

Investor Letters in Subscription Credit Facilities: Strategic Benefits for SMAs and Concentrated Investor Funds

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In this article, the authors examine the shift away from investor letters in commingled funds and explore their continued relevance in separately managed accounts and funds with concentrated investor pools. They highlight how investor letters can offer additional contractual certainty through direct privity, mitigate potential fraud and credit risk, and clarify fund obligations.

Subscription credit facilities are a common financing tool for investment funds, enabling borrowing against the unfunded capital commitments of investors. Historically, lenders required investor letters (also referred to as investor acknowledgment letters) from each investor or at least each borrowing base investor to directly confirm their obligation to fund capital calls for the benefit of the lender.

Over time, robust limited partnership agreement (LPA) provisions in large, diversified funds have largely eliminated the need for such letters. However, in separately managed accounts (SMAs) and funds with concentrated investor bases, investor letters continue to serve a useful purpose by providing added clarity and direct confirmation of investor obligations.

This article examines the market's shift away from investor letters in commingled

funds and explores their continued relevance in SMAs and concentrated investor pools. It highlights how investor letters can offer additional contractual certainty through direct privity, mitigate potential fraud and credit risk, and clarify fund obligations.

FROM INVESTOR LETTERS TO LPAS: HISTORICAL SHIFT IN MARKET PRACTICE

In the early evolution of subscription credit facilities, lenders typically required investor letters from each investor to confirm the enforceability of capital call obligations. As the fund finance market matured, LPAs in large, institutional-grade funds began to include comprehensive lender protections - such as express authority to borrow and pledge commitments, binding investor obligations, waivers of defenses, and third-party beneficiary rights for lenders.

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These built-in safeguards made it feasible for lenders to extend credit without separate investor letters, driven by efficiency and market demand. Requiring individual letters from numerous investors proved burdensome, particularly for large funds. By incorporating financing terms into LPAs - often negotiated upfront with anchor investors and in line with guidance from groups like ILPA - sponsors streamlined fund formation and enhanced credit facility readiness. Consequently, investor letters became largely unnecessary in funds with large investor pools.

CONTINUED IMPORTANCE OF INVESTOR LETTERS IN SMAS AND CONCENTRATED INVESTOR POOLS

While investor letters have become less prevalent in large, multi-investor funds, they remain a helpful tool in SMAs and funds with a concentrated investor base. As of 2025, market practice reflects a clear bifurcation: investor letters are generally not required for diversified funds but are often used where one or a few investors account for a significant portion of total commitments. Key scenarios include:

- *Separately Managed Accounts (Fund-of-One)*: In SMAs or fund-of-one structures, where a single investor (or a very small group) is the sole capital source, investor letters provide direct confirmation of the investor's obligation and help mitigate lender exposure to single-party credit risk.
- *Concentrated Investor Funds*: Where one or a few investors contribute a significant share (e.g., 20–35%) of commitments, lenders often require letters from these investors to confirm enforceable obligations and provide additional credit support.

- *Challenging LPA Provisions, Side Letter Provisions or Special Investor Rights*: Investor letters are also used to override or waive provisions that could impair lender collateral - such as opt-out rights, withdrawal rights, no waiver of defenses or funding restrictions. By obtaining waivers through an investor letter, lenders ensure consistency and enforceability across the investor pool.
- *Public Investors and Sovereign Entities*: Where legal uncertainties such as sovereign immunity exist, investor letters can offer a mechanism to clarify the commercial nature of the obligation and, where appropriate, document waivers or confirmations relevant to enforcement.

In summary, investor letters can supplement the LPA framework and provide additional assurance where lender exposure is more concentrated or complex.

ENHANCING ENFORCEABILITY AND CLARITY FOR LENDERS

A key function of investor letters is to provide clear and direct confirmation of certain investor obligations. Unlike reliance on LPA provisions, which may position the lender as a collateral assignee or third-party beneficiary subject to procedural hurdles, ambiguities and potential defenses, investor letters may help streamline enforcement by establishing a more direct line of privity, particularly in distressed scenarios or where LPAs are silent or ambiguous.

Beyond enhancing enforceability, investor letters may eliminate uncertainties found in fund documents and side letters by providing tailored confirmations that clarify key

obligations. Typical provisions in an investor letter include:

- Express acknowledgment of the credit facility and consent to the pledge of the investor's capital commitment as collateral;
- Agreement to fund capital calls made by the lender following a default, without set-off, counterclaim, or defense;
- Confirmation of the total commitment amount and the remaining unfunded balance;
- Agreement not to reduce, suspend, or withdraw or transfer commitments without lender consent; and
- Direction for payment to a pledged account, ensuring control over capital flows.

These provisions not only reinforce the binding nature of the investor's obligations but may also create an estoppel, preventing investors from later disputing their commitments. As a result, investor letters strengthen both the reliability of capital commitments as collateral and the overall enforceability of the lender's rights.

FRAUD RISK MITIGATION: INVESTOR CONFIRMATION AS A DUE DILIGENCE TOOL

Investor letters have also gained prominence as a fraud prevention and diligence mechanism. While subscription facilities have historically exhibited low default rates, high-profile fraud cases have prompted lenders to strengthen their verification protocols. In these cases, fund sponsors misrepresented investor commitments or misused capital call authority, inflating borrowing bases and circumventing traditional safeguards. Investor letters help

verify commitments directly with the investor, serving as an important layer of fraud detection.

By requiring investor letters, lenders ensure:

- Confirmation of the investor's existence, commitment, and awareness of the facility;
- Direct validation of capital amounts and undrawn balances; and
- A check on fund sponsor integrity, especially in novel or high-risk structures.

While not a substitute for broader diligence, investor letters can complement practices such as capital call verification, investor funding history reviews, and spot checks.

CONCLUSION

While investor letters have become less common in large, diversified fund structures where LPA terms protect lenders, they offer meaningful benefits in SMAs, fund-of-ones, and concentrated investor pools. These letters provide direct enforceability, unambiguous commitments, and targeted risk mitigation - especially in high-exposure structures.

As diligence expectations rise and fraud awareness grows, investor letters are likely to remain an important component of fund finance transactions involving few or high-risk investors. They help align the interests of sponsors, investors, and lenders, fostering greater transparency and credit reliability. In today's market, especially for concentrated deals, investor letters reaffirm an enduring principle in fund finance: it still pays to "trust but verify."