LMA Loan Market Association

Fund Finance Insights

Evolving perspectives on the use of fund finance

May 2025

Introduction

The ability for a fund to incur financial indebtedness often emerges as a key point of negotiation between fund managers and their investors during the fund formation process.

For the fund finance market to continue to develop in a manner that maximises efficiency, liquidity and transparency, it is imperative that its participants are cognisant of the key drivers and concerns of their counterparts and how such drivers and concerns continue to evolve in response to market developments. Enhanced understanding of the use of fund level financing will also minimise market friction, paving a way for optimal liquidity solutions supported by up-to-date guidance and best practices.

In this latest Insights we delve into the perspectives of fund managers, investors and lenders on the maturing fund finance market, with a particular focus on subscription line facilities and net asset value **(NAV)** facilities and examine how these perspectives continue to evolve.

A maturing market

The fund finance market has demonstrated resilience despite economic and geopolitical challenges and is developing into a more mature market driven by rising supply and demand. Some market commentators estimate that the fund finance market is already US$1 trillion and growing. Looking ahead, some participants project the market for NAV facilities alone could reach US$700 billion by 2030.

It is also widely reported that payment defaults and acceleration scenarios in fund financing products have been limited. This is in line with, for example, subscription line facilities being short-term in nature and benefitting from diverse, high-quality collateral. As a result, the fund finance market, which encompasses a diverse range of products, affords attractive lending opportunities for lenders and liquidity solutions for fund managers. For a deeper understanding of the development of key fund finance products in Europe, please refer to our earlier Insight on A Brief History and Evolution of Fund Finance – Europe, as well as the Insight on Middle East and Africa for similar development in those regions.

Notwithstanding the growth in, and attractiveness of, the market, the entry into fund financing requires a considered approach from all market participants.

Fund manager perspectives

A key driver for fund managers to utilise fund financing products is their effectiveness as tools for liquidity management. Subscription line facilities, for example, may serve as a means for bridging capital calls, bridging asset level financing, affording faster access to capital to deploy for investment opportunities and smoothing out capital calls. Collectively, these features encompass the ability to reduce the administrative burden on funds, enabling fund managers to focus resources on more value-add activities, thereby granting funds a competitive advantage.

Other key drivers for fund managers to utilise fund financings, particularly NAV facilities, include their ability to be used for both value-accretive and defensive strategies, affording tailored and cost-effective solutions that other financing products are unable to provide. Please see our earlier Insight on NAV Financing: Behind the Headlines in which we explored drivers behind the use of NAV financing.

In our experience, in addition to recognising the credit requirements of lenders, established fund managers are necessarily cognisant of their investor base when entering into fund level financings. Fund managers often know from the outset whether a managed fund may utilise fund level financing. In such circumstances they would typically engage with their investors to future proof the limited partnership agreement **(LPA)** to accommodate the ability to incur fund level financing at a later stage, it being understood that LPA amendments can be administratively burdensome. Where such permission is unclear in the LPA (for example, older LPAs which may not address NAV financing) fund managers will need to ascertain the appropriate level of engagement with its investors or any established limited partnership advisory committee. Ongoing transparency and open communication foster a constructive dialogue between fund managers and their investors, enabling concerns to be effectively discussed and addressed.

Investor perspectives

While certain investors recognise the potential benefits of fund financing as an important source of liquidity, this perspective is not necessarily universally shared amongst investors. Investors also have varying levels of comfort regarding the use of fund level financing and also varying levels of perceived risks around the different fund financing products available in the market.

Broadly speaking, investors are typically more familiar with the concept of subscription line facilities than NAV facilities as subscription line facilities have been present in the market since the 1980s, have offered relatively predicable terms and security packages and are often considered to be "business as usual" facilities utilised for liquidity management. Investors are generally also more familiar with the benefits and uses for subscription line facilities, and the impact on the investors themselves. The Institutional Limited Partners Association **(ILPA)** first issued best practice guidance in respect of subscription line facilities in 2017 which was supplemented by guidance issued in 2020.

Broad familiarity with subscription line facilities allows investors to better assess risk and ensure alignment with their internal policies. Investor specific sensitivities regarding a fund's ability to incur financial indebtedness and the related impact on the investor, whether driven by internal policy requirements, investment strategy or otherwise, can then be more readily addressed, and we often see this achieved by way of investor specific side letters.

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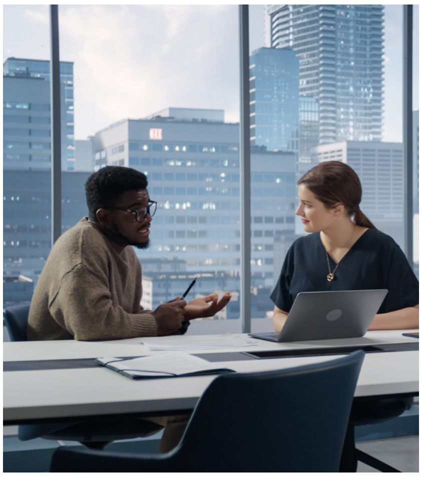
In contrast to subscription line facilities, NAV facilities, which gained prominence in the European market in the early 2000s, are generally more bespoke and tailored to the underlying portfolio assets of a fund, with varying security requirements. NAV facilities are currently less widely used than subscription line facilities, and according to ILPA's Inaugural Limited Partner Sentiment Survey 2024-2025 Edition **(ILPA Survey)** are viewed with scepticism amongst LPs. The ILPA Survey further highlighted that leverage in use at the fund level is the information that limited partners would most like to see presented more consistently (even more so than fund performance). The findings of the ILPA Survey align with those of the LMA/Drawdown Fund Finance Intelligence Survey 2025 that LP resistance is seen as the most significant challenge by borrowers in the fund finance market.

