

# Fund Finance Friday



## S&P 500 3,300???

### January 17, 2020 | Issue No. 60

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## Subscription Finance Loan Agreement Series, Part 17: Events of Default

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We are nearing the end of this series of articles (and making good progress through the clauses of particular interest in the fund finance market, which we are examining). This week we turn our attention to the Events of Default contained in an LMA-based subscription/capital call facility.

As one would expect, in general, Events of Default in subscription/capital call facilities have many features in common with Events of Default contained in other LMA-based loan facilities. We will spend a little time looking at some of those, where there may be some things to think about when adapting these for subscription/capital call facilities, along with a look at some Events of Default which would typically be included only in these types of facilities. We will finish up with some thoughts on other Events of Default which might be relevant in the context of recent events in the market.

As with most discussions on these (and other) facilities, where exactly the balance is struck on a number of these issues depends in large part on the commercial intent and priorities of the parties. For example, as with any other facility, these facilities will include right at the top a “non-payment” Event of Default, and this will generally be drafted in a very similar way to any other LMA-based facility, with any non-payment causing an immediate Event of Default (with some very limited exceptions). For any fund, it is important not to get tripped up by this, so while it is hard to pull back the “non-payment” Event of Default itself, it is important to consider throughout the document where and when obligations to pay arise and to ensure that the fund has sufficient time to access cash (or its investors) to honour such payments.

Following on from “non-payment” are a set of Events of Default for which, if they occur, no grace period (or perhaps a very limited grace period) will apply. In almost all LMA-based facilities, these include a breach of financial covenants, and the subscription/capital call facility is no exception. However, there are other events particular to subscription/capital call facilities which lenders may consider including here. Without providing an exhaustive list, examples would include non-compliance by the fund or its representatives with their LPA and/or the investment policy set out in the limited partnership agreement, or a failure to provide certain information (e.g., financial statements or compliance certificates on time). Compliance and information are both crucial parts of any subscription/capital call financing, hence their inclusion.

Then come a series of Events of Default which also have much in common with those in other LMA-based facilities, including a breach of any other obligations (*i.e.*, other than those specified in the clauses we just considered above or otherwise specified as Events of Default separately) and any misrepresentation. Generally, these Events of Default will only occur if they are “capable of remedy” and are not “remedied” within a set period (often called a “cure period” and set somewhere between 15 and 20 days or business days). The question of what breaches of a facility agreement may be “capable of remedy” and, in what circumstances, is for a separate article. However, a point to note here (and often the subject of discussion) is how the concepts of Events of Default being “capable of remedy” and “cure periods” in this section interact with one of the “standard” interpretation provisions contained at the front end of the facility. That interpretation provision also references “Events of Default” and “remedies” but does not include any concept of whether an Event of Default is “capable of remedy.” For now, suffice it to say that it is worth ensuring there is some consistency between the two.

To wrap up, on Events of Default which (with very few changes) are common to most or all LMA facilities, these will also include (and this is not intended to be an exhaustive list): (i) cross default or cross acceleration of any other financial indebtedness incurred by the fund or related parties in other facilities; (ii) “insolvency” or “bankruptcy”-related events; (iii) invalidity or repudiation of the obligations under the facility or other finance documents, and (iv) cessation of business.

Then there are a series of Events of Default that are specific to subscription/capital call facilities, and these are in many respects as important to include for lenders as are “non-payment” and other Events of Default in any other LMA-based facility. These are Events of Default focused particularly on the fund, its investors and the relevant constitutional documents of the fund. Again, without providing an exhaustive list, the events that lenders should consider here will include: (a) non-payment of obligations by withdrawal of or excuse of a material proportion of investors; and (b) in some but not all facilities, transfers by a material proportion of the original investors. What constitutes a “material proportion” for these Events of Default is a matter of negotiation but generally will be set somewhere between 10 and 20 per cent. Other specific Events of Default in this general group will include (i) the invalidity or unenforceability of the fund’s constitutional documents, including any limited partnership agreement; (ii) any termination of a general partner or manager in respect of the fund (often limited so that it only occurs if that general partner or manager is not replaced by a suitable person); (iii) the occurrence and continuation for a defined period (often 90-plus days but depending on

the underlying constitutional documentation) of any suspension period caused, for example, by the resignation of “key persons” to the fund; and (iv) any termination of the fund (or possibly and depending on the potential impact on the financing) any earlier termination or ending of an investment period. Lenders may well want to include other “fund-related” Events of Default, and it is always important to ensure that these follow and reflect the due diligence done on the fund documents.

