

# France

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**SUBSCRIPTION** facilities, also referred to as “equity bridge financing” in the French market, have proven to be a reliable, cost-effective and useful source of fund finance over the past 15 years, especially following the implementation of EU Directive 2011/61/EU on Alternative Investment Fund Managers (AIFM Directive). The French fund finance market has grown significantly by following and replicating in due diligence reports and finance documents, international fund finance trends and market standards. The increasing sophistication of French law-governed documentation over time demonstrates the strength and maturity of the French market. The product, initially used by large-cap French funds in documentation adapted to French law, but drafted in English, has spread out into the domestic market. This product now tends to be used by small and mid-cap funds and for those players, the documentation used is often drafted in French and less complex.

Although net asset value (NAV) financing is often considered a potential financing solution to bridge the end of an equity bridge facility, or to bring financial support to the underlying investment portfolio of funds, NAV facilities still face challenges in gaining ground within the French fund finance landscape. Despite its promising advantages, including optimised asset utilisation and strategic financial management, NAV financing continues to encounter hurdles in the French market due to perceived maturity limitations. This impediment restricts its widespread adoption among investment funds, reflecting a cautious approach among stakeholders in embracing this innovative financing approach.

## I FUND STRUCTURES IN THE FRENCH MARKET

### Brief overview of French fund structures

Fund structures in France generally fall within the following categories:

1. *De jure* alternative investment funds resulting from the transposition of the AIFM Directive, which are funds that are expressly listed and named by the French

Monetary and Financial Code (CMF). These funds may be structured as a co-ownership of assets without legal personality (*fonds commun de placement*, FCP) or an investment company with variable capital (*société d'investissement à capital variable*, SICAV), usually taking the legal form of a classic unlisted French private or public company, limited by shares (*société par actions simplifiée*, SAS or *société anonyme*, SA respectively).

As an exception, the *société de libre partenariat* (SLP) is structured as a company with a strong *intuitu personae*, similar to a partnership (*société en commande simple*, SCS), rather than an FCP or SICAV.

The very recent French *Ordonnance* n° 2024-662 of 3 July 2024 relating to the modernisation of the alternative investment funds (French *Ordonnance* n° 2024-662) has led to the long-awaited creation of a new category of SLP *without legal personality*: the *société de libre partenariat spéciale* (SLPS), structured as an SCS without legal personality. The SLPS will, no doubt, place the SLP family in a better position to compete with the Luxembourg limited partnership (*société en commandite spéciale*, SCSp) and the Anglo-Saxon limited partnership structures with which they share many similar characteristics.

FCPs and SLPSs must be managed by an alternative investment fund manager (AIFM), whereas SICAVs and traditional SLPs can either opt to be self-managed or managed by an external AIFM.

Other than the SLP, *de jure* AIF structures in France are often structured as FCPs due to the combination of their flexibility, simplicity and attractive tax regime: we draw your attention to the following structures:

- (a) *De jure* AIF structures, principally reserved for professional investors and other “qualified investors” (cf. below), such as the *fonds professionnel de capital investissement* in the form of an FCP (FPCI), the *fonds d'investissement professionnel spécialisé* (FIPS) and the SLP (and the new SLPS), which are “declared” funds (*fonds déclarés*) that do not require the approval (*agrément*) of the French Financial Markets Authority (the AMF).
  - (b) *De jure* AIF structures, open to professional and retail investors, such as the *fonds commun de placement à risques* (FCPR), the *fonds commun de placement dans l'innovation* (FCPI) and the *fonds d'investissement de proximité* (FIP), which are “authorised” funds (*fonds agréés*) requiring AMF approval.
2. *De facto* AIFs (*Autres FIA*), which are funds that, irrespective of their legal form, meet the criteria of an AIF, as defined in the AIFM Directive and transposed into French law. The *société de capital risque* (SCR) is just one example – it is not authorised or declared, but rather “known” to the AMF. The SCR is often regarded as an attractive and “low-maintenance” vehicle for modest fund managers in the venture capital sector, especially where the fund is “self-managed” and raises capital from a limited number of professional investors who are principally

resident in France. However, the SCR's popularity has waned since its inception in 1985, due to operational inconveniences and restrictions.

