

CADWALDER

Whose Cash Is It Anyway?

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By **Tim Hicks**
Partner | Fund Finance

In many subscription credit facilities, lenders establish a multi-faceted timeframe for the borrowers to, among other things, make mandatory prepayments, pay certain tax reimbursements and post cash collateral in the event of a defaulting lender. This time frame is usually comprised of a two-prong test pursuant to a definition such as the following:

“Required Payment Time” means, with respect to any event or circumstance giving rise to a requirement of a Borrower to make any payment: (a) within two (2) Business Days of the occurrence of such event or circumstance, to the extent funds are available in the Collateral Accounts or any other account maintained by a Borrower; and (b) otherwise, to the extent that it is necessary for the Credit Parties to issue a Capital Call to fund any required payment, within ten (10) Business Days of the occurrence of such event or circumstance (but, in any event, the Credit Parties shall issue such Capital Call and shall make such payment promptly after the related Capital Contributions are received).

Clause (b) of the above sample definition often involves some minor negotiation of the time period in which the applicable credit party must make a capital call, but, in most cases, this concept does not result in intense consternation. To the contrary, clause (a) of the above sample definition (the **“Account Clause”**) frequently contains a myriad of contested points.

The first area of negotiation is often whether the funds intended to be captured by the Account Clause should extend to funds held in accounts other than the collateral accounts. Borrowers often argue that the lenders’ reach should be limited to only those accounts that constitute collateral. Lenders counter with the argument that the circumstances in which the “Required Payment Time” definition applies are limited in scope and only in dire circumstances. Accordingly, a lender should be able to look to any available funds to rectify the existing circumstance and satisfy the applicable repayment obligations of the borrower.

The second concern raised by the Account Clause is how to treat funds in the applicable accounts that are allocated, or earmarked, by the borrowers for a particular purpose. Generally, private equity funds do not hold cash in the collateral accounts for extended periods of time or without a specific purpose.

Against this backdrop, borrowers often argue that granting a lender the right to remove funds from the borrowers’ accounts pursuant to the Account Clause can interfere with the borrowers’ time frame for completing an investment. In other words, if a lender is allowed to withdraw funds from the accounts during a two-day period, the borrowers must call capital again to replenish the accounts for the withdrawn funds. This, pursuant to the most common borrower arguments, could result in delays and cause the borrowers to fail to satisfy their obligations to effectuate an investment within a contractually-agreed timeline. Hence, the competing interests of the lenders and the borrowers diverge and the arguments are made over which party should have rights over the amounts in the borrowers’ accounts and whether the lenders must wait for the borrowers to call capital to make the necessary repayment.

We have seen this argument resolved in a number of different ways, but the solution often reached is to preclude the lenders from withdrawing funds from the collateral account (or other accounts) only to the extent such funds are earmarked for a contractually binding investment that will be effectuated in a time frame that would not allow the borrowers to call capital a second time to meet its contractual obligations. For example, if the investment is not slated to occur for twenty days from the date on which the lenders are authorized to remove funds from the borrowers’ accounts, the lenders should not be constrained from withdrawing those funds. The borrowers can call capital again and use the proceeds of that capital call to fund the anticipated investment. On the other hand, if the investment is to be effectuated in under ten business days from the date on which the lenders are authorized to withdraw funds from the accounts, the lenders agree to rely on the credit parties to call capital (clause (b) of the above sample definition) to effectuate the necessary repayment. In the latter case, the lenders would likely expect confirmation that the contemplated investment did in fact occur as planned.

There is certainly no one-size-fits-all solution. However, the question of “whose cash is it anyway?” has an answer that focuses on time. The resolution must protect the lenders’ interest in obtaining a timely repayment but not at the

expense of the borrowers' ability to deploy capital within a desirable timeframe.

'Fund Finance Friday: Industry Conversations' — Podcast with Jeff Johnston of Wells Fargo (54 Minutes)

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Industry Conversations



Cadwalader's Mike Mascia connects with Jeff Johnston, Managing Director and Head of Subscription Finance at Wells Fargo and Chairman of the Fund Finance Association, in this week's podcast edition of *Fund Finance Friday: Industry Conversations*. In the podcast, Jeff and Mike have a wide-ranging conversation, covering not only what Jeff is seeing in his portfolio and how the FFA is adjusting to the uncertainty, but also some of the challenges of leading large teams during stressful circumstances while in WFH, potential fund finance innovations coming out of the disruption and a deeply personal discussion of the passing of Jeff's father-in-law in March.



