NAVs meet margin loans: Single asset back-levering transactions and concentrated NAVs take centre stage

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The markets for financial products made available to private equity, venture capital and other investment funds ("Funds") and the ultra-wealthy are ever-evolving.

Margin lending has a well-established presence in the financial markets, long pre-dating fund finance and, for that matter, Funds as we know them. Traditional margin loans rely on daily mark-to-market pricing and margin call mechanics to ensure that the agreed loan-to-value ratio ("LTV ratio") is maintained. Whether the underlying collateral is a single publicly traded security or a portfolio of securities, the mechanics are the same. The reliance on a publicly reported market price to calculate the LTV ratio renders margin loans *per se* ill-suited when the asset to be financed is equity in a privately held company.

Chapters in previous editions of this book, including our own,[1] have chronicled the rise of the net asset value ("NAV") lending market in the fund finance space. By enabling financial sponsors to leverage their aggregate net equity across a portfolio of assets, NAV financings provide an additional source of liquidity for sponsors seeking funding for additional and follow-on investments or to return capital to investors. An important source of comfort for NAV lenders, however, is the ability to rely on collateral support from a diverse portfolio of assets.

So, what do you do when the leverage needed is for a highly concentrated portfolio or even a single privately held asset? A bit of match-making.

In recent years, we have seen rising interest in what you might call "private margin loans" to provide financing to company founders and other high-net-worth individuals ("HNWI") collateralised by their shares in the still-privately-held companies they founded. In the Funds realm, similar loans are being used to provide "back levering" for individual portfolio investments. In both scenarios, a bespoke combination of NAV and margin lending techniques tailored to the underlying asset provide the valuation and margin maintenance mechanics and other lender protections necessary to make these loans feasible.

In this chapter, we will outline the key features of NAV facilities and traditional margin loans as well as the limitations of each type of facility when applied in the context of a single privately held asset. We will then explore the myriad of ways these features are being mixed and matched to facilitate financings for single or highly concentrated small portfolios of privately held assets.

NAV facilities – background

Enterprising Funds have many options to source quick liquid capital. Funds are consistently taking advantage of third-party financing opportunities from lenders to assist with the running of the Funds or improve returns to investors. These financings are often secured. The traditional form of such financing is a revolving subscription line facility, which "looks up" to the investors and bridges the gap between the Fund's need for capital to make an investment and the investors' ability to provide the capital in a timely fashion. A lender's collateral for a subscription credit facility is each investor's promise to provide capital to the Fund when called upon to do so by its general partner or manager (such promise, the investor's "capital commitment"). The lender(s) will provide a revolving commitment, which may be borrowed from time to time up to the borrowing base amount. Such borrowing base amount will be a percentage of the uncalled capital commitments of credit-worthy "eligible" investors. Due to its reliance on uncalled capital for credit support, a subscription line is not ideal for all Funds. In particular, when a Fund has matured beyond its investment period and has utilised all or substantially all of its capital commitments to make investments, the subscription line financing option no longer provides sufficient liquidity. At this stage in its life, the Fund may consider entering into a facility where the borrowing base amount is based on the NAV of the portfolio investments rather than its uncalled capital commitments.

NAV facilities – structure

NAV facilities "look down" toward the portfolio investments for collateral, security and borrowing base purposes. In a NAV facility, one or more banks, financial institutions, or other lenders will provide a term or revolving loan secured, directly or indirectly, by the underlying portfolio investments of the Fund and related cash flows. The borrower under these facilities may be the Fund itself (including any parallel vehicles) (*see fig. 1*) or a subsidiary of the Fund (referred to as an "aggregator") established to hold the Fund's interest in its underlying investments (*see fig. 2*). In some cases (often where private equity assets are involved), the borrower may be an "orphan" special purpose vehicle ("SPV") that holds a preferred equity interest in an aggregator vehicle (*see fig. 3*). Importantly, the NAV facility should be structured to ensure that any cash proceeds from portfolio investments are routed to the NAV borrower for deposit into a pledged account subject to the control of the lender(s) pending application of any amounts necessary to prepay the NAV facility so as to maintain the requisite LTV ratio. Absent a default, upon satisfaction of those prepayment (or "cash sweep") requirements, any remaining proceeds are permitted to be distributed to the Fund and its investors.

