when viewed in the context of a lender’s right to exit a troubled credit versus the impact of that exit on a borrower who is in the midst of one or more material events of default under its credit facility.

The point isn’t to say that an Irish 110 borrower shouldn’t have any consent right if no event of default (or even if no specified event of default) shall have occurred, or that a fear of violating the Base Erosion Test wouldn’t be an argument for an Irish 110 not consenting to a potential loan assignment to a “non-qualified person.” Instead, the point is finding that place on the allocation-of-risk spectrum where the concerns of a lender in maintaining its sacred right of free assignability outweigh the “tax issue” concerns of an Irish 110.

As noted above, with respect to the Base Erosion Test, the test isn’t failed if any deductible payments are paid to “non-qualified persons” – only if they exceed 50% of the Irish 110’s gross income during its immediately preceding fiscal year. Thus, there are countervailing measures that an Irish 110 can take to manage the 50% limitation on deductible payments to non-qualified persons in order to stay within the rule – such as repaying the loan and/or restructuring its ownership of or payments on profit-participating notes. Would it be administratively difficult to manage the 50% test via tracking the commitment percentage and interest payments to non-qualified persons and/or to restructure ownership and payments under profit-participating notes? Certainly.

However, it seems difficult to argue that at some point (and certainly to the extent a “specified event of default” shall have occurred, and thus the Irish 110 is subject to a payment event of default, an accelerated loan or even a bankruptcy event), the sacred right of a lender to sell its loan to any willing eligible assignee outweighs the “tax issue” concerns of an Irish 110 – no matter how adverse the repercussions may be to its investors.

Player Profile: Matt Taber

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Player Profile

Matt Taber is a Partner at global offshore law firm Harneys and leads its Cayman Islands fund finance practice. He has represented lenders in over 50 fund finance transactions in the last 12 months on the Cayman Islands aspects of their deals. FFF caught up with Matt this week for a Q&A.

FFF: How did you end up in fund finance?

MT: I'll be honest here, slightly by mistake! But I have my old friend, Cadwalader Fund Finance Partner Sam Hutchinson to thank for this. Sam and I trained at law school in London and worked at Lovells in the early 2000s before I went offshore. She got in touch with a deal in 2011 when I was at my former firm and they had been doing some fund finance deals back then. I got up to speed quickly on the issues and have never looked back. So, thanks Sam!

FFF: How has the first half of 2019 shaped up compared to 2018?

MT: We had a quiet January and, to be frank, it was starting to look a little concerning, but right now, the volume is back to what it was in 2018 by this time.

FFF: Are there any emerging issues under Cayman Law that might prove relevant for the fund finance markets?

MT: Cayman and offshore lawyers are always searching for news or issues to make relevant and sometimes we do grasp a little at straws in this area. It's been an intense time in Cayman and new legislation requiring certain entities to be able to demonstrate substance in the Islands is very much to the fore right now. Fortunately, limited partnerships and all investment funds are not subject to the legislation so the issue will only really be relevant for general partners. One to think about as an automatic check rather than anything fundamental.

FFF: Who has had the most influence on your career?

MT: Apart from Sam? I was extremely lucky to have trained at Lovells between 1999 and 2001 and worked with several very good senior lawyers or partners. It would be too much to single any one of them out, but two names in particular immediately come to mind. The first was my last supervisor as a trainee, Russell Strachan, who is now retired. He was a partner in the pensions group at Lovells. The best advice he gave me was not to focus or get carried away too much on jargon or complexity in any transaction. But remember that at its heart, 95% of what we do as commercial or banking lawyers is down to contract law. Stay calm and analyze the situation rationally. The second was Dave Roberts, who is now a partner at CMS Cameron McKenna Nabarro Olswang LLP. Very calm under pressure and supremely focused on the bigger picture – Dave always used to remind me when I said I was too busy that we all have to eat. So taking some time out to have a quick lunch can be really helpful when the pressure is on!

FFF: What was your career high. . . and career low?

MT: Career high – that's a tough one. Can I say meeting my wife at work??

Career low – I'd say the fourth all-nighter in the space of six months as an M&A lawyer in London which was the trigger for me moving offshore! Perhaps I should consider that a high, too.

FFF: What do you think it takes to be successful as a lawyer in the fund finance industry?

MT: An acute sense of the commercial rationale of the transactions that our clients are doing and a very very firm grasp of the fundamentals. That and, certainly for us offshore, having impeccable project management skills!

FFF: If you could give the Fund Finance Association one piece of advice, what would it be?

MT: Always have a good gin and tonic at the drinks events!

FFF: What do you like to do outside of the office?

MT: Obviously spend time with kids and my wife, but other than that, I enjoy CrossFit, cycling, steak and a good bottle of red wine!

FFF: How is the weather in the Cayman Islands right now?

MT: Cloudy and raining – honestly. But it is 30 celsius!

FFF: Tell us two truths and one lie about yourself?

MT:

- I spent two summers helping film a kids TV programme called Rosie and Jim made by the creators of the Teletubbies.
- I've met Brad Pitt
- I like my steak well done

FFF: Family?

MT: My wife, Leonie (currently in Charlotte on a mission to find a new sewing machine!) and two kids, Persey (short for Persephone) and Dominic.

