Changing Practices for Subscription Finance

Debevoise sponsored the 2017 European Fund Finance Symposium, with London partner Tom Smith speaking on the panel entitled “Changing Practices for Subscription Finance.”

The below summarized the key topic highlights from the panel discussion.

* 2017 has been a tremendously busy year for fund financing activity with both key drivers of activity (fundraising and fund size) increasing.
* Prevalence: fund financing is now commonplace as managers recognise the competitive disadvantage they are at without having the product. New entrants to the market do not want to be left behind because they don't have the flexibility afforded by facility (see below on benefits). With lenders now ready to provide fund financing solutions to alternative structures including SMAs and open-ended vehicles, most first-time funds should be able to access fund level financing.
* Complexity: the increasing complexity of fund structures is driving complexity in the finance documentation to accommodate for umbrella facilities, multiple parallel vehicles, SMA and fund-of-one facilities and security across several jurisdictions.
* Flexibility: as the product matures, funds are keen to add as much flexibility as possible to the finance documents – for example, by permitting accession of new entities and having in-built extension and increase mechanics.
* Convergence: the trend towards US and European markets converging continues as the same lenders provide the product across jurisdictions (and firms such as Debevoise provide global legal support and knowledge). We expect convergence with the Asian market to increase over the next few years (the Debevoise London team, for example, has material experience of Asian fund financings and those terms are often similar to European/US loan terms).
* ILPA guidance: the impact of the recent ILPA guidance has been primarily to increase transparency and reporting over the use of subscription lines to LPs which continues the trend towards greater disclosure (although this remains a negotiation point between LPs and GPs).
* Benefits: As we noted on my panel, "the benefits go beyond bridging" and extend to the ability to utilise letters of credit, draw in different currencies, hedge on a secured or unsecured basis and use the facility to equalise between investors admitted to the fund at different closings. It is important to highlight the benefits of fund financing in the context of increased LP focus.
* SMAs: there is lender appetite for providing facilities to SMAs, especially where the investor has a public rating and the lender can get comfortable with the LP credit.
* LIBOR: There is focus on how to deal with the impending fall-away of the use of LIBOR. However, with the term of many capital call facilities expiring before 2021, the market has not yet addressed the point in documentation.
* Hybrid facilities: Hybrids are increasingly prevalent, particularly with credit funds, to give "more firepower" to investing or for early release of capital at the end of a fund life. There are arguments for and against hybrid facilities (secured over LP commitments and NAV) versus splitting out a capital call facility at fund level and a NAV facility at SPV level. Banks are still developing their abilities to provide the combined product.

Debevoise has a large, global fund finance practice supported by teams in London, New York and Hong Kong. If you are interested in discussing any of the above, please let me know.