Finally, a brief word on other (or expanded) Events of Default that may be considered in the context of the fallout from the reported elements of the Abraaj case. While in many respects this is the Goldsboro incident of the fund finance world, with the impact being significantly less disastrous than could have been the case, lenders may want to consider the extent to which (subject to commercial and competitive considerations) they might seek additional or expanded Events of Default to add to their protections against the type of reported events in that case. These may include (and again this is not an exhaustive list) the addition of, for example, significant disputes between investors and the fund or its general partner or manager (even in the case of the latter, in relation to funds other than the borrower) and the expansion of “insolvency”-type Events of Default to other holding or affiliate entities in the same group as the general partner or manager.

# The Cayman Islands Private Funds Bill, 2020 — Are Fund Finance Deals Impacted?

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By **Derek Stenson**  
Partner | Conyers



By **Michael O'Connor**  
Partner | Harneys

On January 8, 2020 the Cayman Islands Government published the Private Funds Bill, 2020 (the "Bill"). The Bill builds upon the reputation of the Cayman Islands as a co-operative and transparent jurisdiction and introduces for the first time a requirement for private funds to register with the financial regulator in the Cayman Islands – the Cayman Islands Monetary Authority ("CIMA").

While the introduction of the Bill is an important step in the evolution of the Cayman Islands as a leading jurisdiction for the formation of private funds vehicles, it will result in significant changes to the supervision, regulation and registration requirements of such vehicles in the Cayman Islands and so is of immediate relevance to sponsors, service providers and lenders to private funds.

## What is a Private Fund?

Almost all Cayman Islands fund vehicles that are commonly seen within private equity and venture capital structures will fall within the definition of a "private fund" under the Bill.

Many alternative investment vehicles within such structures will also be caught within the definition of "private fund" and, while they will be required to register with CIMA, such vehicles will be exempted from certain provisions of the Bill (most notably, annual audit).

The Bill applies to each "private fund" which is defined as any company, unit trust or partnership whose principal business is the offering and issuing of its investment interests (which carry an entitlement to participate in the profits or gains of the fund and are not redeemable at the option of the investor), the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments; where:

- the holders of such interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and
- the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly, for reward based on the assets, profits or gains of the private fund.

A company, unit trust or partnership will not be a private fund if it falls within the list of "non-fund arrangements" in the schedule to the Bill.

## What is the current position and how does the Bill change this?

At present, closed-ended funds are exempted from the requirement to register with CIMA. Accordingly, most private equity and venture capital funds that are established in the Cayman Islands are currently not subject to any CIMA registration or regulatory requirements.

Following the introduction of the Bill, such vehicles will be required to register with CIMA and will be subject to the supervisory measures of CIMA. Additionally, such funds will need to comply with various governance and filings requirements set out in the Bill. Once registered, a private fund will be required to pay an annual registration fee, comply with annual return and local audit requirements, inform CIMA of material changes to the information submitted as part of its registration application and retain appropriate accessible records.

## What does this mean for lenders in fund finance transactions?

The short answer is that, subject to a lender conducting due diligence to its satisfaction that a fund is in compliance with the new requirements, the Bill should not materially affect a "standard" subscription line fund finance transaction

involving Cayman Islands borrower vehicles.

Some of the required due diligence will necessitate further consideration as the Bill comes into effect and guidance on its application is issued by CIMA, but below is a list of matters which may need to be factored into fund finance transactions:

#### Registration

The Bill provides that a private fund shall not accept capital contributions from investors in respect of investments until it is registered by CIMA.

As the core of a subscription line facility will usually be the ability of the general partner (or the lender in its place) to draw down investor capital commitments, it will be vital that any Cayman private fund vehicle that is party to a credit facility is registered with CIMA ahead of the initial credit extension.

