COVID-19 and Fund Finance – considerations for Fund Managers

6 April 2020
By: Bryony Widdup

In brief...

In the investment management world, the volatility created by an unexpected occasion such as the coronavirus pandemic might be a challenge, it might be an opportunity, it might be a trigger for strategy adaptation like any other market fluctuation.

Unlike operating businesses which are broadly negatively impacted (unless you happen to be in some very particular industry segments), investment managers can trade, many very successfully, through these types of market events. However, amidst all the focus on portfolio and investor matters, on delivering returns in dynamic market conditions, it is important to review the fund's leverage arrangements as well.

Covenants: This is probably the most obvious area, and the place where most minds will immediately turn. Depending on the type of facility, financial covenants may be commitments orientated, in which case reviewing the triggers on commitment eligibility will be important. Generally any indication from an investor that it will be unable to fund its commitment when due would create both an information reporting obligation under the facility and potentially lead to the commitment falling out of eligibility. That should be reviewed and monitored, with the credit condition of investors clearly being key in this regard. In a hybrid or asset-backed facility there will also be some covenants which are asset-facing and these are likely to need urgent reconsideration in light of fluctuations in portfolio values. In particular with quarter end reporting dates in mind, consequences of breach, potential cure periods and waivers might need to be on the table.

Other "material adversity" terms: There has been some discussion around the potential for trigger of Material Adverse Change (MAC) clauses in current circumstances, however, this is likely to be less relevant in the majority of fund financings which should not generally contain unamended MAC clauses. Concentration is also relevant – broadly based portfolios are often more resilient in any case. Of course there will be some fund financings over very concentrated portfolios in particularly badly affected sectors which may therefore be more "at risk" of this kind of general trigger, but the view now (similarly to previous "crisis" markets) is that if there is a MAC then there are likely to be other facility clauses which give a much stronger basis for event of default which would be triggered instead.

Reputationally, MAC is not something on which banks would be keen to rely and for funds whose lenders fall under the authority of the Prudential Regulation Authority, some express guidance has been issued urging leaders to differentiate between normal covenant breaches and those which may be arising as a result of the pandemic, to waive circumstance-specific breaches and to act in good faith, not implementing new charges or restrictions on

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as

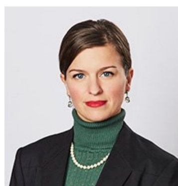
borrowers in connections with such waivers. Obviously this may be helpful for funds when discussing and such matters with their lenders.

Drawstops: In the event that new monies are required, or under a Revolving Credit Facility (RCF) which is subject to periodic rollover, it is necessary to consider drawstops that might apply. Generally, RCFs will be subject to event of default drawstop on rollover but documentation may need to be reviewed to confirm. If default does apply, which will generally be the case for new monies at least, consideration will also need to be given to the prospects of an event of default as well as whether one has actually occurred.

Hedging limitation: Some facilities may contain limitations on hedging. Whilst implementing derivatives strategies to assist portfolio strategies is often key, the facility may require this to be effected in a particular level in the structure (e.g. asset holding vehicles may be freer than the funds themselves), the facility may have restrictions around how this can be structured (e.g. prohibiting some types of associated security and credit support (which might also be “financial indebtedness” impacting facility covenants depending on where it comes from in the structure)), and there may be an outright financial cap. All of these elements should be taken into account before new hedging strategies are undertaken in leveraged structures.

Tenure: Given future uncertainty, particularly around finance liquidity in the coming months, it is a good time to take a look at loan maturity schedules, consider extension provisions, accordions which might be useful in the circumstances and to understand what refinancing options might be available should that become necessary. In our view, the market is likely to deliver less favourable refinancing terms in the short to mid-term. Factoring that in to decision making over, for example, the commerciality of potentially more expensive extension fees but which then maintain a more favourable covenant environment, will make up some of the important decision making funds need to take around tenure and leverage availability in the coming months.

AUTHORS



Bryony Widdup
Partner
London | T: +44 (0)20 7349 0296
bryony.widdup@dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as