

The Evolution of Subscription Credit Facilities for Separately Managed Accounts in Europe

Paul Tannenbaum, Kristin M. Rylko and Catherine T. Kiwala

There has been a strong surge in recent years of large institutional investors such as state retirement plans and sovereign wealth funds making use of separately managed accounts (“SMAs”) as an investment vehicle. Tailored commercial terms and documentation have become increasingly attractive to such investors (each, an “Investor”) and, in addition, sponsors see a benefit in meeting some of their largest and most loyal Investors’ demands through the establishment of SMAs.

Investments have been made with or in private equity firms, credit firms and private equity real estate firms, both in the United States and, more recently, in Europe. This has, in turn, led to an increased number of credit facilities backed by capital commitments of applicable Investors (“Subscription Credit Facilities”) being sourced and provided to SMAs.

Separately Managed Accounts— An Overview

An SMA comprises a legal entity established for the purpose of executing usually a single Investor’s investment agenda, under the management of an experienced investment advisor (or similar role) (each, a “Sponsor”). Typically these entities are structured as limited partnerships whose only limited partner is a single Investor. The Sponsor, in turn, assumes a non-equity (or *de minimis* equity) role—i.e., acting as general partner—which entails the day-to-day operations and management of the entity.

SMAs have steadily gained market share, both in the United States and in the European market (as compared to pooled funds and other investment structures) for several reasons. One, the structure affords the ability to implement bespoke, flexible investment strategies responsive to the Investor’s risk appetite, desired asset classes and industries, and to suggest the Investor’s investment policies, as well as tailored reporting requirements specifically negotiated to capture the Investor’s own internal reporting needs. Two, when assets under management are high enough to realize efficiencies of scale, management fees tend to be lower for an SMA than for a pooled fund. Finally, a fund with a single Investor does not expose the Investor to the risk that other limited partners may default, thereby avoiding negative impacts on the profitability and overall creditworthiness of the fund. While the single Investor feature is a major driver for the growing popularity of the SMA investment structure, it is this aspect in particular that creates some of the key points to consider in relation to Subscription Credit Facilities entered into by such SMAs. To be clear, SMAs do not come without complexities, as Sponsors are often required to explore any potential conflicts of interest that may arise between investments funded by the SMA and other pooled funds generally included in the particular Sponsor’s fund structure. The negotiation and documentation of the SMA

may also be as costly and time-consuming as establishing a pooled fund.

Subscription Credit Facilities for SMAs

Both pooled funds and SMAs alike rely on the capital commitments of their respective investors to fund investments, and Subscription Credit Facilities are generally regarded as a valuable tool for an investment vehicle to deploy such capital in alignment with its operations strategy.¹ Among other benefits, Subscription Credit Facilities provide an attractive source of quick liquidity (even providing next-day or same-day funding) and can minimize the need to issue capital calls to finance investments, thereby avoiding burdening the Investor as part of the closing process for an investment.

The issues a lender must consider in relation to SMAs in Europe and related facility documentation are in many respects similar to the issues impacting separate accounts and single investor vehicles in the United States.² And as the popularity of SMAs for European Sponsors and their Investors has increased, Sponsors are frequently exploring financing options for their SMAs from their lenders. Like their US counterparts, European lenders have generally demonstrated an appetite to provide facilities for SMAs subject to a more stringent credit analysis given the concentration risks inherent in reliance on a single Investor. Lenders take into account a number of factors such as familiarity and relationship with the underlying Investor and/or the Sponsor itself; for certain European lenders, whether the bank and Investor operate in similar jurisdictions with an institutional understanding of the culture and local economy in which each operates; and, finally, the pricing of the facility, both in terms of up-front and ongoing costs to the SMA. While certain European lenders are more active than others in providing Subscription Credit Facilities to SMAs, many have indicated

that viability for a particular fund is typically considered on a case-by-case basis in light of the above factors.

