

Hybrid fund finance transactions – offshore legal considerations

Service area / [Banking and Finance, Investment Funds](#)

Legal jurisdictions / [British Virgin Islands, Cayman Islands](#)

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Introduction

Hybrid fund finance facilities are emerging in the Asia Pacific market as an increasingly popular product with significant commercial upside for both lenders and fund borrowers alike.

In this note we consider some of the offshore legal considerations for lenders and borrowers which can arise in these complex and bespoke financing transactions.

Hybrid transactions

Hybrid deals are so named because they combine elements of:

- a subscription line or capital call financing where the loan is secured by the uncalled capital commitments of investors in the fund; and
- a net asset value (“NAV”) facility where the loan is secured by recourse to the assets of the fund (which can include income and distributions from investments and shares in holding companies).

Benefits

Offering hybrid facilities provides lenders the opportunity to:

- establish and maintain a relationship with a sponsor client which will exist throughout the relevant fund’s lifecycle of fundraising, investing, portfolio management and exit (as liquidity will continue to be available after the capital commitments of investors have been drawn); and

- potentially achieve attractive pricing as compared with standalone subscription or NAV facilities, in view of the fact that fewer institutional lenders have the capability to readily offer hybrid facilities as a mainstream product.

From a sponsor’s perspective, a hybrid facility:

- offers liquidity throughout the fund lifecycle; and
- can mitigate efficiency concerns around putting in place and managing separate subscription line and NAV facilities.

Challenges

The credit analysis for a hybrid facility will be more complex, requiring analysis of the creditworthiness of investors in the fund (relevant to the credit support from undrawn capital commitments) as well the underlying assets (relevant to the credit support from the fund’s investments).

Hybrid facilities also involve additional legal due diligence and structuring considerations requiring lenders and their counsel to fully understand the fund’s structure, investment strategy, business, cash flows, and recourse. Careful structuring in all respects that takes asset eligibility criteria, lender voting rights and security enforcement into account is essential.

Where (as is often the case in APAC) the fund and / or its portfolio investments are established offshore (e.g. a Cayman fund with parallel vehicles, feeder funds and portfolio holding companies or SPVs incorporated in the British Virgin Islands or the Cayman Islands) we set out some high level due diligence considerations below.

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Offshore legal considerations

As the APAC fund finance market develops, permissive borrowing and security provisions are becoming more common in fund documents.

The fund documents will need to be carefully reviewed to ensure that they contain provisions specifically permitting the fund to incur and secure not only subscription line finance debt, but also to create security over fund assets and (if relevant) grant guarantees.

There can be highly technical enforcement issues where the security consists of a mixture of capital call, share security and rights to distributions and where certain assets or entities fall outside the security package.

These are issues which it is essential for counsel to quickly identify and advise upon at an early stage as they relate to the individual deal.

Specialised diligence of the organisational documents of all obligors should always be undertaken to verify the good standing, capacity and authority of the relevant parties to the deal.

Share security

If a hybrid deal is to be secured by shares in a portfolio holding company, the terms of any financing arrangements entered into by the portfolio companies should be checked to ensure that no change of control provisions are triggered.

Another trap for the unwary which sometimes arises in hybrid deals specifically involving share security is the issue of third party shareholder consents in circumstances where portfolio holding companies to be secured are not wholly owned by the fund borrower. The terms of any shareholders agreements should be carefully examined to check for:

- any restrictions on 'transfer' of shares in the company (the concept of 'transfer' is usually widely defined to include both a grant of security over shares or an outright transfer, both of which are relevant considerations for a lender at the transaction and enforcement stage);
- any relevant tag-along, drag along or right of first refusal provisions in favour of the other shareholders which could affect a lender's enforcement strategy; and
- leakage to third parties generally.

Conclusion

Hybrid facilities are a developing product in APAC with exciting prospects for lenders and borrowers. Due to the complexity of hybrid deals, careful structuring, credit analysis and legal advice is required.

Carey Olsen regularly acts as offshore counsel on highly complex fund finance matters and we have significant expertise in this area.

For assistance, please reach out to your usual Carey Olsen contact.

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