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The last 12 months have, once again, seen continued innovation and development in the fund finance industry. Most notable have been the consistent interplay between structured finance solutions and fund finance with some standout English law governed transactions completed this year; the increased look to institutional capital to enhance liquidity for fund finance transactions; the fund finance initiative launched by the Loan Market Association ("LMA"), which focuses on improving liquidity, efficiency, transparency and supporting the sector through guidelines, education and collaboration; the role of ESG in fund finance; increased regulatory focus on fund finance transactions; and, of course, the continuous discussions around the use of net asset value ("NAV") based financings among alternative asset managers.

In this year's chapter, we will explore two of these developments particularly as they relate to English law transactions – NAV financing (when does it become uneconomical and how would an enforcement of this type of facility look?) and ESG.

NAV-based financing

Much has been discussed around the utilisation of NAV-based financing this year but almost exclusively in relation to their usage by Private Equity ("PE") fund managers *versus* managers of other asset classes. NAV-based finance to PE secondaries, private credit, and infrastructure has long been established and broadly adopted by market participants and investors. However, it is worthwhile pointing out that NAV financing by PE managers is not a new phenomenon – certainly in the English fund finance market we were structuring these deals in the early 2000s. What has perhaps changed is their use by larger managers and the increased focus on fund finance transactions generally and the lack of any enforcement data – it is still the case, and this is true across all fund finance products, that there have been very few enforcements of any of these types of facilities. It is somewhat ironic that a stellar track record for an asset class that some estimate to be close to $1.5trn should garner such concern precisely because of its excellent track record.

Before we explore this subject in more detail, it is worth adding some context to the PE NAV market.

The purpose for adding leverage to a fund can vary, but in our experience the vast majority of facilities have been utilised to create equity value, either through capital expenditure or to fund growth, as opposed to leveraging equity value to accelerate distributions to limited partners.

There are many factors that can drive a manager's decision to utilise leverage, but principally these are the cost of leverage and the return that debt-driven growth will provide. With the unprecedented rapid rise in benchmark rates, many have asked the question – at what point does NAV finance become uneconomical or dilutive to returns? Whilst the answer appears simple, there are any number of variables that can impact the overarching decision, but any which way you dissect it, the inflexion point really is as simple as the point at which the total cost of debt (margin, benchmark, fees) exceeds the target internal rate of return ("IRR") of the fund. This is on the proviso that the NAV is used to fund growth capital expenditure or bolt-on acquisitions rather than to accelerate distributions, which, as previously alluded to, from our experience is the case for the majority if not all NAV trades. This can be broken down into a worked example to see both the benefit of NAV for a PE sponsor and the cost inflexion point.

In this calculation we have made the following assumptions:

- Annualised all-in cost of NAV loan: 8.58% (includes margin: 5%, EURIBOR: 3.2%, upfront fee: 1.5%).
- Anticipated hold per hold period of asset and duration of NAV loan: four years.
- Expected multiple on invested capital ("MOIC") on exit: 2.5x.
- Cost of equity (equivalent to target IRR of a PE sponsor): 22%.
- The timing of cashflows has an impact on ultimate IRR (both inflows and outflows), but for simplicity, we have assumed no intervening cashflows between the initial investment and the ultimate disposal.

	Debt funded	**Equity funded**
Day 1 acquisition cost	£150,000,000	£150,000,000
Year 1 cashflow	–	–
Year 2 cashflow	–	–
Year 3 cashflow	–	–
Year 4 cashflow[1]	£345,383,375.55	£307,377,049.18
Discount rate	8.58%[2]	22%[3]
NPV	£345,383,375.55	£307,377,049.18
IRR	18%	15%

[1] *NPV (net present value) of exit proceeds (based on MOIC on exit discounted using the cost of capital)*

[2] *Cost of debt*

[3] *Cost of equity*

The point of inflexion is when the discount rates are the same, which in this example is the point at which the all-in cost of debt matches or exceeds the IRR to get the same NPV on the exit proceeds. Whilst pricing across NAV finance has remained relatively stable, the forward curve for all major benchmark rates is reducing as global macro-economic conditions improve.

English law in enforcement

Notwithstanding the stellar track record of these transactions and the absence of any enforcements, many market participants and observers have been keen to understand how a PE NAV enforcement would play out. There are a number of complexities and considerations for a lender looking to trigger a default in a NAV Facility. In the vast majority of European NAV-based transactions, the NAV Facility is almost always governed by English law; however, the security agreements are governed by the laws of the jurisdiction in which the assets being pledged are located.