Figure 1:

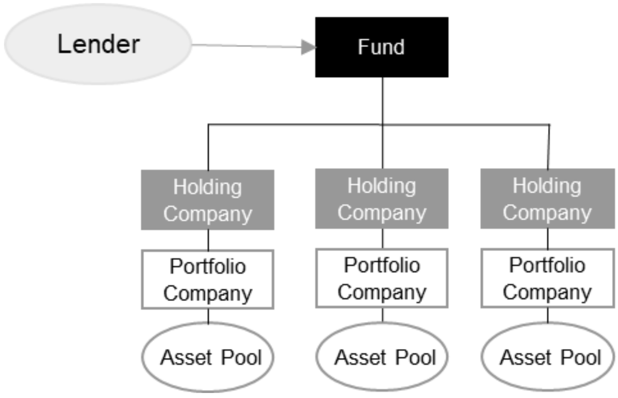


Figure 2:

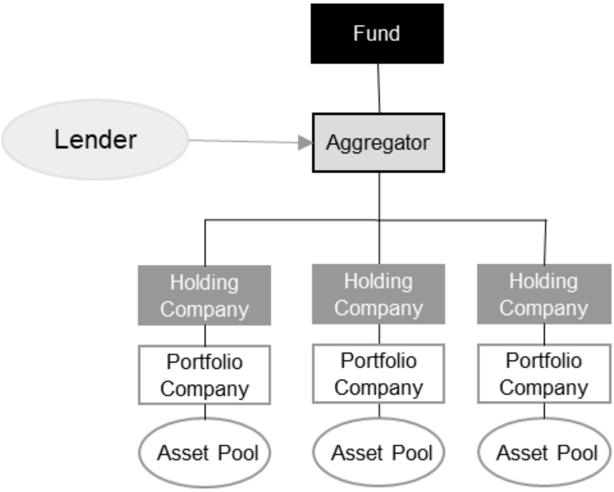
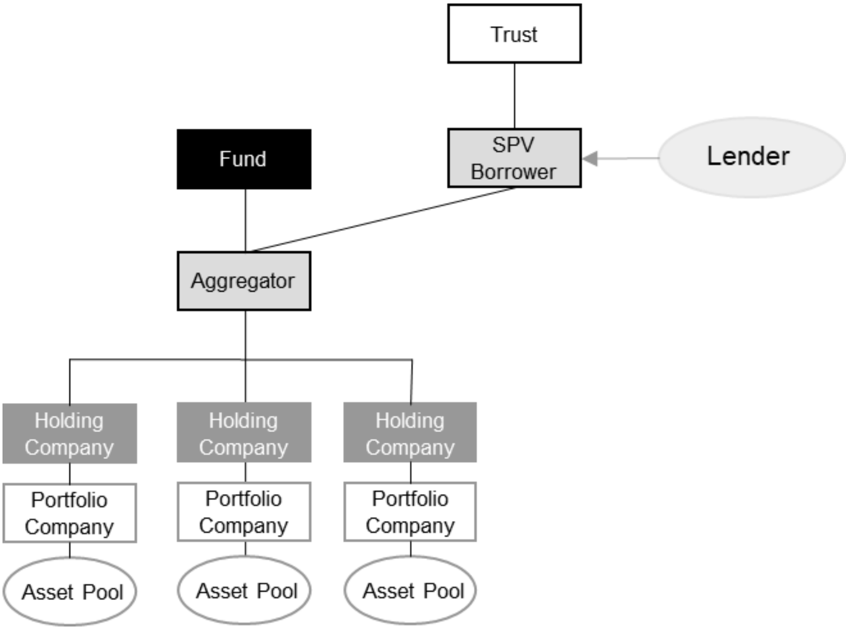


Figure 3:



NAV facilities – features

NAV facilities can be distinguished by (1) the nature of their collateral, (2) how the borrowing base is determined, and (3) prepayment and cash retention triggers. We will review each of these features below.

