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Capital call facilities: All change?

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A recent case, and perhaps the only fund finance case, at least to the authors' knowledge, has seen some lenders rush to close a fund finance 'loophole' (our emphasis).

Background

A capital call facility, or a subscription facility, bridges the gap between the time a fund is required to fulfil its obligations to complete an investment and when a call is made on the investors of the fund. The term of that loan is a relatively short period of time and typically for no longer than a 12 month period. It is generally seen as low risk for lenders; until recently default rates have not been a feature of such facilities.

Lenders can, and sometimes do, take security over a variety of assets including the right to call for funds from investors under the terms of their fund arrangements, notably limited partnership agreements or other subscription agreements.

Notice of that security will be given to the investors; ideally (for the lender) this will be done at the time of the creation of the security but it is not uncommon for notice to be given at a later date. For example, this may be done at the time of circulation of a report, say within the next quarter after the date the security is created.

A recent case involving the Abraaj group exposed this 'time lag' and particularly the failure to serve notice promptly, which saw a lender fighting to enforce the right to call for monies from a fund's investors following, amongst other things, the release by the fund of its investors' obligations.

Security in the Channel Islands

Whilst as a matter of Jersey law, security over contractual rights is perfected by way of registration of such security on the Jersey Security Interests Register, notice of that security is given as a matter of course to investors into the fund to assist in any subsequent enforcement.

In contrast, Guernsey law requires that notice of this type of security (which is created by way of legal assignment) must be given to investors in order for the security to be validly created, and therefore enforceable. (There is no procedure for "perfection" of such security in Guernsey, by registration or otherwise.) Typically lenders require that notice be given within a particular timeframe.

Lessons to be learnt

To answer the question in this briefing's title, fund finance arrangements in Jersey and Guernsey will not change in their entirety as a result of this recent case law. The Security Interests (Jersey) Law 2012 does not

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require notice to be given to perfect the security but we may see notice of that security being given somewhat closer to the date of the creation of the security.

In Guernsey, as security is not created under the Security Interests (Guernsey) Law 1993 (and so cannot be enforced) until notice has been given to investors, we may see notice being given closer to the grant of the facility rather than risk a delay.

However, as well as requiring that notice be given to investors sooner, lenders who operate in the fund finance sphere may wish, amongst other things, to:

- consider covenants in the underlying loan agreements to ensure that a fund cannot unilaterally amend or release an investor's obligations without the prior written consent of the lender;
- look more closely at side letters negotiated between the fund and its key investors;
- ensure that the undrawn commitments of 'blue chip' investors in a fund do not fall below a commercially agreed threshold during the term of the facility agreement;
- draft events of default to capture any litigation between the fund and its investors subject to a *de minimis* threshold;
- strengthen their position as regards powers of attorney provisions in the finance documents to enable the lenders to act before an event of default;
- monitor the calls made on investors and in particular their frequency and the lapse of time between the call and the payment; and
- review in careful detail the provenance of investors, typically, to ensure that they are not able to claim state immunity or where investors are state entities, their undrawn commitments are not included within any financial models.

Collas Crill act on both lender (bank) and fund (borrower) perspectives across all our jurisdictions. For more information, please contact one of the team.

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