The process of a default and enforcement involves navigating both the contractual rights and obligations under English law and the security interests governed by the laws of the other jurisdiction(s). Whilst the below steps provide an overview of the process, the governing frameworks, and key considerations for enforcement, it is worth stressing that these exact same considerations and steps would be relevant on any other type of cross-jurisdictional financing and none of the security interests created as part of a NAV financing involve taking security interests that do not appear across the spectrum of other types of financing – nothing new is being created here, in fact what ensures that both the lender's and manager's interests are aligned on these deals is that rather than only one asset underpinning a financing (often highly levered), the majority or all of the portfolio underpins a NAV financing (usually at a very modest loan-to-value ("LTV")).

1. **Understanding the governing frameworks**:
   A. *NAV Facility governed by English law*:
      I. Contractual rights: If a NAV Facility is governed by English law, the lender's rights in relation to the borrower's default (such as acceleration of debt, claims for damages, equitable remedies such as specific performance or termination of the agreement) will be determined under English law.
      II. Default provisions: Whilst the usual remedies for breach of an English law contract are available to lenders, in the vast majority of cases the lender's primary recourse will be to the acceleration provisions in the NAV Facility. The NAV Facility will define what constitutes a default (e.g., non-payment, insolvency, breach of covenants) and the lender's remedies upon default (e.g., the right to call in the debt, the right to demand payment immediately, or to exercise or direct the security agent to exercise all or any of its rights, remedies, powers or discretions under the finance documents (including the security agreements)).
      III. Enforcement of judgments: Any judgment or award obtained in an English court will generally be enforceable in any other country that is a signatory to the Hague Convention on the Recognition and Enforcement of Foreign Judgments (2005) (subject to ensuring that exclusive jurisdiction is conferred on the English courts in the NAV Facility in order to comply with the requirements of the Hague Convention), or in jurisdictions where there is a relevant bilateral treaty or reciprocal arrangements.
   B. *Security agreement governed by a different jurisdiction*:
      I. Security over assets: If the security agreement is governed by a different jurisdiction (e.g., where the collateral or assets are located), the lender's rights to seize, liquidate, or enforce security interests are determined by the laws of the country where the security interest is created.
      II. Legal effect of security interest: The effectiveness and enforceability of the security interest depend on the laws of that local jurisdiction, which may include formalities such as registration or notarisation, and specific procedures for enforcement, such as judicial actions or the need for local court approval.
      III. Cross-border recognition of security interests: Whilst English law will govern the NAV Facility, the security may need to be enforced in the local jurisdiction under its local laws. In some cases, there could be conflict of law issues that need to be resolved and considered at the outset.

IV. Regulation: Depending on the nature and location of the underlying portfolio assets, regulatory consents may be required either to appropriate or sell the shares of the holding company (due to the indirect change of control in the ownership of the portfolio asset triggering a need for regulatory approval). This consent may be needed from regulators located in neither the UK nor the jurisdiction of the holding company but rather in the jurisdiction(s) in which the particular portfolio asset operates or resides.

V. NSIA: For investments located in the UK, if any enforcement action will result in more than 25% of the shares or the voting rights of an entity within the 17 key sectors specified in the UK National Security and Investment Act 2021 ("NSIA"), a notification will need to be made to the Secretary of State to request clearance before any transfer can complete.

2. **Considerations for enforcement by the lender**:

A. *Default under the NAV Facility*:

I. Upon default, the lender would typically seek to accelerate by either placing the loans on demand or by demanding immediate payment under the terms of the English law NAV Facility.

II. In practice, the lender would likely first engage in out-of-court remedies (e.g., sending demand letters) before filing a claim in court or commencing arbitration, depending on the dispute resolution provisions in the loan agreement.

B. *Enforcing the NAV Facility in a local jurisdiction*:

I. Jurisdictional issues: One of the key challenges is where to bring an action for enforcement. Since the NAV Facility is governed by English law, the lender would likely bring a claim in England & Wales to obtain a judgment. However, the borrower's assets (e.g., property or guarantees) might be located in a local jurisdiction, which could require the lender to seek to enforce the judgment of the English court in that local jurisdiction.

II. Recognition of foreign judgments: If the lender obtains a judgment in England & Wales, the next step is to recognise and enforce that judgment in the jurisdiction where the security is located. This requires compliance with that jurisdiction's laws regarding the recognition of foreign judgments. In the European Union, it is no longer possible to rely on the Brussels I Regulation (Recast) for the enforcement of judgments from the English courts (post-Brexit), but judgments can be enforced under and subject to the requirements of the Hague Convention. In other countries, the lender must rely on local laws or applicable treaties.