Collateral

The collateral for a NAV facility will typically consist of (i) the proceeds of any portfolio investments, and (ii) equity interests in the borrower and any entity or other investments owned directly by the borrower. In some cases, the assets being pledged may be the portfolio investments themselves, but more often, those portfolio investments are held via a series of intervening holding companies. In the typical NAV structure, the only equity pledged is the equity of the borrower itself and the borrower's interest in the top-tier investment holding companies. Where the borrower is an aggregator, the obligations may (but will not necessarily) be guaranteed by the Fund parent. For purposes of this chapter, it is sufficient to focus on the fact that lenders "look down" to the assets held indirectly by the Fund for their collateral protection rather than "looking up" to the investor capital commitments.

Borrowing base

The borrowing base for a NAV facility is typically determined by looking at the LTV ratio – that is, the ratio of the outstanding loans provided (before and after giving effect to the proposed use of each borrowing) to the net fair market value of the included portfolio assets (as valued by the sponsor in accordance with its usual valuation policy – see more on this below).

In calculating the numerator of the LTV ratio, lenders often incorporate concentration and diversity requirements for the underlying assets. For example, a lender might require a certain number of assets be held within the portfolio at any given time and/or include concentration limits to govern how much of each type of asset may be "included", or the maximum portion of the value that may comprise a single asset, for purposes of determining the LTV ratio. Not all assets are created equal for lenders evaluating the riskiness of their loans, and the appropriateness of the LTV calculation and maximum permitted LTV ratio, and the "haircuts" derived by application of the diversity and concentration limits reflect this.

Cash monitoring and retention

The LTV ratio regulates how much credit may be extended under the facility at a given time. In that respect, a NAV might look similar at first to an ordinary asset-based loan ("ABL") or subscription credit facility. However, when one looks to what happens when the requisite LTV ratio is exceeded (i.e. a "borrowing base deficiency" in ABL parlance), a NAV facility behaves much differently. In an ABL or subscription facility context, a borrowing base deficiency triggers an immediate obligation to prepay the loan to the extent necessary to bring the borrowing base back into compliance. Those prepayments are funded either from other cash resources of the borrower (in the case of an ABL) or from capital calls issued to investors (in the case of a subscription facility). One of the key features of a NAV facility, by contrast, is that it relies on the (often illiquid) investments of the Fund for collateral support, and the remaining uncalled capital available to fund prepayments of the NAV facility may well be insufficient to cover a borrowing base deficiency. The borrower therefore has no guaranteed ready access to cash with which to fund a prepayment. In light of this, a borrowing base deficiency – or LTV breach – does not trigger an immediate obligation to prepay the NAV facility. Instead, a cash sweep event goes into effect such that, as and when cash proceeds are received from portfolio assets, 100% of those proceeds will be swept to prepay the loan until the required LTV ratio is reached, after which the sweep percentage returns to its normal level. Unlike the ABL or subscription facility contexts, there is no stated deadline by which those proceeds must be received and/or such prepayments completed. That said, there typically is a second LTV threshold, significantly higher than the level at which a cash sweep is triggered, which, if surpassed, results in an event of default entitling the lender to accelerate the NAV facility and exercise its remedies.

To ensure that the cash sweep mechanism is complied with, the NAV facility documents will require that all cash proceeds received by the borrower from its interest in the portfolio investments are deposited into a pledged account that is subject to the control of the NAV lender. These proceeds must be used first to satisfy any outstanding cash sweep obligations. Subject to certain exceptions,[2] proceeds may only be withdrawn from the secured account and used for other purposes of the Fund (including distributions to investors) once all cash sweep obligations have been satisfied and provided that no default or event of default is otherwise ongoing.

NAV facilities – valuation of assets and lender dispute rights

One of the trickiest elements of a NAV facility – and the technology of the NAV most relevant for this chapter – is answering the question of how to value the assets when there is no publicly available reference price.

