**CAPITAL CALL FACILITIES[1]**

By Zainab Al-Qaimi

The panel explored the capital call facilities in light of the current state of the market – discussing the repercussions of slow fundraising. The challenges and opportunities in managing liquidity and capital constraints in various financing contexts were touched on, as well as the growing importance of ESG and sustainability considerations in finance.

**Outlook**

In terms of timing, it was suggested that the hostile fundraising environment has come at a convenient time for banks, who are struggling with capital allocation over the last 12 months, which has perhaps provided an artificially buoyant market. However, banks are optimistic looking at the year ahead.

As a consequence of a slowdown in fundraising, the market is seeing multiple different closings happening throughout the fundraising period of a fund. This has a substantial impact from the operational perspective of the bank on the credit side. This could also have pricing implications as lenders joining at the first closing of a facility will be at a disadvantage to those who join later as the lenders coming in at a later date will have the benefit of greater visibility as to the utilisation and workload of the facility's credit.

Despite market conditions and slow fundraising, there has been an increase in demand. While deployment has slowed down to some extent in certain classes, facilities are remaining in place over longer periods of time, which results in an increase in the aggregation of exposure across certain asset classes among most lenders.

The rise of non-bank lenders causes issues for subscription finance. Although there are certain asset classes which lend themselves to more term loan structures, they are more involved in terms of structure and therefore documentation and negotiation.

**The position of subscription finance in an evolving market**

The continuing consensus is that there will always be a place for capital call finance. It is no longer being used merely for the purposes of an IRR boost or backdoor leverage – they are now truly operational facilities that help GPs with the management of capital calls from their investors. Subscription financing

[1] Panelists included Gül Akad (Simmons and Simmons); Julien Claudel (Société Générale); Nicola Germano (Intesa Sanpaolo); Michael Hubbard (Cadwalader, Wickersham & Taft); and Stuart McIntosh (SMBC).

helps to smooth the initial J curve that exists in the early life of a facility regardless of where interest rates sit at the time, and support with complex equalisation processes. Lenders have been forced to adapt to smaller, more complex LP bases from the inception of a fund.

**Basel IV**

In the lead up to the regulation's implementation, various approaches have been adopted by bank lenders in the last six months. Uncertainty prevails around interpretation of the rules, with lenders having different interpretations and solutions while working towards the same goal – better capital treatment.

Ratings, uncommitted structures and securitisations are all among the options that bank lenders have as they experiment to find a suitable solution in the next year. Basel IV will mark a turning point for the market when it comes into effect, particularly for bank lenders.

While the interpretation and details remain subject to finalisation, it cannot be said that banks have not had fair warning – having been on the horizon for over a decade, those subject to the regulation have had ample time to prepare.

**Ratings**

Although there remains a question mark over public ratings against private ones, there is an expectation that this feature will become more common going forward.

It is not necessarily difficult to obtain a rating for an existing facility. The difficulty arises in managing to get a rating alongside initial closings while securing the best offer from lenders. While there are banks that do not require a rating themselves, the syndication process becomes easier from a bank's perspective if that rating is already in place.

This plays into the wider challenge of how GPs are managing their bank group. There needs to be a push for more avenues of conversation between rating agencies and GPs. Narrowing down the number of banks is a significant part of the solution, as it allows the delivery of solutions to come from the lender's side, as opposed to placing pressure on GPs to find these.

**ESG**

Placing an ESG loan at portfolio company level is relatively simple – but replicating this on a fund level is more complicated. While there is a pool of capital available and a prescribed fund strategy, there is little visibility on where the capital will be deployed amongst the portfolio companies. This means that it is difficult to specify KPIs that are material but also achievable.

Given that this is an emerging area in the fund finance realm, there is a further challenge of ESG metrics defined by lenders, which have to be broad enough to apply to as many clients as possible – whereas it is likely that funds in the ESG space will be focusing on a certain niche, which could prove difficult to align with a lender's far-reaching metrics.

From an LP perspective, fund finance has yet to reach a point of focus in the ESG space – but this is only a matter of time. Over the past 12 months, the priority has been on asset and house level. In the midst of the liquidity crunch throughout 2023, the focus was on getting the financing in place without adding complications presented by ESG specific strategies. However, we are seeing more funds raising specific strategies – and in order to meet the net zero target, $4.5 trillion will have to be deployed per annum by 2030. There is an incredible amount of focus that public and government agencies will not be able to fulfil – private markets will have to step in here.