3. *Undertakings for collective investment in transferable securities (UCITS)*, which are undertakings for collective investment, authorised pursuant to EU Directive 2009/65/EC on the co-ordination of laws, regulations and administrative provisions relating to UCITS. Funds finance activities are generally not adapted to the UCITS sphere, due to the nature of this product.

## Common fund structures in the fund finance sector

The most common structures encountered today in the fund finance sphere, pertinent for the purposes of this chapter, are the FPCI, the FIPS and the SLP.

All three fund structures are “declared” funds open to “qualified investors” (i.e., professional investors and other investors with a certain level of experience or knowledge and/or a minimum commitment amount):

1. The FPCI is more restrictive than the two other structures and is usually used for private equity funds, due to statutory restrictions on its asset composition. Key characteristics include the following:
  - (a) the constitutional document for an FPCI is a *règlement* (by-laws);
  - (b) there is a mandatory statutory legal quota in relation to the asset composition of an FPCI: 50% of fund assets must consist of eligible securities in specified unlisted entities;
  - (c) the fund's assets need to respect the above-mentioned legal quota no later than the last day of the second accounting year of the FPCI and at least until the end of the fifth accounting year following the creation of the FPCI;
  - (d) in order to benefit from a preferential tax regime for French resident investors, the FPCI must also agree to respect a statutory tax quota;
  - (e) there are other statutory restrictions and thresholds regarding the composition of an FPCI's assets – of note, up to 20% of fund assets may be invested in eligible securities that are admitted to trading, by companies whose market capitalisation is less than €500m. This threshold was recently increased from €150m by French Law n° 2024-537 of 13 June 2024 aiming to increase the financing of enterprise and the attractiveness of France (French Law n° 2024-537);
  - (f) there is a statutory borrowing limit, fixed at 30% of fund assets (previously 10%);

- (g) the CMF expressly permits third-party rights to be granted over fund assets and the undrawn commitments of investors, including personal or real security interests (*sûretés personnelles ou réelles*), pursuant to the conditions set forth in the *règlement* (Article R. 214-205, III of the CMF); and
  - (h) the fund is tax transparent.
- 2. The FIPS is a type of FPS, a category of funds that is much less restrictive than the FPCI family: there is large contractual freedom in terms of its asset composition, operation, management and governance. Key characteristics include the following:
  - (a) the constitutional documents for a FIPS consist of a *règlement* and a *prospectus*;
  - (b) the FIPS is not subject to any statutory legal or tax quota in respect of its assets and is, therefore, often used for a larger range of asset classes; it can invest in a wide spectrum of assets;
  - (c) there is generally no statutory borrowing limit and the scope of “qualified” investors is similar to that of an FPCI;
  - (d) whilst there is no statutory equivalent of Article R. 214-205, III of the CMF for the FIPS, as a matter of market practice, a contractual clause tracking the same wording is often inserted into the constitutional fund documentation and/or the investor’s subscription agreement; and
  - (e) the FIPS is tax transparent.
- 3. The SLP (as well as the SLPS) is also a member of the FPS family and thus benefits from much of the flexibility afforded to the FIPS. There is no *mandatory* statutory legal or tax quota (the SLP may *opt* to comply with these quotas in order to benefit from the FPCI preferential tax regime). However, the SLP is also governed by an adjusted version of the general French statutory company law provisions applicable to French companies. Key characteristics include the following:
  - (a) the constitutional documentation for an SLP consists of *statuts* (articles of association), since it is essentially a French company (SCS). However, contrary to a classic French company with legal personality, only an extract of the *statuts* is published upon incorporation, thereby maintaining the commercial confidentiality of the fund documentation;
  - (b) an SCS is a legal form that echoes the governance structure of an Anglo-Saxon limited partnership: there is *intuitu personae* and there are limited partners (*associés commanditaires*) and a (*managing*) unlimited partner (*associé commandite (gérant)*), similar to a general partner (GP). This means that creating an SLP is more administratively onerous than establishing an FPCI or a FIPS: the unlimited partner structure needs

to be incorporated initially with the competent *Registre de Commerce et de Sociétés* (Register of Trade and Companies, RCS), followed by the incorporation of the fund itself with such RCS, prior to carrying out any AMF “declaration” formalities. By contrast, the FPCI and FIPS are not incorporated with the RCS and do not have an unlimited partner governance structure;