The Drawdown Article on LP Funding Performance

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Alice Murray of *The Drawdown* wrote an article earlier this week titled “Nothing to see here: LP defaults are fake news.” The article covers the Fund Finance Association’s response to the COVID-19 market disruption and reports on how well investor capital call funding has held up through the crisis to date. Cadwalader’s Mike Mascia is quoted throughout. The subscription-required article is available [here](#).

PEI Articles Relevant for Fund Finance

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There has been a flurry of articles relevant to the fund finance community that were published this week and last. In a follow-up to an earlier article about two instances of European LPs defaulting on capital commitments, *Private Equity International* (PEI) issued a brief response aptly labeled “[Investor liquidity: reading the runes](#).” The original article struck a chord and became PEI’s most-read article since the crisis hit, but PEI’s latest article states that the two defaults are isolated cases with little expectation of defaults among large established investors and that liquidity may be the bigger issue, even topically likening increased capital calls as the PE equivalent of hoarding toilet paper. On Tuesday, *Buyouts* editor Chris Witkowski published an article titled “LPs feel liquidity heat but no fears of widespread defaults.” The article focuses on a reported uptick in capital calls and LPs focused on monitoring their liquidity position. Steve Moseley, the Head of Alternative Investments at Alaska Permanent Fund, is quoted. The article is available [here](#). And Thursday, PEI published an article by Alex Lynn titled “Eaton: Large US institutions grappling with capital calls,” available [here](#). The article quotes Peter Martenson, a partner at advisory firm Eaton, on calls he has reportedly fielded from investors seeking liquidity solutions in light of the slowdown in PE distributions and other incoming cash flows.

ILPA Takes Investors' Temperature

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The “denominator effect” tops the list of LP considerations in the current environment, according to an April 8 ILPA publication. The term is shorthand for the shifting portfolio allocation toward private equity that happens when the value of public equity holdings decline. IPLA summarized its anecdotal investor survey findings in a report titled “ILPA Insights: LP Perspectives on the Impact of COVID-19.” Aside from target portfolio allocation, LPs are also reportedly concerned about the pace of capital calls, although 42% of LPs report no change or a decrease in capital call frequency. A majority of LPs report receiving more frequent and detailed information from GPs. The full report is available [here](#).

On the Move — Fund Finance Tidbits

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On the Move



Alex Bolton recently joined First Republic as a Managing Director, focusing on private equity finance. First Republic's private equity finance offering includes capital call facilities, management company lending, GP finance, and a range of other banking solutions for private equity funds and their principals.

Alex joins First Republic after eight years at National Australia Bank's New York office where he led the Fund Finance structuring, execution and portfolio management group.

Cadwalader Fund Finance Contributes to Healthcare Workers

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Our associate Danyeale Chung this week led a give-back effort from our team to healthcare workers in both New York and Charlotte where family members of our teammates are working on the front lines helping virus patients. The personal sacrifice these medical professionals are making is astounding. Gift packages of food, coffee and snacks are being sent to the hospital staffs on the front lines. As a reward for meeting our fundraising target, Mike Mascia agreed to post this ridiculousness in this week's *FFF*. Mike Exotic!



Recommended Reading

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- Corporate borrowers are requesting and often obtaining waivers on maintenance covenants from bank lenders, according to a recent [report](#) by Bloomberg LP. Lenders have been willing to grant these waivers to avoid triggering defaults and have, in many cases, been able to negotiate higher rates, additional fees or other concessions.
- The Chartered Alternative Investment Analyst (CAIA) Association published a white paper setting out an action plan in anticipation of increased retail investor participation in alternative investments. *Institutional Investor* covered the white paper [here](#). We have written about the outlook for increased individual participation in private funds a few times recently as a long-term source of fundraising growth. The CAIA Association publication is a reminder that more retail participation may be coming with increased regulatory oversight.
- Softbank Group Corp. anticipates a loss approaching \$17 billion in its Vision Fund for the recently ended fiscal year, [according](#) to *The Wall Street Journal*. Of the \$100 billion capital committed to the fund, 40% is structured as preferred stock, paying a 7% annual dividend.
- JPMorgan Chase & Co. Chairman and Chief Executive Officer Jamie Dimon's [letter](#) to shareholders on "dealing with an extraordinary crisis."
- Oaktree Capital Management Co-Founder and Co-Chairman Howard Marks' [Memo](#), "Knowledge of the Future."