The process for valuation of portfolio assets is fairly straightforward, but frequency, intra-period adjustments and lender dispute rights can be highly negotiated. Typically, the NAV of the portfolio is determined by the sponsor on its usual schedule and in accordance with its usual methodology for reporting to its investors. For private equity Funds, this most often means that the value of the portfolio investments is marked quarterly in accordance with the Fund's stated valuation policy. For Funds holding debt positions or a range of debt and equity investments, some of which may be traded in a liquid secondary market, monthly or even more frequent marking and reporting may be required.

Whether the portfolio values are determined quarterly or more frequently, there is an inherent lag between the as-of date of the valuation and the time it is reported to the NAV lender. For quarterly valuations, for example, the value will be determined as of the last day of the fiscal quarter but not reported to the lender until 45 to 60 days thereafter. Year-end valuations have an even greater lag, with 90 to 120-day reporting periods.

To get comfortable lending based on LTV ratios that are subject to the sponsor's discretion and which, in a rapidly changing market climate, may materially overstate current market value of the asset at the time of reporting, lenders generally require that dispute rights be included in the NAV facility documentation. These provisions provide the lender with the right to substitute its own determination of the value of relevant assets or, if the borrower objects to the substitute value, to obtain two to three firm market bids and/or an independent third-party valuation. If the third-party bids or valuation result(s) in a value that is a specified percentage (often 5 to 10%) lower than that reported by the sponsor, the third-party bids/valuation will control. Until the third-party bids or valuation are obtained or the valuation dispute is otherwise resolved, additional borrowings and distributions to investors will generally be permitted only to the extent they would be allowed using the lender's proposed valuation. Cash sweep requirements that would be triggered by the lender's proposed valuations may be deferred pending resolution of the dispute.

Margin loans – background

As alluded to earlier in this chapter, single asset or "private margin loan" facilities also make use of familiar concepts from traditional margin loans.

Margin loans were originally conceived in the second half of the 19th century to provide capital to finance the buildout of railroads and other infrastructure projects across the United States. Investors combined their own available cash with borrowings from banks or brokers to plow ever-greater investments into railroads and other publicly traded companies using the purchased securities as collateral. Purchasing shares in this manner has become known as "buying on margin".

Margin loans – structure

Like NAVs, margin loans "look down" toward the pledged company stock for collateral and borrowing base purposes. In a margin loan facility, one or more lenders provide(s) the borrower with a term or revolving loan that is secured by publicly traded equity securities. The collateral may be securities of a single company or a portfolio of multiple companies. Like the NAV facility, a margin loan facility will be structured to trap proceeds from the underlying collateral to fund any required prepayments before such proceeds may be withdrawn by the borrower and used for other purposes. The borrower under these facilities may be the owner of the reference securities or its direct or indirect parent company.

Margin loans – features

As with NAV facilities, we will review the following margin loan facility features: (1) collateral; (2) the borrowing base; and (3) prepayment and cash retention triggers. In addition, we have included a brief note about U.S. securities regulations. While not directly applicable to NAV facilities or margin loans over privately held shares, this regulatory background is important to understand when structuring private margin loans over shares in companies that may become publicly traded during the life of the facility or which are being taken private as a result of the relevant transaction.

<u>Collateral</u>

The collateral for a margin loan will consist of (i) shares in one or more publicly traded companies, (ii) the pledged securities account subject to lender control to which such shares are credited, and (iii) any proceeds of those shares. The shares will be required to be held in a pledged securities account maintained with a third-party custodian and subject to an account control agreement in favour of the lender. Absent a default or event of default under the margin loan, the borrower will typically be permitted to issue buy and sell orders with respect to securities in the account, but any withdrawals from the account will be subject to the conditions specified in the margin loan agreement and will require the instructions of the lender.

<u>Borrowing base</u>

As with NAV facilities, the borrowing base for a margin loan is determined by looking at the ratio of the outstanding loans to the value of the collateral on deposit in the custody account. However, unlike for NAV facilities, the publicly traded nature of the collateral permits daily recalculation of the LTV ratio based on observed market prices without a reporting delay. For facilities supported by multiple underlying securities, concentration limits and diversity criteria will apply to ensure that the collateral value supporting the loan is not overly reliant on a particular position, country, industry, etc. In addition, the facility may feature limits on the exchanges on which underlying collateral may be traded and their currencies, and may feature an outright prohibition on credit for securities in certain industries (such as weapons manufacturing).