- (c) there is generally no statutory borrowing limit;
- (d) the scope of “qualified” investors (that are not professional investors) who are eligible to invest in an SLP is more limited than the FPCI and the FIPS;
- (e) whilst the SLP has legal personality (unlike the SLPS), it is deemed to be tax transparent by operation of the law, with a similar tax status to the FPCI; and
- (f) the SLP was France’s initial answer to the Luxembourg SCSp and Anglo-Saxon limited partnerships, with a view to competing with such structures on the international market.

Recent legal and regulatory developments at an EU and domestic level have increased the potential of these three fund structures. Key points to highlight include:

- These three fund structures are the most adapted to the ELTIF regime, optimised by the recent ELTIF 2.0 EU reform and related adjustments introduced by French *Ordonnance* n° 2024-662:
  - please note that where any of the above structures are authorised under the ELTIF label, there is a borrowing limit of 50% of NAV for funds marketing to retail investors, and 100% of NAV for funds marketing to professional investors (the limit was previously 30%). Where such borrowing is fully covered by security on assets or the undrawn commitments of investors, these thresholds would not apply in most cases; and
  - please also note that funds with the ELTIF label may also have a larger spectrum of everyday retail investors, beyond “qualified investors”. ELTIF 2.0 dispensed of the ELTIF 1.0 minimum investment commitment of €10,000 and 10% financial instruments portfolio cap.
- French *Ordonnance* n° 2024-662 has also permitted these three fund structures to issue tracking securities that trace any specific asset or proceeds within the fund’s portfolio, a reform that may open the door to facilitating NAV facilities in France:
  - the CMF now explicitly permits the FPCI, FPS, SLP (and SLPS) to issue “tracking” units or shares (*parts* or *actions*) that will put an end to years of innovative structuring to try to economically simulate the legal effect of tracking, by providing a clear legal basis for such complex *montages*;

- the FPS, SLP (and SLPS) may also issue classic or “tracking” debt securities (*titres de creance*); and
- the advent of the SLPS will enhance France’s competitiveness in the funds market (French *Ordonnance* n° 2024-662) (cf. below).

## Impact of fund structures on due diligence and investor considerations in the French market

### *Impact on due diligence*

As already highlighted above, equity bridge financing is still more advanced in France than the NAV facility offering, so this section will rather focus on due diligence in the equity bridge financing context and, in particular, issues specific to France and investor sensitivities.

As we have seen in the main section of this guide, due diligence is an intrinsic part of any fund finance transaction, both for a lender and a fund manager. The lender should review:

- the repercussions of the specific statutory rules applicable to the relevant category of AIF (or any “labels”);
- the manner in which the fund is structured, including corporate governance structures, specific to the relevant AIF; and
- contractual fund documentation (constitutional documentation, any management agreement, investment advisory agreement, co-investment agreement, depositary agreement, investors’ side letters and investors’ subscription agreements).

Preliminary due diligence questions are generally similar in each jurisdiction: is borrowing, and the provision of security for that borrowing, permitted at fund level under the fund documentation? Are there restrictions on borrowing (e.g. the statutory borrowing limit for an FPCI or an ELTIF-labelled fund structure (cf. above)) or security? Are there any side letters?

An in-depth analysis is also required on the basis of the specific documentation applicable to the fund; we will visit this subject in more detail below (cf. *Due diligence – equity bridge facilities*).