FFF: Any fund finance predictions for the rest of the year?

MT: Nothing earth-shattering, I don't think. The market remains buoyant, and consistent fund formations and a consistently positive outlook for private equity will inevitably lead to more funds looking for this type of facility.





Shout-Out for Cadwalader Securitization Team

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Congrats to our Partners in our Capital Markets group for earning both the Structured Finance and Securitization “Team of the Year” and “Deal of the Year” awards at the International Financial Law Review (IFLR) Americas Awards earlier this month in New York. To see the press release, click [here](#). Our securitization partners are a great resource for us on hybrid and NAV-related financings.

Pitchbook on Public Versus Private Fund Performance

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By **Chris van Heerden**
Director | Fund Finance

Publicly listed GPs raise larger flagship funds than their private counterparts, wait less between fundraises and outperform on IRR and PME metrics. These are the conclusions in a recent *Pitchbook* [research note](#) examining the effects of going public on GP behavior. In a nutshell, *Pitchbook* finds no evidence of short-termism at work at publicly listed firms.

Beyond these findings, the report is helpful in filling in the backstory behind today's macro themes. Private equity returns have been in a downtrend for more than a decade. Firms have responded to the associated pressure on carried interest by increasing scale to grow management fee income. This higher-priority, stable income stream is naturally valued more by shareholders. Not surprisingly, public firms have been more prolific in broadening their strategies to move into credit, infrastructure, real estate and other specializations.

Subscription finance fits well into this narrative as both public and private funds target a shorter time to deployment. Until we hear about investors running into GP concentration limits, we expect fund sizes to continue higher and, with that, facility sizes to test new records. The *Pitchbook* report is available [here](#).

On the Move—Fund Finance Tidbits

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On the Move

Seasoned fund finance banker Brad Boland joined Signature Bank last week as a Managing Director in its Fund Banking Division. He joins from Wells Fargo, where he was a Managing Director and Co-Head of Originations in the Subscription Finance group. Brad brings close to 20 years of experience to Signature Bank in the origination, structuring and execution of subscription facilities, asset-backed financings and traditional corporate credit facilities. Prior to joining Wells Fargo, he spent 10 years at Bank of America in its Global Structured Products, Sports Finance & Advisory and Portfolio Management groups. Brad has relocated to San Francisco for his new role, which will involve supporting Signature Bank's efforts financing top-tier private equity firms and alternative asset managers with a focus on West Coast managers.

If you have an update you would like included in FFF, please email us at fund-finance-friday@cwt.com.

Fund Finance Hiring

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Fund Finance Hiring

- State Street has launched a search for a department head to lead the bank's Alternatives Lending group. Based in the New York area, the appointee will oversee the existing book of business, manage the origination of new fund financing solutions and provide strategic direction to the platform. More details can be found [here](#).
- 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](#).



By Michael Mascia
FFA Board Member

With the Memorial Day holiday in the United States, it was a relatively quiet week in Fund Finance. Our summer interns started last week, and we assigned a summer associate with reaching the end of the Internet in hopes of finding something new. To little avail. The break did give us all a little time outside the office, and I finished reading *White Shoe: How a New Breed of Wall Street Lawyers Changed Big Business and the American Century*. It was a fun and fascinating read.

Written by John Oller, a former partner at Willkie Farr & Gallagher LLP, *White Shoe* chronicles the larger than life turn-of-the-century lawyers that founded several of the preeminent New York law firms. Among the lawyers portrayed, detailed accounts are provided of Paul Cravath's representations of George Westinghouse, William Cromwell's extensive work and role in the creation of the Panama Canal, Francis Stetson's representations of U.S. Steel and International Harvester for J.P. Morgan Sr., and Elihu Root's transition from Wall Street lawyer to U.S. Secretary of State and U.S. Senator. The book gives extensive details into their transactions, trials and witness testimony, especially around the creation of antitrust legislation and trust-busting prosecutions.

Reading the accomplishments of these early lawyers, you cannot help but feel a little inconsequential. The scope of their philanthropy even in today's dollars is astounding. And their contributions outside of their practices to the federal government, the political process, the war effort, their law schools and the bar dwarf anything the modern lawyer is able to accomplish. I also learned a lot I did not know about the early days of Cadwalader and the professional accomplishments of George Wickersham and Henry Taft. If you find the intersection of early American financiers and industrialists and Wall Street law firms interesting, you will love the book. I finished it in two weekends and a plane ride - the 315 pages are not a David McCullough or Ron Chernow marriage commitment equivalent. The author page is available [here](#).

Cadwalader Set to Host London Fund Finance Review

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Cadwalader is holding its inaugural Fund Finance Review in the UK in our London office on June 5. Partners Jeremy Cross and Samantha Hutchinson will be joined by Collier Capital's Mark Hindriks to provide a market overview and discuss best practices in fund finance following recent developments. To learn more, please reach out to your Cadwalader contact.

Women in Fund Finance Announce Peloton Event

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The Fund Finance Association's Women in Fund Finance group this week announced a spinning and networking event at the Peloton Studio in New York. The event will take place June 12 starting at 6:30 p.m. For more information, click [here](#).