<u>Cash monitoring and retention</u>

Margin calls

If the value of the collateral supporting a margin loan declines such that the LTV ratio exceeds a specified "margin call LTV", a margin call will occur. This means that the lender will require the borrower to deposit additional collateral into the custody account and/or prepay a portion of the loan in order to bring the LTV ratio back down to the maintenance level. The additional collateral may consist of additional shares in companies already included within the portfolio, cash and/or, where the borrower is controlled by a Fund, a standby letter of credit or an equity commitment letter from the Fund. If the borrower does not respond to the margin call by submitting additional collateral, calling capital or paying down the loan by the stated deadline, an event of default will occur and the lender may call the loan immediately due and payable and foreclose on the collateral.

Mandatory prepayments/issuer events

In addition to margin calls, which require partial collateralisation or prepayment, certain events may result in mandatory prepayments of the entire margin loan. These events typically include a change of control of the borrower and so-called "issuer events" with respect to the issuer(s) of securities included in the collateral. Issuer events may include: (i) the market reference price for the assets falling below a minimum required reference price at the close of business on any trading day; (ii) the issuer's announcement that its shares will no longer be listed for trading on the relevant exchange; (iii) a suspension of trading of issuer's shares in the market for two/three or more consecutive trading days; (iv) the announcement or occurrence of a tender offer, exchange offer or takeover of the issuer wherein any person acquires more than a specified percentage of the outstanding shares; (v) the issuer's shares are nationalised or otherwise required to be transferred to a government agency; and (vi) the average daily trading volume of the listed shares is less than a minimum volume required by the margin loan agreement. In addition, other events affecting the collateral shares, such as share splits, reclassifications of shares, share dividends, share repurchases by the issuer, mergers and other transactions that could have a dilutive or concentrative effect on the value of the collateral shares may result in a "facility adjustment event" giving the lender the right to readjust the LTV thresholds, concentration and diversity criteria and other metrics in the loan so as to counter the effect of the facility adjustment event and ensure the loan continues to reflect the original commercial arrangement. If the lender concludes that no adjustment of the facility is possible that would maintain the commercial intent, then an issuer event will be deemed to have occurred and the facility will be required to be repaid.

<u>Regulation</u>

One of the key differences between traditional margin loans, on the one hand, and NAV facilities and private margin loans, on the other, are the U.S. government regulations that apply to margin loans. As noted above, margin loans became popular in the late 1800s, driving not only the intended increase in investment into infrastructure but also rapid rises in the stock markets. As with any asset bubble, so long as money kept flowing into the system and prices kept rising, everyone was happy. Until they were not. Margin lending regulations were virtually non-existent at the time, and many people, from Wall Street financiers to the local newspaper boy, were caught up in the mania. As prices began to decline in 1929, borrowers were forced to sell increasing amounts of shares to fund margin calls, which only drove prices lower and fuelled the contagion. Successive waves of margin calls and panic selling in late October 1929 resulted in what is still the worst percentage decline in the U.S. stock market, wiping out fortunes, bankrupting banks and companies across the country and giving way to the Great Depression.

Having seen the effects of over-reliance on margin lending, the U.S. Congress included restrictions on margin lending by brokers and other lenders in the Securities Exchange Act of 1934 ("Exchange Act") in the hopes of preventing similar financial devastation in the future. Those statutory enactments authorised the Board of Governors of the Federal Reserve System ("Federal Reserve") to adopt regulations to establish margin requirements and to prevent the excessive use of credit for the purchasing or carrying of or trading in listed securities. The Federal Reserve then adopted Regulation T (governing securities credit by brokers), followed soon thereafter by Regulations U (governing margin lending by banks) and G (governing margin lending by lenders other than banks or brokers). The Federal Reserve harmonised Regulations U and G over the ensuing decades and, in 1997, merged former Regulation G into Regulation U, with the latter regulation now governing margin lending by all lenders in the United States other than brokers. Additionally, in 1970, Congress amended the Exchange Act to restrict U.S. persons or foreign persons controlled by or acting on behalf of or in conjunction with U.S. persons from obtaining margin credit from a lender outside the United States to purchase or carry securities of U.S. issuers where the credit does not conform to the requirements of the margin regulations. That statutory provision has been implemented by the Federal Reserve in Regulation X.