It is important to review investors’ side letters and subscription agreements to ensure that there are no “hidden” clauses in relation to lender-sensitive issues (including, but not limited to, excuse rights, draw stops, overcall or shortfall limits, Most Favoured Nation (MFN) clauses, LP transfers permitted without GP consent, possibility to reduce or cancel total commitments, LP clawback/recall/reinvestment/recycling/temporary distributions provisions, subordination of distributions to investors, waiver of defence, counterclaim and set-off rights, etc.).

Where there are development finance institution (DFI) investors in the fund, it is all the more important to review their lengthy side letters, verify their internal policies on equity bridge facilities and ensure that they are comfortable. For example, some DFIs, as a matter of policy, will in no circumstances agree to general security being granted over actual undrawn commitments, but might agree to security over the fund's bank account as long as such DFI investors always pay into the fund's actual bank account, and not the lender's account.

**Spotlight on key fund structure issues specific to fund financing in France – investor considerations**

- **Statutory borrowing limits**

In France, an equity bridge facility is usually set up at the level of one or more funds managed by the fund manager and/or at the level of a special purpose vehicle (SPV) that is a direct subsidiary of the fund.

Where the fund is an FPCI, borrowing limits apply. The *direct* borrowing limit at the level of the FPCI under French law was initially 10% of fund assets, which led to a market practice of structuring borrowing *indirectly* at the level of SPVs wholly owned by the fund. Since the amendment of the CMF to increase the FPCI statutory borrowing limit from 10% to 30% in 2019, we are progressively seeing more structuring at the level of the actual FPCI, rather than indirect borrowing via an SPV.

As we have seen, where a French fund acquires the ELTIF label, a borrowing cap will apply (50% of NAV for funds marketing to retail investors, and 100% of NAV for funds marketing to professional investors). In some circumstances where borrowing is fully covered by security on assets or the undrawn commitments of investors, this can be excluded from the cap.

- **Practices regarding direct or indirect security rights over undrawn commitments of investors under French law, driven by large institutional investors and DFIs**

As we have seen, the CMF expressly permits third-party rights, including personal and real security interests, to be granted over the undrawn commitments of investors, but French market practice is more conservative, especially when compared with Luxembourg.

In summary, the type of fund will dictate the structuring of funds financing and the security package, but generally, in France, some institutional investors are not particularly receptive to traditional security interests (such as pledges) over the actual undrawn commitments (some DFI investors are also not comfortable with any security over the right to issue drawdown notices). Investors tend to prefer a

pledge over the fund's bank account and/or the contractual civil law stipulation *pour autrui* mechanism that we describe in more detail below (cf. iv Security and guarantee).

## **Conclusion on fund structures: impact of the current market on French closed-ended fund structures – recent developments**

### ***End-of-life French fund structures: NAV facility, a “quasi-exit” solution providing liquidity – democratisation of private equity***

A 2022 AMF consultation and the 2022 France Invest “Rendre le capital-investissement ACCESSIBLE” report highlighted the adverse repercussions of COVID and current market conditions on the life cycle of French closed-ended fund structures, open to professional and retail investors.

It was noted that the current economic climate has led to a majority of French funds not ramping down within the stipulated fund term. This is a particular concern in France, due to the current drive towards democratising private equity. Opening private equity to everyday retail investors will increase the need for more protection and liquidity, as evidenced by the recent ELTIF 2.0 reform, recently accommodated by adjustments to French law through the medium of French *Ordonnance* n° 2024-662.

As a result, French fund managers have been under pressure to find liquidity for their investors and exit within the agreed fund term, in view of market conditions.

In this vein, in June 2024, French Law n° 2024-537 increased the maximum statutory term for an FCPR from 10 to 15 years. In consideration for the increased flexibility granted to fund managers in winding down their FCPR structures, there is a new article in the CMF requiring the by-laws of an FCPR to provide for a pre-liquidation period and the fund manager to take measures necessary to prepare for exits.

Furthermore, whilst sophisticated continuation funds have become a mainstream staple for providing liquidity and exit opportunities in the French market, they also involve complex structuring and significant conflicts of interest issues that are not adapted to all LPs or fund managers.