Open and consistent dialogue between fund managers and their investors addressing how a NAV facility is being utilised will place investors in an optimal position for risk assessment and understanding the rationale of fund managers. For example, the early distribution concern (i.e. use of NAV facilities to fund early distributions) was highlighted by ILPA as one of the key LP Concerns Regarding NAV-Based Facilities. Meanwhile recent market survey results of the PE NAV market discussed in our earlier Insight on NAV Financing: Behind the Headlines, suggest that such use for early distributions is declining in Europe.

From the outset of any conversation between fund managers and investors regarding fund level financing, it is important to recognise that the narrative regarding purpose, risks and ramifications will differ between products. Investors should accordingly be cognisant of the distinction between different types of fund financing facilities, and fund managers are encouraged to highlight these in investor dialogue. The ILPA guidance as to Recommendations for Improved Transparency and LP Engagement, which forms part of ILPA's NAV-Based Facilities Guidance (the **Guidance**) published in July 2024, outlines more detailed recommendations for what the dialogue between fund managers and investors should cover (including how to approach older LPAs which may not explicitly address NAV-based financings).

The Guidance was developed with the input of ILPA member investors in consultation with (i) fund managers, (ii) professional service providers and (iii) ratings agencies and continues to provide valuable guidance on investor perspectives to the broader market. The Guidance highlights investor concerns and offers practical recommendations on how these issues can be effectively addressed. Alongside fostering a more transparent dialogue between fund managers and their investors, broader market discussion of fund finance facilities will serve as a valuable tool to enhance investor understanding as to how a fund's strategy may be supported by fund level financing.



Lender perspectives

The growing number of both bank lenders and alternative credit providers positioning themselves in the fund finance market with differing mandates and product offerings demonstrates the attractiveness of fund level financing as a viable business opportunity. However, lenders must navigate this opportunity against the backdrop of regulatory requirements, particularly with respect to liquidity requirements, and balance it against the commercial risks associated with providing fund level financing solutions.

Different lenders have varying preferences regarding the types of products they offer and the underlying asset classes they focus on in the provision of fund financing products. These preferences are often influenced by their cost and source of funding, risk appetite, familiarity with the relevant underlying asset class or jurisdiction, and opportunities to provide a wider suite of products and services. For example, certain bank lenders concentrate on providing subscription facilities, often as part of a broader suite of products and services. In contrast, alternative credit providers may choose to specialise in more structured NAV-based solutions for their fund clients which focus on underlying asset classes in which they possess specific expertise.

Lenders often view themselves as strategic partners, supporting their fund clients in achieving investment objectives by offering tailored solutions. A critical aspect of this role is understanding the drivers and considerations of stakeholders, particularly the fund managers and their investors. A key safeguard in a lenders' toolbox is conducting adequate due diligence on the relevant fund borrower, and, depending on the nature of the financing, its investor base and/or its underlying portfolio assets.

In evaluating a fund financing opportunity, lenders typically undertake a thorough due diligence process. This involves comprehensive review of fund constitutional documentation (including the LPA and side letters) and, particularly in the case of NAV facilities, diligence of the underlying portfolio assets. A lender's due diligence process will inform whether the relevant fund's objectives are aligned with the product offering, and risk appetite, of that lender and whether such alignment can be achieved via structuring. We expect lenders to continue to focus on working with fund managers to structure fund finance facilities in a value-add manner so as to address the objectives of the various stakeholders, whilst managing the risk profile from a lender perspective.

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Looking ahead

The use of fund finance comes with several considerations which need to be explored from different perspectives that continue to evolve along with the market. This sits against a backdrop of ongoing scrutiny by regulators, including the Bank of England, on the incurrence of fund level financial indebtedness. This is where the importance of education and transparency comes in. An understanding of fund financing can lead to increased liquidity, efficiency and transparency in the market, for example through enhanced understanding and management of risk.

The ongoing evolution of the maturing fund finance market in a manner that maximises efficiency, liquidity and transparency, underscores the necessity for market participants to understand the primary drivers and considerations of other market participants. Additionally, it emphasises the need for continuous education regarding the swiftly changing landscape. In this respect, several key associations are working to offer guidance to market participants, including the LMA, ILPA and the Fund Finance Association.

We invite readers to collaborate with industry associations to foster enhanced dialogue and education across the broader market to contribute to the efficient evolution and understanding of the fund financing market.

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To learn more about the LMA's work to support efficiency, liquidity and transparency in the fund finance market, please visit the LMA's Fund Finance Microsite:

https://www.lma.eu.com/fund-finance

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