Broadly speaking, for loans by bank or non-bank lenders other than brokers that are secured, directly or indirectly, by "margin stock" and which are borrowed for the purpose of purchasing or carrying margin stock, Regulation U caps the LTV ratio at 50% of the current market value of any margin stock collateral, with most other types of collateral having "good faith" loan value. "Margin stock" is generally any equity security that is traded on certain exchanges in the United States, including exchange-listed American depositary receipts ("ADRs") of foreign issuers.

The Federal Reserve generally views loans to investment funds differently from loans to industrial or commercial companies for purposes of Regulation U, with a loan to such a fund being presumed to be indirectly secured by the securities in the fund's portfolio even in the absence of any indirect security-type arrangements (such as a negative pledge) in the loan documentation. As a result, if more than 25% of the value of the Fund's assets consists of margin stock, a loan by a bank or non-bank lender to that Fund would be presumed to be indirectly secured by margin stock.

The margin regulations are highly complex and an exploration of the details is beyond the scope of this chapter, but it is important to be aware that these regulations exist to ensure that NAVs and private margin loans do not fall foul of them if there is a potential for the underlying collateral to include or become margin stock.

Margin loans – valuation of assets

Valuation of assets for a margin loan is relatively straightforward due to the availability of mark-to-market reference prices. Margin loans will have a "calculation agent" responsible for the daily determination of asset values and LTV ratios. Unlike NAV facilities, the secured parties (and specifically the calculation agent) are responsible for determining the asset values and LTV ratio in the first instance.

Application to single privately held assets

Neither NAV facilities nor a traditional margin loan approach work well by themselves when the underlying asset to be financed is equity in a single privately held company.

In the case of NAV facilities, the lenders lose the benefit of spreading risk across a diverse portfolio of assets. Moreover, without the ability to rely on cash flows resulting from transactions involving different portfolio companies at different times, the cash sweep mechanisms of a NAV facility are ineffective to keep the LTV in line if values decline. Instead, there would be an undesirable all-or-nothing aspect to the loan, with the entire loan coming due if the default LTV is triggered. The discretionary element of sponsor-driven valuations and the lag in reporting discussed above add to the heightened risk of concentrated NAVs and single asset financings.

In a similar vein, traditional margin loan mechanics that rely on daily marking to market based on public reference asset prices cannot function where the underlying asset is privately held.

The answer: Private margin loans/back-levering facilities

Over the past 12 to 18 months, we have seen a marked rise in concentrated NAVs and single-asset back-leveraging transactions. These have come about for a variety of reasons, including providing protective liquidity for portfolio companies to weather market uncertainty or facilitate refinancing of maturing debt, financing opportunistic add-ons and returning capital to investors while extending holding periods for portfolio companies to await better market conditions for exits. Prior to the more recent freeze in the syndicated loan market, we also saw sponsors using back-leveraging transactions as an additional layer of financing for acquisitions, providing the "equity" for their portfolio acquisitions at a lower cost of capital *vis-à-vis* capital calls from their investors.

Outside the Fund world, we have also seen these facilities being used by family offices who may hold only a limited number of investments and by HNWIs, typically company founders. In the latter case, the borrowings enable the founders to monetise a portion of their shareholdings to provide capital for other start-ups or simply to de-risk their personal financial position via diversification into other investments.

To overcome the weaknesses of both NAV facilities and traditional margin loans discussed above, concentrated NAV and single asset facilities typically mix and match concepts from both domains to tailor a solution that works for the asset in question.

Single asset financings – valuation

There is a spectrum of mark-to-market and valuation techniques that may be employed depending on the underlying asset.