In light of the above, fund managers have had increasing recourse to “quasi-exits” and the ensuing liquidity offered by the fund finance market, leading to an increased interest in NAV facilities, leverage recaps and preference caps, which may thus become more frequent in the French market in the long term.

Issues, such as portfolio cross-collateralisation, have historically caused significant barriers to NAV facilities taking off in France: the express possibility under French *Ordonnance* n° 2024-662 for the FPCI, FIPS and SLP to issue “tracking” securities (as applicable) may potentially assuage some of the reticence that the French market has had towards NAV facilities.

### **The New SLPS – a true competitor to the Luxembourg SCSp and Anglo-Saxon limited partnership**

Finally, the arrival of the SLPS, a limited partnership without legal personality, as a new alternative to the SLP, will mean that France can offer the international LP funds market a more flexible, accessible and intuitive limited partnership product. Whilst the SLPS has a similar regime to the traditional SLP, there are some welcome adjustments that take into account its lack of legal personality, including the creation of a mass of commingled assets (*biens communs*) and the debts and liabilities generated by: (i) the administration of such commingled assets; and (ii) the operation of the SLPS (*masse commune*). The manager of an SLPS may freely administer the *masse commune* in the interests of the partners and, in that context, may dispose of the *biens communs*. The liability of each limited partner is limited to its rights in the *masse commune*.

The SLP's legal personality has historically been a sticking point in some jurisdictions, reducing the appetite for the SLP in the international LP market (an illustration being hybrid mismatches/tax transparency debates regarding UK treatment of the "corporate" SLP structure, as well as Belgium's reluctance to treat the SLP as a transparent structure). The recent introduction of the SLPS will hopefully help to neutralise these barriers to the attractiveness of the SLP in the institutional LP market.

As a consequence, we believe that we will see more of this new fund structure in the fund finance market in the near future.

## **II ANATOMY OF A TRANSACTION**

### **Term sheet**

According to French market practice, the term sheet is usually prepared by the arranger. However, it is not unusual that the first draft is prepared by the fund and its counsel to secure the key legal and commercial terms of the contemplated financing. The term sheet broadly follows or summarises Loan Market Association (LMA) provisions and includes a description of the fund's structure chart (including its general partner, the investors, any feeder, staff or parallel funds, any sponsor and the relevant management entities), the parties and, most importantly, the financial covenants, the security package and guarantees, and a limited list of representations and warranties, undertakings, events of default and mandatory prepayment events. Deviations from the agreed term sheet are difficult to negotiate in the long-form of the facility agreement, unless motivated by findings made by lenders' counsel during the legal due diligence process of the fund's documentation or, in case of a NAV facility, its underlying assets and interests.

## How to structure an equity bridge facility under French law?

### ***Subscription facility or equity bridge facility?***

Unlike in other jurisdictions, a subscription facility is referred to by the French market as “*equity bridge financing*”, but it encompasses all the features of a subscription facility as described in this guide. For all practical purposes they are the same thing.

### ***Is the French fund using leverage? Revolving facility or term loan facility with replenishment of commitments?***

Equity bridge facilities have been structured by the French market to consider constraints applicable to institutional investors that were unwilling to invest in AIFs regarded as using “*leverage*” within the meaning of the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing the AIFM Directive.

Such EU regulation excludes from leverage reporting obligations AIFs that have entered into borrowing arrangements that are “*temporary in nature*” and “*relate to and are fully covered by capital commitments from investors*”. As such regulation mentions that revolving credit facilities should not be considered as being temporary in nature, French legal practitioners (unlike in other jurisdictions) have taken a conservative interpretation of such provision and decided not to use revolving facility documentation for the structuring of equity bridge facilities, but instead, opted to develop a bespoke precedent of committed and uncommitted term loan facilities agreement that includes facility commitment replenishment features after repayment of outstanding utilisations.

The replenishment of the committed facility is more or less automatic and, in most cases, requires not much more than a formal replenishment request from the borrower to the lender, including the borrower’s confirmation that no event of default has occurred or is continuing.