Documentation Considerations for Subscription Credit Facilities Provided to an SMA in Europe

The documentation posture taken by most market lenders in Europe differs in a few ways from the approach taken for pooled funds where a larger diversified investor pool supports the facility. In pooled funds, should an Investor default or fall out of the borrowing base, the commitments of the other Investors remain as a source of repayment for Subscription Credit Facility obligations. In an SMA structure, the single Investor's capital commitments are the primary credit consideration for the lender.

Generally, European lenders will seek to ensure that the fund documents appropriately address authorization of the general partner or investment manager to enter into Subscription Credit Facilities on behalf of the SMA and to pledge the fund's assets (which include, in the case of a Subscription Credit Facility, the Investor's agreement to advance capital when called). Fund documents generally include detailed borrowing provisions addressing lenders' requirements³ and other language relating to the ability to call capital typically required by lenders. As such, most European transactions with pooled investment vehicles do not require investor consent letters ("Investor Consent Letters") whereby investors separately enter into an agreement in favor of a lender, acknowledging and making representations regarding the investor's commitments to the fund and the security created in favor of the lender.

Documentation for a Subscription Credit Facility to an SMA typically follows the standardized forms used in the European

market (as applicable for the governing law of the facility agreement) and incorporates a well-known suite of documents—including a facility agreement, charges and account charges. The traditional approach in Europe to Subscription Credit Facilities of applying a coverage ratio (being the ratio of uncalled capital commitments of certain investors to aggregate financial indebtedness of the borrower)—as opposed to the US-style convention of formulating a borrowing base with investor concentration limits—is also well suited to Subscription Credit Facilities for SMAs, given the single Investor feature. However, because an SMA usually only has a single Investor, European lenders typically seek to bolster the standardized documentation with additional documentation in order to both deepen the lender’s knowledge of and comfort with the underlying Investor and establish contractual privity between the lender and the Investor notwithstanding the adequacy of the fund documentation for the SMA. As such, European lenders to SMAs will in most cases require an Investor Consent Letter from the single Investor. As mentioned above, Investor Consent Letters have not been commonplace in European Subscription Credit Facilities, and so the recent increase in Subscription Credit Facilities for SMAs in Europe has created additional focus on Investor Consent Letters amongst European lenders, Sponsors, Investors and their applicable legal advisers.

Nevertheless, in the context of a Subscription Credit Facility for an SMA, the Investor Consent Letter is important from a lender’s perspective for a number of reasons. First, the Investor Consent Letter creates a direct agreement between the lender and the Investor (which for many lenders that provide this product is a key credit requirement given that the creditworthiness of the single Investor is the primary source of repayment for Subscription Credit Facility obligations).

Second, sovereign immunity, which may apply to Investors that will invest in SMAs, will often not be adequately addressed in fund documentation, and lenders will require this to be dealt with in the Investor Consent Letter.

The scrutiny on the single Investor applies not only at a credit level for the lender and in relation to the diligence undertaken on the fund documents (as discussed above) but also impacts key provisions documented in the facility agreement and ancillary documents. Typical exclusion events that would exclude a particular Investor in a pooled fund from the borrowing base in a Subscription Credit Facility may be less flexible in certain aspects, including cure and grace periods. In addition, certain major exclusion events in relation to investors where there are multiple investors in a fund are typically re-drafted in SMA Subscription Credit Facilities as events of default. The remaining exclusion events trigger a mandatory prepayment, which, if not waived within an agreed timeframe (usually 30 days), would result in an event of default. Furthermore, transfers by the single Investor will generally require strict levels of approval from the lender. Lenders will also seek tighter reporting requirements given that the Sponsor is only reporting itself to, and managing the commitments of, a single Investor, and lenders will expect more timely delivery of information than Sponsors are often given when they are managing a large pool of investors. These terms are a few examples of the approach taken in Europe to the documentation as a result of the reliance placed on the single Investor by the lender providing a Subscription Credit Facility to the SMA.