If a borrower is claiming that one or more of its Cayman Islands vehicles that is a party to a credit facility is not within the scope of the Bill, the lender should require sufficient documentary comfort to confirm that this is the case.

#### Existing Private Funds

CIMA has not yet issued guidance prescribing by when existing private funds will be expected to register. If a Cayman Islands fund that is party to an existing credit facility misses the deadline to register with CIMA, then the lender's security over the call rights of such fund will be potentially unenforceable until the registration occurs (as an attempt to call capital during such period could be contrary to law). Accordingly, compliance with the CIMA registration deadline (once it is confirmed) by Cayman Islands funds that are party to a credit facility will be of the utmost importance from a lender perspective.

#### Alternative Investment Vehicles

As noted above, alternative investment vehicles ("AIV") (a term which has not yet been defined in the Bill) will be required to register with CIMA but will not need to comply with the annual audit, valuation, safekeeping, cash monitoring or securities identification requirements.

However, the prohibition on receipt of capital contributions until the AIV is registered with CIMA will still apply. As a result, to the extent that undrawn commitments of AIV investors will form part of the security package, the same approach as above should be considered (confirmation that the entity is registered or sufficient documentary comfort of its out-of-scope status).

The Bill also contains reference to "restricted scope private funds," but CIMA has not yet issued guidance prescribing which funds will fall within this definition.

#### Ongoing Requirements and CIMA Information Requests

CIMA has a broad range of powers under the Bill, including that it may request a private fund to provide CIMA with such documents, statements or other information in respect of a private fund as CIMA may reasonably require in connection with its functions.

Accordingly, lenders should require each Cayman Islands private fund that is party to a credit facility to notify the lender of any material correspondence (to be negotiated) from CIMA in order for the lender to remain informed and act accordingly in respect of any potential regulatory queries that CIMA may have.

#### Annual Audit and Return and Valuation Provisions

Once registered, a private fund will be required to comply with annual return and local audit requirements and inform CIMA of material changes to the information submitted as part of its registration application. Lenders may wish to require that copies of such annual returns and audited accounts are provided as part of ongoing reporting for both information purposes and also to ensure that they are being prepared and filed with CIMA in accordance with the private fund's obligations.

The Bill also contains requirements for valuations of fund assets and cash monitoring to be undertaken in each case by independent third parties or by the operator (in which case any potential conflicts of interest must be properly identified, managed, monitored and disclosed to the investors of the private fund). Again, to the extent that asset valuations and

cash in accounts are independently verified, it may be prudent to require that such reports are also provided to the relevant lender for informational purposes.

### CIMA Regulatory Actions

In addition to the powers that CIMA has to request documents and information mentioned above, CIMA may also take more robust actions in certain circumstances (e.g., if a private fund is unlikely to meet its obligations as they become due or is carrying on business fraudulently). In such circumstances, CIMA may take a number of actions, including cancelling the private fund's registration or appointing a person to assume control of the affairs of the private fund.

As any of the above regulatory actions could be troublesome to a lender's position, consideration should be given to whether any additional protections should be built into credit agreements – for example, the inclusion of an event of default to cover a situation where any regulatory actions are taken by CIMA.

### **Do lenders need to take any immediate action?**

Lenders do not need to take any immediate action in respect of facilities where Cayman Islands private funds are part of the borrower fund structure.

Lenders should, however, begin to consider whether there are particular changes to their standard loan documents or credit processes that they wish to implement upon enactment of the Bill (the Bill is not yet law in the Cayman Islands and will be considered for enactment at the 30 January 2020 meeting of the Cayman Islands Legislative Assembly (and remains subject to revision until formally enacted)).

For existing private funds that will be required to register, there will be a transitional period within which to comply. Once this date is known, and the registration deadline approaches, lenders should check in with Cayman Islands borrowers as to progress and to confirm that they will meet the registration deadline (or that they view certain entities within the existing structure as out of scope).

Following the enactment of the Bill, it is expected that newly formed private funds will immediately fall within the scope of the Bill and so additional consideration should be given as to how this might impact the timeline for launching Cayman Islands private funds and the putting in place of subscription line facilities.