A consensus was found among French market players and practitioners to consider that utilisations not exceeding 364 days should meet the first condition to characterise borrowings as “*temporary in nature*”. Regarding the second condition, requiring borrowings to be fully covered by the commitments of the investors, it is not unusual to include a covenant to this effect in the equity bridge facility, even though the agreed “*coverage ratio*”, or “*borrowing base ratio*”, which are, by definition, much more restrictive, should already address this condition indirectly.

### **What if the French fund is subject to statutory borrowing limits?**

Another French market exception to keep in mind when structuring financing for a French fund is any potential statutory borrowing limit. Until November 2019, no French fund structured in the form of a FPCI was permitted to incur borrowings exceeding 10% of its assets. This borrowing limit has been increased and is now capped at 30% of its assets but, interestingly, this limit applies only to borrowing and does not apply to the granting of guarantees by the fund. Thus, to comply with this borrowing limit, but maximise recourse to the fund's investors, the equity bridge facility is often granted to a SPV, wholly owned by the fund that would, in return, grant a guarantee to the lender. The recourse to the investors would secure the guarantor's payment obligations under its guarantee that guarantees the SPV's payment obligations as borrower under the equity bridge facility.

## **Due diligence**

### **Equity bridge facilities**

The French due diligence process would cover the same list of fund documents and items as described elsewhere in this guide. In particular, due diligence will seek to establish: the absence of borrowing, guarantee and security limits; which entity is entitled to issue drawdown notices to the investors; how this right can be delegated to the lender; the form of drawdown notice to be used; the inclusion of an acceptable "*stipulation pour autrui*" provision, in line with French market expectations (see below section on security and guarantee); the capacity to make "overcalls" to investors to compensate potential defaulting investors; investors' set-off rights against the fund and how they may impair the investors' undrawn commitments; "key person" clauses; "change of control" clauses and "suspension periods" in relation, *inter alia*, to GP removal or suspension of the investment period provisions and their potential impact on the fund's capacity to continue to issue drawdown notices to the investors; investors' "exclusion events", including excuse and draw stop rights; and how "temporary distributions", "temporary repayments", LP clawbacks, reinvestment, recycling and any other recall rights, or ability to reduce total commitments, may affect the undrawn commitments of the investors.

### **NAV facilities**

For the implementation of a NAV facility, the primary focus of due diligence is on the fund's assets and rights. How can security be taken on the underlying investments of the fund and the cashflows up to the fund, before their distribution to the investors? Are there any restrictions such as "negative pledge", "change of control" or transfer restrictions provisions that may impair the granting of security interests, their validity and binding effect and, most importantly their potential perfection and enforcement? The approach is much more bespoke and will be driven by the type of investment (equity or debt) of the fund, its investment policy and the structuring of its underlying investments.

The constitutional documents of the fund need to be reviewed to verify that a new NAV facility is permitted, as often the French fund's documentation anticipates the implementation of an equity bridge facility (with the inclusion of a "*stipulation pour autrui*" provision) but not a NAV facility. The waterfall provisions in fund documentation are also key to ensuring a priority payment in favour of the creditors of the fund can be achieved. In addition, the terms of any existing equity bridge facility may include restrictions on permitted financial indebtedness, guarantee and/or security that will need to be waived and/or amended, prior to entering into the NAV facility.

### III THE FACILITY AGREEMENT

If the sponsor or the fund manager are based in France, the legal documentation is usually governed by French law, even if, in some circumstances, the borrowing entity may be incorporated in another jurisdiction, such as Luxembourg. However, if the parties are aiming to syndicate the facility among international lenders, the documentation is more likely to be governed by English law. Whatever the choice of applicable law may be, any lender granting a facility to a French borrower or to finance a French purpose must comply with the French banking monopoly rules and hold the requisite banking licence, or benefit from one of the available exceptions to such statutory monopoly rules, which are criminally sanctioned.

#### ***Who on the fund side needs to be a party?***

The French fund and its duly authorised or regulated fund manager or French portfolio management company (*société de gestion de portefeuille*) that is also acting as an AIFM.