Additional Product Offerings for SMAs in Europe

The rise in SMAs and financings being provided to SMAs in Europe has led to some innovative products and documents being

offered by European lenders, particularly for Sponsors that manage a number of SMAs. In these instances, Sponsors have often sourced financing for multiple SMAs from a single lender or club of the same lenders. Where this is the case, the use of umbrella facilities (one documented facility agreement entered into with a number of fund borrowers that each have access to a Separate Subscription Credit Facility under the single document on a non-cross-collateralized basis) (“Umbrella Facilities”) is often considered. These types of facilities may be viewed as efficient across the platform and reduce the required documentation for a number of separate facility agreements that have substantially similar terms.

Other technologies that have been used for SMA financings include common terms agreements (each a “CTA”). Similar to Umbrella Facilities, a CTA agreed between the lender and the Sponsor contains the key legal documentation provisions found in a standard facility agreement for a Subscription Credit Facility (including, by way of example, repayment, interest provisions, tax, representations, undertakings, events of default and lender and agency mechanics). The CTA may then be appended to any number of short form facility agreements for a Subscription Credit Facility for any number of SMAs. The short-form facility agreements will include the relevant parties, facility amount, commercial terms (such as pricing and fees) and any other terms applicable for the specific SMA and the Subscription Credit Facility being provided to such SMA. As the CTA will be in an agreed form for each facility agreement required, execution of each facility agreement (once the CTA is agreed) can be very efficient.

One benefit of the CTA in contrast to an Umbrella Facility is that a CTA can be agreed upfront and can then be appended to short-form facility agreements required by SMAs over time at the relevant points at which the

Sponsor required the Subscription Credit Facility for such SMA (with any amendments required to the CTA being made as applicable). An Umbrella Facility, by contrast, is typically entered into by all applicable borrowers at the same time albeit additional borrowers may accede as required. Although Umbrella Facilities and CTAs are not new to the European market, the increase in financings being provided to SMAs in Europe has resulted in increased consideration of these products by Sponsors.

Conclusion

European Sponsors and Investors alike are likely to continue seeking opportunities for SMAs, and this will in turn drive demand for financing products to be sourced and made available to these fund structures. As the types of Investors investing through SMAs potentially diversifies, further lender scrutiny could lead to more developments in the approach to the diligence undertaken on fund documentation and protections sought in the facility agreement and Investor Consent Letters. For larger sponsors with multiple SMAs, there could also be an increasing appetite for Umbrella Facilities and CTA documentation processes. Despite the bespoke nature of the SMA structure, we anticipate that European lenders and Sponsors alike will continue to work on creative structural and documentation solutions for Subscription Credit Facilities to SMAs in order to provide liquidity to this growing segment of the market.

Endnotes

- ¹ See "[The Advantages of Subscription Credit Facilities](https://www.mayerbrown.com/en/news/2017/03/the-advantages-of-subscription-credit-facilities)" in the *Fund Finance Market Review Spring 2017* (available at: <https://www.mayerbrown.com/en/news/2017/03/the-advantages-of-subscription-credit-facilities>).
- ² See "[Separate Accounts vs. Commingled Funds: Similarities and Differences in the Context of Credit Facilities](https://www.mayerbrown.com/en/perspectives-events/publications/2013/07/separate-accounts-vs-commingled-funds-similarities)" in the *Fund Finance Market Review Summer 2013* (available at: <https://www.mayerbrown.com/en/perspectives-events/publications/2013/07/separate-accounts-vs-commingled-funds-similarities>) and "[Lending to Single Investor Funds: Issues in Connection with Subscription Credit Facilities](https://www.mayerbrown.com/en/perspectives-events/publications/2016/09/lending-to-single-investor-funds-issues-in-connect)" in the *Fund Finance Market Review Fall 2016* (available at: <https://www.mayerbrown.com/en/perspectives-events/publications/2016/09/lending-to-single-investor-funds-issues-in-connect>).
- ³ See "Model LPA Provisions for Subscription Credit Facilities" in this *Fund Finance Market Review Spring 2019* on [p. 30](#).

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience..

Please visit [mayerbrown.com](https://www.mayerbrown.com) for comprehensive contact information for all Mayer Brown offices.

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website. "Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown.

© 2019 Mayer Brown. All rights reserved.

Attorney Advertising. Prior results do not guarantee a similar outcome.