Private Equity

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The Changing Landscape of Subscription Credit Facilities

The continuing European economic uncertainty has done little to reduce the popularity of subscription credit or capital call facilities, which are liquidity products used by funds to bridge investor drawdowns.

This popularity is driven by the significant benefits they provide to funds — fast and reliable access to capital, certainty of execution and enhancement of investor returns. They are also low-risk products for financiers and have strong performance. Once the preserve of a few institutions, the European fund finance market is becoming increasingly competitive with the involvement of experienced U.S. players.

The products on offer have some similarities, but there are also significant differences driven by the policies and credit criteria of lenders. These will require careful consideration by a fund manager.

Fund documentation

Typically U.S. fund documentation provides detail for the capital call package, whereas European fund documentation has tended to rely on a wide ability to borrow and secure. Ensuring any lender requirements are incorporated into the fund documentation at the outset will help to smooth the process.

Investor side-letters

These letters — whereby investors acknowledge the financing directly in favour of the financiers — are often a condition for the availability of financing for U.S. lenders. But typically they have not been required by European banks. Obtaining these letters can be a lengthy and uncertain process and, again, are most effectively dealt with if flagged early on in the process.

Security

A power of attorney and/or an assignment of the right to call-down and receive undrawn investor commitments, as well as a pledge over the subscription accounts, are standard security requirements for this type of financing. But this package isn't obtainable in all jurisdictions or for all fund types. Establishing early on what is obtainable and how flexible a lender can be with its standard security requirements is essential.

Uncommitted lines

Many subscription finance lines are offered on a committed basis only but certain institutions offer uncommitted products, the obvious benefit being that no non-utilisation fee is payable during the life of the facility. The downside is that a fund will need to be comfortable with the fact that the facility can be withdrawn at any time, and this is where the experience, standing and past practice of the institution offering this product will need to be closely examined by a fund manager.

Fund models

Many subscription financings in Europe are provided to closed-ended funds, but some funds are moving away from this traditional private equity model to alternative models such as segregated accounts, deal-by-deal fundraising and direct-investing. Investors are looking to invest in open-ended funds attracted by the increased liquidity. These types of funds need financiers that are willing to adapt their traditional financing models to these different types of structures and able to offer bespoke and creative financing solutions.

The value of subscription finance products to funds means their popularity will continue to surge, and while the increasingly competitive market offers funds more choices, the devil will be in the detail and pricing will not necessarily be the determining factor.

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