On one end of the spectrum are companies that, although privately held, have public-traded bonds or other liquid debt instruments for which there is an available market quote. In those cases, more traditional margin lending mark-to-market and margining techniques may be employed, either using the debt trading price as a proxy for the underlying equity value or tying margin requirements directly to the trading price of the debt. There is an important catch, however, that must be addressed. If the reference asset is a debt instrument rather than the common equity, that instrument can disappear by refinancing or repayment or its validity as a proxy for the equity value may be compromised by amendments that affect the trading price (e.g. juicy increases in interest or fees or addition of collateral) or by the issuance of more junior tranches of debt. In these transactions, much time is often spent negotiating the scope of facility adjustment events and replacement reference asset provisions to protect lenders in the event of post-closing amendments to the original reference asset or other changes to the issuer's capital structure that could artificially inflate the LTV ratio being relied on by the lender.

On the other end of the spectrum are companies that rely on quarterly sponsor valuation in the same manner as typical NAVs. For these transactions, more fulsome dispute rights, margin loan-style margin call mechanics and Fund recourse are often key to off-setting the increased risks of inferior access to regular third-party market price quotes.

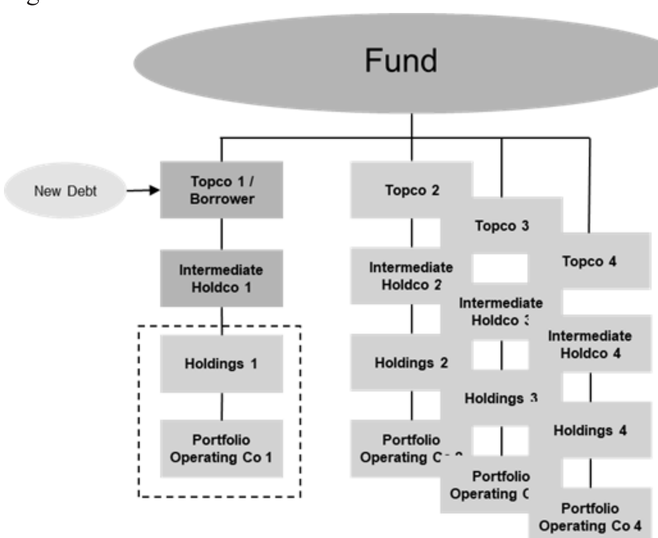
In the middle lie a variety of alternative valuation methods that may be applicable. Non-sponsor-owned companies, especially tech companies, for example, may require quarterly independent valuations ("409A valuations") for tax reasons in connection with their issues of stock options to employees. Lenders may also require independent valuations, at least annually if not quarterly, to obtain a disinterested opinion as to the equity value. In any case, incorporating dispute rights into the documentation, to enable the lender to seek its own independent valuation if it believes the value being reported by the borrower is overly optimistic, provides important comfort to lenders to address the risks of uncertainty and reporting delays inherent with private assets.

Single asset financing – margin calls and recourse

Single asset financings most often employ margin call mechanisms from traditional margin lending rather than relying on the cash sweep mechanics more often seen in NAV facilities. As there is no diversification of risk and cash flow generation across a range of assets, the lender has an immediate right to be repaid as needed to maintain the requisite LTV ratio. As with traditional margin loans, acceptable additional collateral may include cash, cash equivalents, letters of credit or equity commitment letters (in sponsor-driven transactions) or additional shares in the underlying issuer (in non-sponsor-driven deals where less than 100% of shares owned by the Fund or HNWI are subject to the financing).

For a variety of reasons, these financings may be put in place at a level beneath the main Fund vehicles (*see fig. 4*) or, outside a Fund context, at an SPV wholly owned by the HNWI or other party seeking the financing. They may or may not be recourse to the Fund or HNWI. If the financing is full recourse to the Fund or HNWI via a guaranty or Fund equity commitment letter, margin calls resulting from a decline in value will trigger a payment obligation under those credit support documents.

