Proskauer

ILPA Changes to Credit Facility Disclosure: What Fund Managers Need to Know

June 29, 2020

Use of subscription credit facilities by private funds has increased significantly since the last financial crisis. Now, as fund managers grapple with the liquidity challenges presented by COVID-19, there is more attention than ever on subscription credit facilities and other fund finance products. As a response, the Institutional Limited Partners Association (ILPA) has prepared guidance on enhanced disclosure in relation to the use of credit facilities.

Proskauer's leading international Private Investment Funds team sets out details of the newly proposed recommendations and explains how fund managers can prepare themselves for implementation.

The need for new guidance

Heightened investor attention to disclosure has been driven by concerns around how funds will manage their credit facilities in light of the COVID-19 crisis and, in particular, how this will impact investor's ability to manage their liquidity requirements. The new guidance aims to provide a framework for consistent disclosure on key aspects of subscription credit facilities and builds on ILPA's existing 2017 recommendations on usage of such facilities by funds. While the 2017 recommendations led to improvements around transparency and reporting on subscription credit facilities, ILPA's view is that greater standardization around disclosure would lead to mutual benefits for investors and fund managers.

Background to the new recommendations

ILPA published its subscription credit facilities recommendations in 2017. This guidance noted that subscription credit facilities had evolved beyond a short-term bridging function and were being used by fund managers as a broader cash management tool.

While acknowledging the usefulness of such facilities, ILPA highlighted concerns around the costs to the fund (including upfront fees and interest expenses), potential UBTI tax considerations (for U.S. tax exempt investors) and the impact on IRR of the use such facilities[1]. Further, ILPA noted the potential for lenders to exert control over fund management decisions and, of particular relevance to the current crisis, warned that shocks to financial markets could create liquidity risk for investors if there were simultaneous capital calls across multiple funds and credit facilities.

As such, ILPA's recommendations included: (1) increased transparency and disclosure in relation to subscription credit facilities (including the impact on IRR), (2) imposition of thresholds on the amount and maximum duration of debt incurred under such facilities, (3) starting calculation of the fund manager's preferred return hurdle from when the credit facility is first drawn and (4) a recommendation not to use debt to cover distribution in anticipation of, but prior, a portfolio company exit.

Following publication, there was some concern among fund managers that the reporting regime proposed by ILPA could become overly burdensome and that changing the start time for calculating preferred return would make the cost of using subscription credit facilities prohibitive. As such, we note that very few fund managers have adopted the recommendation around the preferred return calculation.

Disclosure recommendations returned in 2019 with the publication of ILPA Principles 3.0. In the section on subscription credit facilities, ILPA suggested the following in relation to disclosure:

> "*Quarterly and annual reporting should include a schedule of fund-level leverage, including commitments and outstanding balances on subscription financing lines or any other credit facilities in use by the fund.*"

ILPA also recommended that the anticipated material terms of any fund level financing be disclosed at the time of the closing of the fund and that the full terms should be available to investors on request.

The new recommendations: reporting and disclosure

The new recommendations provide for disclosure of the following items:

As part of quarterly reporting

1. Total size of facility
2. Total balance of the facility
3. Individual LP and GP’s unfunded commitment financed ($ and %) through the facility
4. The average number of days outstanding of each draw down
5. Net IRR with and without the use of the facility
6. A schedule of cash flows alongside the partner’s capital account statement and schedule of investments

On an annual basis as a supplement within the annual reporting package

1. Total size of facility
2. Total balance of the facility
3. Individual LP and GP’s unfunded commitment financed ($ and %) through the facility
4. The average number of days outstanding of each draw down
5. Lead Bank*
6. Fund Draw Down Limit*
7. Fund Maximum Allowable Borrowing (Days)*
8. Facility Term Expiration*
9. Facility Renewal Option*
10. Collateral Base*
11. Interest Rate*
12. Upfront Fee Rate*
13. Unused Fee Rate*
14. Additional Fees*
15. Total Fees Paid*
16. The current use of the proceeds from such lines, i.e., solely to bridge capital calls (and the nature of those capital calls) or for other purposes (such as accelerated distributions)*
17. Net IRRs both with and without the use of the facility to their investors*
18. Clearly defined methodology for calculating net IRR amounts with and without the use of the facility*

ILPA recommends that the quarterly items be provided as part of the 30 June 2020 reporting package. It also suggests that those annual items above marked with an (*) be provided initially as part of 30 June 2020 reporting (the first reporting period following publication of the guidance), and then for all annual items to be included as part of annual reporting going forward.

There are no specific recommendations around the exact format that should be used for the additional disclosure, although an illustrative example is included in the recommendations. ILPA notes that, based on a survey of CFOs, investors would like the information to be presented explicitly so that it is easy to discern from the regular reporting.

The new recommendations: predictability of capital calls

In addition to recommendations on subscription facility reporting, ILPA has recommended that fund managers should provide investors with:

- as much notice as possible of capital calls (and not just the minimum 10 business days' notice), particularly where the amount of the capital call was higher than an agreed percentage of the investor's uncalled commitments; and
- an estimate or estimated range of the amount of capital to be called.

The new recommendations: calculating subscription facility exposure

Finally, the recommendations provide investors with a methodology by which they can calculate their exposure to any debt incurred by the funds, using information provided by fund managers as part of quarterly reporting.

Next steps for fund managers

In light of the recommendations, we suggest that fund managers:

- give thought to an appropriate format for reporting on credit facilities;
- collect the required information on their existing credit facilities so that it's ready for reporting (and, in particular, form a view on an appropriate methodology for calculating net IRR with and without the use of credit facilities); and
- determine whether it is possible to give greater notice of capital calls and, if so, outline the circumstances in which additional notice will be provided.

****

Proskauer's market leading international fund finance practice has extensive experience acting for fund managers and financial institutions in relation to all types of fund finance.

Proskauer’s market leading international private investment funds practice has extensive experience acting for fund managers and investors throughout the US, Europe and Asia.

Please do get in touch if you have any queries.

[1] In certain instances use of a credit facility without disclosure on the impact of IRR may be viewed as misleading by regulatory agencies, and fund managers should give consideration to the same in offering documents when reporting prior performance.

Related Professionals

- **Nigel van Zyl**
  Partner