### **Conclusion**

While the introduction of a new regulatory regime for Cayman Islands private funds heralds a new chapter in the regulation of private funds in the Cayman Islands, it should also be noted that for many funds the requirements of the Bill will serve largely to codify existing practices in governance and operations of such vehicles.

Accordingly, although a borrower's requirement to register its Cayman Islands private funds with CIMA (and a lender's due diligence to ensure that borrowers are compliant in this regard) will require additional actions in the process of closing funds and fund finance facilities, we do not expect the Bill to be a deciding factor in the inclusion of Cayman Islands vehicles in private fund structures and transactions.

As a positive to lenders to such structures, they will have the added benefit of being able to take comfort from the additional regulation of such vehicles but, from a lender perspective, the primary lesson that should be taken from this article is that more robust diligence procedures will need to be implemented as Cayman Islands private funds move into the regulated sphere.

## Player Profile — Guillaume Hartog

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Player Profile



This week we connect with Guillaume Hartog, who heads the Subscription Finance team within BNP Paribas, covering EMEA and the U.S. Prior to that, he was part of the bank's Leverage Finance team in London.

### ***FFF: How did you end up in fund finance?***

Guillaume Hartog: I was a Director within the UK LevFin team when BNPP decided to enter this new market. I had been tasked with structuring a couple of deals first and writing a procedures manual. Six years later, the bank happened to have a book in excess of €10bn and we closed 50+ deals.

### ***FFF: How has 2019 shaped up compared to 2018?***

GH: 2019 was a record year for the BNPP Fund Financing team: we closed 24 deals, vs. 11 in 2018. This has impacted our team as well, as we have been recruiting.

### ***FFF: Are there any emerging issues that might prove relevant for the fund finance markets?***

GH: The Abraaj liquidation process obviously, as final recovery from the banks involved will be scrutinised. Depending on the outcome, it might happen to be a "pre-Abraaj" and a "post-Abraaj" time. One is right to recall that Abraaj appears to be massive and rather unique.

And, perhaps in the long run, Basel IV could impact return on this product for banks. But no crystal ball.

The rest is normal evolution of a market which is getting more and more mature and standardized and is evolving alongside the overall economic cycle that leads financial sponsors to maximise fund-level financing and weaken some terms.

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

GH: Sam Hutchinson. Apart from Sam, there have been a lot of folks, including many of my colleagues and managers at BNP Paribas.

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

GH: A planned tête-à-tête lunch with Sam ... and when she cancelled it!

### ***FFF: What do you think it takes to be successful in the fund finance industry?***

GH: Very simple: to gather the right team and right people with good structuring backgrounds in order to deliver on this complex type of financing for demanding clients (often in a high time-pressure environment).

Beyond structuring skills, a good commercial sense and a clear strategy to navigate into what started as a niche market but turned out to become a large and very competitive market where we have to be selective. And, at the end, we shouldn't forget that we have to strike deals with clients we choose to serve.

A bit of fearlessness and a good command of English might not harm as well! I remember a day I was on the stage as a panellist in a fund financing forum in front of an audience comprised of all the main market players – all more experienced than me. It was a moment of terrible stress and a bad memory for me!

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

GH: On the top of my mind, keep educating bankers and newcomer banks generally. We usually play with big amounts and this is a cyclical business. Serious business goes hand in hand with a high degree of structuring and security.

Also, take care of the next FF generation: the market is developing and will last for long as a very powerful technology. We shall invest in the future! I value people and relationships more than numbers.

The good news is that these are two things that the Fund Finance Association already does well.

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

GH: Without a doubt, reading from A to Z a subscription facility credit agreement.

**FFF: Tell us two truths and one lie about yourself.**

GH: Well, very simple when it comes to the truth: it is the team which is doing the job; I simply monitor P&L.

As for a lie: my answer to what I do outside the office. I prefer by far family time or to share a glass of good Burgundy with friends!!!

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

GH: The overall market size will continue to expand, perhaps at a slower pace, in line with the fund raising cycle. But the market will develop into a multi-faceted market, with higher usage and various kinds of utilisations of fund-level financing, in the like of ESG-linked facilities, NAV facilities, assets-level financing backed by funds, and ad hoc fund-level financing when needing a greater optionality.

If well designed, we are open to various types of utilisations and structures. So “create, don’t compete” appears to be a good motto to me.

