



Fund financing in the Channel Islands; it's about good financial management

Insights - 25/02/2019

Good fund managers understand the importance of maintaining a strong relationship with investors, who expect good financial management, orderly capital call notices and, of course, timely returns on their investment.

Fund managers must also manage the day to day operation of the fund. The fund might require additional capital to fund a time sensitive investment, returns to investors might be hindered because of an illiquid investment, or working capital might be required pending an asset realisation or a capital call to investors. Each of these can result in unnecessary multiple capital calls from, and returns on investment to, investors. With efficient use of fund financing however, the fund can reduce the frequency of capital movement between fund and investor, and better manage the relationship with investors.

The fund market in Guernsey and Jersey is supported by debt finance provided by established bank lenders and alternative debt providers, which facilitates asset acquisition, working capital and, particularly in more difficult markets, provides liquidity which is absent from the fund's underlying assets.

Subscription facilities

Subscription facilities (also known as "capital call" or "capital commitment" facilities) are credit facilities provided predominantly to closed ended funds that are secured with the fund's uncalled capital commitments and the rights to call capital from investors which, in the case of a fund structured as a Guernsey or Jersey limited partnership, will be held by the fund's general partner.

Funds use subscription facilities to smooth out capital calls from investors and reduce the level of communication with investors; it makes sense to use a subscription facility to finance an investment rather than use a capital call in circumstances where a return to investors is considered imminent. Similarly, subscription facilities can be used to avoid frequent capital calls for relatively small amounts of working capital. Typically, fund documentation allows subscription

facilities to be entered into on short notice, which is an advantage in respect of time sensitive investments.

NAV credit facilities

As the life of the fund progresses, the amount of uncalled capital reduces as the fund makes capital calls and invests in assets. At this point NAV facilities (approved by reference to the new asset value of the borrower) become useful in providing the fund with finance. NAV facilities are credit facilities provided to a fund secured with the fund's assets. This might include security over the rights to proceeds from the fund's assets and/or security over the equity interest of the entities holding the assets. Where the assets are high quality, the NAV facility might be unsecured, but the lender will take comfort from the regularity and type of valuation, the ratio of the value of the loan to the value of the assets, covenants as to minimum net asset value, transfers during default periods and negative pledges, and restrictions on the diversification of the underlying portfolio investments, minimum liquidity and investment strategies. The lender might also require mandatory prepayments. Clearly in this situation robust valuations are crucial.

Hybrid facilities

A recent trend is the popularity of "hybrid" fund financing, where subscription financing is blended with NAV financings. The security granted by the fund initially is the same as one would expect in respect of subscription facilities. As the fund matures however, the amount of uncalled capital diminishes and, all things being equal, the amount of assets increases. A hybrid facility therefore looks to both the uncalled capital commitments and the net asset valuation of the fund's assets, and will require security in respect of both.

This allows a continuous provision of finance throughout the life of the fund pursuant to a single credit agreement. A challenge for Hybrid facility providers is that they need to be comfortable with the amount and quality of the uncalled capital (which will involve due diligence in respect of the fund investors) in addition to controls on the assets of the fund and visibility in respect of the valuation of those assets.

Ogier expertise

With funds under management approaching £600 billion in the Channel Islands, the islands are a centre for investment fund expertise and excellence. Ogier regularly advises in respect of the facilities discussed above and the security supporting them.

Christopher Jones is a partner in Ogier's Guernsey team where he advises financial institutions, investment funds and corporate clients on a broad range of multi-jurisdictional transactions.

About Ogier

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Key Contacts



[Christopher Jones](#)

Partner

[Guernsey](#)

E: christopher.jones@ogier.com

T: [+44 1481 752337](tel:+441481752337)

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