Figure 4:



If recourse is limited to the SPV borrower and the posted collateral for the loan, the Fund or HNWI has a decision to make. To prevent a default, it can inject further assets into the SPV or provide credit support of its own in satisfaction of the margin call. Given that LTV advance rates for these transactions are typically well south of 50% (10–20% is the norm), the expectation is that the economically rational response for any Fund or HNWI with the wherewithal to do so is to provide the additional collateral to protect its equity in the underlying asset. If it opts not to do so, an event of default will result, and the lender will be entitled to foreclose on and sell the collateral, resulting in the Fund's or HNWI's loss of control of the asset.

Single asset financing – ensuring the ability to enforce

In a traditional margin loan, the collateral is publicly traded securities, so enforcement is straightforward – the lender simply sells the shares into the market on the exchange on which it is listed, subject to potentially applicable securities law limitations. If the size of the position in relation to the average trading volume is such that an immediate sale may negatively affect the market price or may prove difficult to execute, the lender may opt for smaller transactions over an extended period of time or execute a block sale to maximise foreclosure proceeds, but generally speaking it will have an unfettered right to dispose of the collateral in any commercially reasonable manner, subject to potentially applicable securities law limitations.

Where the underlying asset is a privately held security, by contrast, the lender needs to be mindful that practical and/or contractual limitations may impact its ability to quickly convert the collateral to cash.

As with any NAV loan over private equity interests, a foreclosure by a lender may trigger change of control provisions in underlying opco debt agreements and/or regulatory consent requirements that would be less likely triggered in the sale of the shares of a public company. Given that, in these cases, we are dealing with a single asset or possibly a handful of assets, however, negotiating those consents or otherwise addressing those issues is less daunting than it would be for a large portfolio of assets. Consequently, rather than put in place more complex structures designed to create a liquid collateral instrument (for example, a preferred LP interest), which can be sold without triggering a change of control of the issuer, the lender may opt to take the pledge of the issuer shares and accept the risk of obtaining consents at the time of foreclosure or may structure the transaction with recourse to the Fund to create other, hopefully easier, avenues for collection if things do not go to plan.

In many cases, especially outside the Fund context, the limitations on enforcement will arise not from change of control issues but from transfer restrictions in the charter documents and shareholders' agreements governing the issuer's shares. Whether the financing is for a company founder or to back-lever a Fund's share of a consortium investment, transfer of the issuer's shares is likely to be subject to restrictions, including rights of first refusal, pre-emptive rights, tag-alongs and drag-alongs and even outright prohibitions on transfer without consent of the issuer board or specified groups of shareholders. In these instances, the lender will want to ensure before making the loan that it has all consents necessary to permit a foreclosure transfer free of these burdensome limitations. As a condition to making the loan, the lender will customarily require that it receive a consent signed by the issuer, as well as consents from any required shareholders, to waive transfer restrictions that would otherwise apply to a foreclosure sale. These can be highly negotiated, as the issuer and shareholders will often preclude a sale to a competitor of the issuer or other "disqualified institutions". In addition, the issuer will want to ensure that any transfer by the lender does not jeopardise the tax or regulatory status of the issuer or risk resulting in a public offering of its shares. These are fair concerns, and must be balanced carefully against the lender's desire for a quick and easy recovery.

Conclusion

In summary, the ability of the financial markets to create new product lines and find ways to solve liquidity needs is limited only by the imaginations of market participants. Over and over again, we have seen the market pull tools from a variety of toolboxes and use them to solve new problems or respond to challenging market conditions. This is illustrated well by the combination of NAV and traditional margin lending techniques to extend the concepts to cover single or highly concentrated interests in privately held shares. As market participants, both on the lender and borrower side, become more familiar with these products and more comfortable with how they operate, we have no doubt that the market for these financings will continue to expand.

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Endnotes

1. See "NAVigating the collateral waters: You have a boat but will it float?", *GLI – Fund Finance 2022*, Sixth Edition.
2. Such exceptions often include (i) funding investments that the Fund had contractually committed to make prior to the cash sweep going into effect, and (ii) funding certain operating expenses of the Fund, which may include (often subject to a cap) management fees payable to the Fund sponsor.

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