#### ***Change of control, replacement or removal of the fund manager***

The change of control clause usually applies to the fund manager. As in other jurisdictions, it has become market practice to allow the fund manager to be replaced by an affiliated entity, provided that the latter: (i) holds all the requisite authorisations to perform its obligations; (ii) accedes to the facility agreement; and (iii) duly fulfils satisfactory "KYC checks" performed on it by the finance parties.

#### ***Representations and warranties, covenants and events of default***

There are some French-specific amendments that will need to be made to the facility agreement in respect of representations and warranties, covenants and events of default. The representations as to status and regulatory status of the fund manager will need to be carefully assessed on a case-by-case basis for the particular fund vehicle. Representations and covenants in relation to the fund documentation, constitutional documents and subscription documents need to be carefully reviewed to ensure that they: (i) correctly reference the relevant documents for the fund, which

may vary on a vehicle-by-vehicle basis; (ii) duly take into account any service provider documents relevant to the transaction; and (iii) address any points which may have arisen from the due diligence on the fund.

**Negative covenants** – It is common in France as in other jurisdictions to include prohibitions and restrictions on the obligors (i.e.: the guarantors and the borrowers), such as on financial indebtedness, security and guarantee and merger, bearing in mind that they should not apply to the fund manager itself, whose representations and undertakings should be strictly limited to its role as fund manager of the relevant French fund and its right to issue drawdown notices to the investors of said fund.

**Information covenants** – The information covenants are rather detailed, and lenders expect to receive at least the same level of information that the investors would receive from the fund and its fund manager. The list of information to be provided to the lenders is rather extensive and would encompass prompt or immediate information on: the triggering of a “suspension period”; the end of the “investment period”; a change in the “structure chart” (especially if new parallel or feeder vehicles are set up); the occurrence of “exclusion events” affecting investors; any changes to the “fund documents”; the transfer or cancellation of “investor commitments”; and the inclusion of new investors.

**Financial covenants and ratios** – For equity bridge facilities the “coverage ratio” and the “borrowing base ratio” models are both seen in the French market and tend to apply on a continuing basis, meaning that any change to the investor base, resulting from transfers between investors, or the occurrence of “exclusion events” affecting any investors (subject to a materiality threshold to be agreed) must be disclosed immediately to the lenders and trigger a new calculation of the applicable financial ratio, sanctioned if not complied with, by an immediate partial prepayment of outstanding utilisations to restore satisfaction. Often, a “response ratio” to calculate the proportion of investors that have complied with the payment of their called subscriptions is included in the equity bridge facility and a “performance ratio”. In addition to the investors’ undrawn commitments, a NAV component may also apply.

**Covenant adjustment** – After any new inclusion of investors in the fund and until the final closing of the fund, the fund may request the lenders to include new investors as “qualified investors” in the borrowing base and to revisit the coverage/borrowing base ratio so that a new coverage threshold applies. The decision to onboard new investors (or existing investors increasing their existing commitments) and to change the applicable coverage threshold must be approved by unanimous consent of all lenders, after satisfactory legal due diligence of the relevant subscription or transfer documentation and KYC checks.

**Events of default** – The events of default will need to be adapted to take into account certain insolvency references and processes specific to France, as well as certain regulatory events of default.

**Conditions precedent** – The required conditions precedent will be very similar to those required in other jurisdictions and will include the constitutional documents and fund documents, corporate resolutions (sometimes including investment committee

decisions), certificates and finance and security documents. The French market approach to legal opinions in France on fund finance transactions is for the borrower's counsel to provide a due incorporation and capacity opinion and lender's counsel to provide a validity and enforceability opinion in respect of French law-governed documents.

## IV SECURITY AND GUARANTEE

The required security will vary depending on the type of facility and whether the fund is acting as guarantor or borrower under the contemplated financing. The type of security commonly used on fund finance transactions dealing with assets located in France or rights governed by French law will follow the same security package as that described elsewhere in this guide, but would be governed by French law and adapted to French law requirements for their validity, binding effect and enforcement.

