

# Fund Finance 2025

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# Financing evergreen funds: the growth of individual investors in the private equity secondaries market

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Participation in the private equity secondaries market has historically been dominated by large institutions, with most transactions being funded by private secondaries funds backed by pools of institutional capital. However, times are changing. As has been widely reported, while the secondaries market has experienced rapid growth in recent years, it still provides only a fraction of the liquidity needed to service the primary market. As a result, fund managers have cast the net wider to try to attract additional capital to take advantage of market opportunities. One of the additional sources of that capital that has been heavily pursued is investment from individual investors. This chapter discusses the development of a market for retail-focused secondaries funds, and in particular the rise of evergreen funds. It also explores some of the key considerations for lenders in providing financing to such funds.

## Evergreen funds

Frequently, funds marketed to natural persons are structured as “evergreen” funds that have no defined timeline for wind-down. As a result, these funds have developed other mechanisms to provide investors with liquidity. Some funds are set up as “open-end” funds, and others as “closed-end” funds.

Open-end funds may require subscribing investors to pay all of their commitments upfront or, where the manager is comfortable with the credit risk of the investors (based on a private banking relationship, for example), the fund may obtain contractual capital commitments from investors that can be drawn down by the fund manager as needed to make investments. Once cash is contributed to the funds, it is deployed into new secondary investments or held in more liquid investments until it is needed. Subject to any gates, deferrals or lock-in periods that apply to redemptions, investors can elect to redeem (or tender) all or a portion of their interests in the fund periodically. For example, it is not uncommon for interests in an open-end fund to be subject to redemption by investors on a quarterly basis after the interests have been owned by the redeeming investors for a minimum “lock-in” period of 12 months. In order to ensure that the fund has sufficient cash to process such redemptions, there may be a limit on the overall percentage of interests (e.g., 5%) that can be redeemed in any one redemption period. For some funds, redemption is a firm obligation, and a minimum amount of redemption requests must be satisfied by such funds during each redemption period. For other funds, redemption is a soft obligation, and such funds can decline

to process redemptions (or may reduce the percentage of interests to be redeemed) in a given period as needed to manage liquidity in light of market conditions or other circumstances affecting the fund.

In the United States, open-end funds are the most common type of fund marketed to individual investors. Such funds are typically trusts or limited liability companies that are registered under the Investment Company Act of 1940, and are thus subject to a range of regulations that cover aspects of the fund's operations such as marketing, valuation of assets, incurrence of debt and conflicts of interest. In Europe, open-end funds often come in the form of Irish or Luxembourg alternative investment funds and are increasingly, though far from exclusively, being launched as European Long-Term Investment Funds.

In contrast to open-end funds, closed-end evergreen funds do not provide for a right of redemption or tender. These funds periodically raise capital to make investments in the secondaries market. To provide fund investors access to liquidity, they may be established as listed vehicles and arrange for the interests of the fund to be registered for trading on a stock exchange or other trading platform. Closed-end funds (at least in terms of funds that follow a secondaries strategy) are more often found in European jurisdictions (for example, quoted investment trusts in the UK). These funds are attractive to sponsors in that they do not require investments to be liquidated to manage redemption requests. However, such funds are subject to increased public reporting obligations, and shares in the fund may trade at a discount to net asset value.

The increase in launches of evergreen funds targeting individual investors is not surprising given the recent market environment. On the fund side, fundraising has been challenging for fund managers, making the greater time and expense of sourcing high-net-worth money (and even non-high-net-worth retail money) more worthwhile. At the same time, slow M&A and IPO markets have made it more difficult for fund managers to synchronise the timing of investment realisation events with fund maturities. Evergreen vehicles provide fund managers with greater flexibility to manage the timing of exit events. On the investor side, individual investors have long sought access to alternative investment strategies that have traditionally been reserved for deep-pocketed institutional investors. Evergreen funds provide that access, while also promising a certain amount of access to nearer-term liquidity compared to traditional private funds.

## Asset-focused financing

Like traditional funds, evergreen vehicles use financing. However, they are not always good candidates for subscription lines as investors may fully fund their commitments upfront, or the fund's more retail-focused investor pool may not fit traditional underwriting models built around rated, institutional investors. The result is that these funds often use NAV facilities that are underwritten on the assets of the fund, often even in the early stages of the fund. At inception, such facilities may be used to finance investment activity as the funds build up an investment portfolio and continue to raise capital from investors. As the fund matures, the facilities are increasingly used to manage cash flows – paying expenses, meeting capital calls from underlying investments, making tax distributions and, importantly, funding periodic investor redemptions.

## Revolving facilities dominate

As a result of the cash management focus of these funds, the credit facilities tend to be revolving facilities rather than term financings, allowing the fund to draw down and repay borrowings as needed. This provides flexibility to the funds, but it also limits the potential universe of lenders willing to provide facilities – the insurance companies and private fund lenders that regularly compete in many corners of the fund finance market generally prefer drawn loans. In order to make the loans more attractive to lenders, they often incorporate upfront fees and/or minimum utilisation requirements so that lenders have a minimum level of income in the event that the facilities are not heavily drawn. Some facilities may combine a term tranche and a revolving tranche.



## Investment pools are dynamic

Many financings for traditional secondaries vehicles are underwritten based on static portfolios of investments. Further, those investments tend to be held to maturity. Lenders are able to evaluate the underlying investment funds, their sponsors and even the portfolio companies in which the funds invest before entering into a loan transaction. In addition, they are able to underwrite expected cash flows on the investments rather than their price in the secondaries market. Portfolios for evergreen funds are different; they tend to be more dynamic. Given the long duration of these funds, their investment portfolios may turn over. The funds' sponsors may also be more likely to sell positions that were previously acquired, rather than holding them until their natural maturity. This requires a different approach to underwriting, as lenders have to find other ways to define the profile of an ever-changing portfolio. That approach often involves a more robust set of eligibility criteria for portfolio investment funds to be included in a credit facility borrowing base. It may also involve a broader set of "material investment events" – adverse events that cause a portfolio investment to be excluded for the purpose of the financial covenants. This approach almost always involves the imposition of diversification requirements.

## Diversification is key

Risk assessments of secondaries portfolios are based in large part on diversity. Lenders can ensure that a specified level of diversification is maintained by imposing concentration limits in the borrowing base. For example, limits are imposed on the percentage of a borrowing base that can comprise investments in a single fund, investments in a specified number of funds (e.g., top three, five or 10 funds) and investments in funds with the same sponsor (or affiliates of a sponsor). Additional diversity criteria that are applied may include investment strategy (e.g., buyout, credit, real estate, infra and growth/equity), geographic focus (e.g., limits on emerging markets exposure), sector exposure (e.g., energy, industrials, healthcare, financials) or vintage (e.g., limits on newer funds or older "zombie" funds). Concentration limits may also look through the funds to the underlying investments, to ensure that the portfolio is not overly exposed on an aggregate basis to particular companies, industries or geographic regions. Robust diversification requirements are a good way for lenders to manage the dynamic nature of investment portfolios for evergreen funds.

## Conclusion

The trend of proliferation of evergreen vehicles focused on individual investors in the private equity secondaries market is clear. The rate at which these vehicles are being established reflects growing demand from individual investors for access to private assets, as well as the undercapitalisation of the private equity secondaries market more generally. The diversity of the underlying portfolios held by these funds provides an attractive financing opportunity, and we expect this to continue to be an area of significant growth in the fund finance market.

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- Enforcement
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- Ratings
- Collateralised fund obligations

Written by leading industry participants from across the industry, this is the definitive legal guide for the global fund finance industry in 2025.

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