Again, fund financing is a powerful and flexible technology to support the private capital investment industry; we are still at the beginning of something much larger, and definitely no longer a niche market.

Needless to say that, in my banker’s views, it shall all remain within reasonable parameters. But this is another story and I have little influence on this.

## Secondaries Investor Q&A with 17Capital

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*Secondaries Investor* this week published a Q&A with Pierre-Antoine de Selancy, Managing Partner of 17Capital. The article discusses preferred equity's appeal to investors as an alternative asset class, the growth in transaction volume and the structural evolution of transactions. The pay wall-protected article is available [here](#).

## Intertrust Article on Fund Finance Industry Growth

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Intertrust published an article earlier this week titled “New research charts fund finance’s progress from niche to mainstream.” [The article](#) covers the growth of fund finance as the industry matures and provides insight on challenges to continued growth in the future. It cites data gathered from surveys among investors and investment professionals in the industry.

## Fund Finance Partners Article on BDC Leverage

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Fund Finance Partners this week published an article titled: “Improved BDC Leverage Options Set to Take Off in 2020.” The article covers the easing of the '40 Act's leverage limitation on BDCs by increasing their debt-to-equity ratio from 1:1 to 2:1. BDCs that obtained the approval of their boards of directors last year for increased leverage are now able to amend existing credit facilities and/or enter into new ones. The article is available [here](#).

## Validus Contributes Fund Finance and Risk Management Insight to Market-Leading Private Capital Book

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Kevin Lester and Sarah Lobbardi of Validus Risk Management have contributed to two chapters in the recently launched book, *Private Capital – Private Equity and Beyond*, authored by London Business School professors Florin Vasvari and Eli Talmor and endorsed by private market heavy-hitters such as Jeremy Coller (Coller Capital), Henry Kravis (KKR), David Rubenstein (Carlyle), Stephen Schwarzman (Blackstone) and Helen Steers (Pantheon).

Sarah discusses the key reasons why private managers benefit from involving an external advisor to structure, manage and negotiate fund finance facilities, while Kevin considers the evolution of currency hedging in the context of private capital managers.

Professors Vasvari and Talmor are internationally recognised experts in the field of private capital research, and Validus is thrilled to have contributed to the book.

Validus is a leading independent financial services firm specialising in providing financial risk management, fund finance advisory, and technology solutions to the alternative investment industry.

For more information, please visit [here](#).

## On the Move — Fund Finance Tidbits

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On the Move



Jorge Grafal has joined Mizuho Americas as part of the firm's initiative to grow its presence in fund finance. He is working alongside industry veteran Jonathan Peiper and seeking to source, structure and execute subscription finance facilities for best-in-class fund managers. He will also serve as a key point of contact within Mizuho for ancillary business opportunities across the firm's full spectrum of products and services.

Jorge has been a funds banker for almost 10 years, having most recently worked as an Associate Director on National Australia Bank's fund finance team. Throughout his career, Jorge has focused on subscription finance facilities, NAV facilities, fund-level foreign exchange services and tailored credit products for private equity employees' GP commitments. He serves as Co-Head of the Fund Finance Association's New York Next Gen Network and is excited to plan new content for the platform into 2020.

### **Liz Pinault | People's United Bank**

Liz Pinault recently joined People's United Bank as a Portfolio Manager in its Fund Bank division. Liz has over 20 years of banking experience, most recently as a Commercial Loan Officer at Boston Private in the Specialty Lending Group. She previously held multiple positions with Santander Bank. Liz has a B.A in Economics and International Relations from Lehigh University.

## Fund Finance Calendar

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### Upcoming Events in Fund Finance

January 22-23, 2020	PEI CFOs & COOs Forum, New York
February 12, 2020	Women in Fund Finance Networking Boat Trip, Miami
February 12-14, 2020	10th Annual Global Fund Finance Symposium, Miami
March 16-18, 2020	PartnerConnect East 2020, Boston
July 8, 2020	6th Annual European Fund Finance Symposium, London

If you have an event that you would like listed on the Fund Finance Friday calendar, please email us at [fund-finance-friday@cwt.com](mailto:fund-finance-friday@cwt.com).