C. *Enforcing the security interest*:

I. Securing collateral in local jurisdictions: If the security interests (e.g., a mortgage or lien on assets) are located in a foreign country, the lender must enforce the security under that country's laws. This could require:

i. Obtaining local court orders to seize or sell the collateral.

ii. Taking possession of the collateral, which might require legal assistance in the local jurisdiction, particularly if the assets are in a country with different legal procedures or if the collateral is located in a protected class (e.g., real estate or government assets).

II. Extraterritorial enforcement issues: Enforcement of a security agreement governed by local law may encounter difficulties if the local jurisdiction does not have reciprocal recognition arrangements or if local law limits enforcement actions against certain types of assets (e.g., public assets, immovable property). Some countries have restrictions on the enforcement of foreign judgments or security interests and lenders should seek opinions from local counsel at the outset of the transaction in order to identify any applicable restrictions.

3. **Conflict of laws and jurisdictional challenges**:
   A. Choice of law clauses: The NAV Facility may have a choice of law clause specifying English law as the governing law, but the security agreement may specify the law of a different jurisdiction. Courts will generally uphold such clauses, but there could be issues of conflict of laws if local courts determine that their own laws take precedence in certain matters (such as the perfection and enforcement of security interests).
   B. Forum selection clause: If the NAV Facility includes a forum selection clause (specifying that disputes will be heard in a specific jurisdiction, typically England), then the lender may be required to bring proceedings in that jurisdiction to enforce the loan. However, enforcement of a judgment obtained in England may require separate proceedings in the local jurisdiction to enforce the security interest.

In summary, whilst there are a number of considerations and factors in here, these exact same considerations and factors would apply in relation to any type of cross-border financing and there is nothing legally that differentiates this product to others in the market from an enforcement perspective.

ESG

The market has considered the integration of ESG terms in subline transactions in depth over the past few years. In March 2024, the APLMA, LMA, LSTA and Fund Finance Association published "*A Guide to the Application of the Sustainability-Linked Loan Principles in Fund Finance*" examining the use of sustainability-linked loans in fund finance transactions. A number of challenges were identified in this publication, including limited historical data in recently formed funds, uncertainty and lack of visibility over investments as well as inadequate benchmarking with other funds. In a NAV financing, these challenges are arguably less pronounced because ESG strategies and polices may already have been implemented both at the fund level and in portfolio companies. In addition, challenges regarding information and data are more likely to be addressed as a result of compliance with ESG law and regulation (e.g., the Sustainable Finance Disclosure Regulation ("SFDR")). This raft of law and regulation looks set to continue in 2025, requiring greater analysis of sustainability information and data at fund level. Taken together, the manager is able to understand ESG risks and opportunities across portfolio companies in more granular detail. This allows for more efficient structuring of sustainable loans, including sustainability-linked loans, green and social loans or a combination of both, which leverage the sustainable information at portfolio and fund level to create structures that address the challenges of NAV lenders. Where these are done correctly and take into account developments in the wider ESG ecosystem, lenders can also benefit from increased liquidity by structuring these transactions to attract a range of investors, including institutional investors and family offices.

Summary

Long gone are the days where very little changes in fund finance: we have no doubt that next year will see more innovation, creation and growth. As with the growth rates we have seen in previous years, we do not expect that increase to result in an increase in defaults given manager and lender alignment on these transactions and conservative LTVs, among other factors. As fundraising normalises, we do anticipate ESG coming back to the fore and likely beyond subscription facilities into NAV Facilities where arguably they should be significantly easier to implement. For sure we will see more of structured finance solutions having a role to play in fund finance but the implications for all market participants need to be carefully considered, e.g., the advent of securitisation structures for the continued involvement by insurance companies in the UK and Europe. Finally, insofar as liquidity is concerned generally, we consider the LMA's initiative to bring more transparency, efficiency and liquidity into the market as an extremely important and timely development for the fund finance market, particularly given the regulatory scrutiny on the fund finance industry these past 12 months.

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Acknowledgment

The authors would like to thank Thomas Spinks for his valuable contribution to this chapter.

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- Hybrid facilities
- Subscription lines
- Enforcement
- Secondaries
- Ratings
- Collateralised fund obligations

Written by leading industry participants from across the industry, this is the definitive legal guide for the global fund finance industry in 2025.