Subscription Finance Hot Topics[1]

By Justin Keller and Albert Tan

Against the backdrop of a broader market characterized by difficult fundraising, constrained balance sheets, and ongoing regulatory developments, experts from both the lender and sponsor-sides of the fund finance industry engaged in a wide-ranging discussion on the practices and expectations of market participants in the current environment. The dialogue returned again and again to the relationship-driven nature of the industry and the importance of communication and collaboration amongst all stakeholders to optimize outcomes.

Below is a summary of high-level takeaways from the discussion.

- In the context of a difficult fundraising environment and confronting tougher access to capital due to balance sheet concerns, sponsors need to be in communication with lenders early and often in a fund's life in order to gauge potential borrowing base capacity under any future subscription facility. At the same time, sponsors should also remain in communication with capital markets partners in order to evaluate other potential sources of financing.

- Similarly, fund formation and finance legal teams should communicate at early stages in order to ensure that the partnership agreement and/or side letters do not become a hindrance to securing a subscription facility. Because the subscription facility is now a mature product, fund documents and loan documents have evolved together, so fund documents rarely present deal-killing issues. However, the slowdown in fundraising has given investors greater leverage, and as a result, side letters have become more conservative of late. Counsel should be involved in vetting side letters before they are presented to lenders to get ahead of any material issues.

- In addition to early communication with respect to fund documentation and the composition of the investor pool, sponsors also need to be proactive in planning and communicating structuring decisions to reduce costs and deal friction down the road. It may be cheaper to form and activate a feeder or parallel fund into a credit facility at the outset of the facility, even if it is not certain the vehicle will be utilized. In any case, having a discussion proactively and collaboratively will make it more likely that sponsors are able to get full borrowing capacity for all investors. From a lender's perspective, sponsors can structure their funds and the credit facilities that support them in as complicated a manner as they like (provided the lawyers sign off). However, it is important for lenders to communicate and sponsors to understand that increasing complexity is going to increase costs and may increase closing timelines.

[1] Panelists included: (1) Haroldo Ale Filho | Vice President | DigitalBridge; (2) Richard Chiu | Director, Fund Finance | Mizuho Americas; (3) Patrick Hurley | Partner | Goodwin Procter LLP; (4) Justin Schneider | Head of Portfolio | Sumitomo Mitsui Trust Bank; and (5) Katherine Tandler | Associate | Paul Hastings. The panel was moderated by Edward Turowski | Managing Director, Head of US Non-Bank Financial Institutions and Fund Finance | CIBC.

- NAV lines are a specific area where early communication and collaboration can prove beneficial. As NAV lines have become more prevalent, sponsors who want to employ them will likely need to address restrictions in the partnership agreement, most frequently leverage limitations or limitations on the term of the fund's debt. Further, that requires sponsors to have had discussions with investors regarding how and why leverage is going be employed long before the changes to the partnership agreement are addressed.

- The factors lenders are evaluating in determining whether to provide subscription financing in this environment have not fundamentally changed. Lenders look to the credit quality of investors, the strength of lender protections in the fund documents, and the quality of the relationship with the sponsor. This last factor is paramount—the meaningfulness of the facility in the context of the broader relationship will often be more significant than pricing in determining whether it makes sense to extend the facility.

- Sponsors need a diversified pool of lenders to accommodate their different needs as global investors. Different banks have different capabilities, and it is important for sponsors to understand what these different capabilities are in order to leverage them properly and align with the fund's strategy. Sponsors can establish and maintain strong relationships with lenders by engaging with complementary products offered by the banks that may be important to such banks. Depth and breadth of the relationship is very important.

- The three factors most important for sponsors in evaluating subscription facilities are certainty of closing, size, and pricing. An established relationship goes a long way toward addressing certainty of execution, and sponsors may pass on lower pricing to ensure closing with a known lending partner. With respect to size, sponsors want to think about how they intend to use the facility and how quickly they will utilize it, so that they get the size right and do not pay unnecessary unused fees. Pricing always factors in as sponsors evaluate their return hurdle and the extent to which they are able to use a facility for leverage, which is vitiated if borrowing costs are too high.

- The discussion further touched on the evolving regulatory landscape globally, with differences in regulations across jurisdictions posing challenges for fund managers and lenders. Panelists emphasized the importance of staying informed about regulatory developments in various regions to navigate compliance requirements effectively and of maintaining open lines of communication between lenders and sponsors in respect of new pending regulations.