**Pledge over bank accounts** - In an equity bridge facility, security over the bank accounts on which the drawdowns of the investors are paid is taken whereby for a NAV facility, the security would be taken on the bank accounts on which the distributions are collected before their distribution to the investors.

**Stipulation pour autrui** - Unlike other jurisdictions where security is granted by the fund over the undrawn commitments and its right to make capital call from its investors, the French market has opted for a different route and has developed a different approach to structure and organise the lender's recourse to the commitments of the fund's investors by using the so-called "stipulation pour autrui" (third-party right provision) achieving in the end, by different means, the same result.

### **How does the "stipulation pour autrui" used by the French market in the context of equity bridge facilities work?**

The *stipulation pour autrui* is a civil law concept, governed by Article 1205 of the French *Code Civil* whose purpose is to create rights in favour of a third party (here, the lender under a future equity bridge facility) that is not party to a contract (here, the limited partnership agreement (LPA) of the fund governed by French law).

In order to work efficiently, this mechanism should be included at the outset in the constitutional documents of the fund and follow a specific form of words, reflecting French market practice. The absence of such wording, or incomplete wording not covering all the lenders' expectations, is likely to jeopardise the implementation of the equity bridge facility. In case of doubt, it is recommended to share the proposed wording to any potential lenders and to have it pre-approved before inclusion in the relevant constitutional documents of the fund.

The wording should cover the following: (i) the fund, in its capacity as stipulator (*stipulant*) irrevocably stipulates in the LPA to the benefit of future and unknown lenders under any equity bridge facility to be entered into after the first closing of the fund that the investors, acting as promisor (*promettant*), shall pay their undrawn commitments (up to the full commitment amount agreed by each investor to the fund, as set out in its subscription agreement) into the fund's collection account that is pledged in favour of the lenders, in compliance with any drawdown notices sent by the agent on behalf of the lenders; and (ii) each investor, acting as promisor (*promettant*), irrevocably promises in the LPA of the fund in favour of the lenders and the agent, acting as beneficiaries (*bénéficiaires*), to pay, upon receipt of such drawdown notice, its undrawn commitments into the pledged bank account. The fund, acting as stipulator (*stipulant*), waives its right to revoke at any time such third-party stipulation (*stipulation pour autrui*).

As from its acceptance by the lenders and the agent, the *stipulation pour autrui* becomes irrevocable. Such acceptance occurs at the time the equity bridge facility agreement is entered into and is formalised by an acceptance letter, executed by the agent acting on behalf of the lenders, which is addressed to the fund.

The fund would usually inform its investors that an equity bridge facility has been entered into and that their *stipulation pour autrui* has been accepted and is now irrevocable in its next management report. However, this information requirement has moved to become more a condition precedent to the utilisation of the facility (as is the notice of security to investors in other jurisdictions) to ensure that the investors are made aware of the acceptance of their *stipulation pour autrui* up front. In case of syndication of the equity bridge facility, the new lenders may request the execution of a new acceptance letter in their favour, but this formality is not strictly required if they are succeeding to the right of an existing lender, referred to in the initial acceptance letter.

The *stipulation pour autrui* is not *per se* an *in rem* security and, as such, does not grant any preference right to the lenders on the investors' undrawn commitments (as would do a receivables pledge). However, as from its acceptance, the lenders and the agent are vested with direct and irrevocable recourse rights against each investor. The absence of pledge over the undrawn commitments is also mitigated by the fact that the investors' commitments must be paid into a pledged collection account and that there is no additional indebtedness at the level of the fund.

### **What if no *stipulation pour autrui* was included in the constitutional documents of the French fund? Is the pledge over undrawn commitments a workable alternative?**

The inclusion of a *stipulation pour autrui* provision in the constitutional documents of the fund after the first subscriptions of investors is rather costly and cumbersome to implement and should definitely be anticipated in the first drafts before submission to the investors.

This being said, as an alternative, funds structured in the form of an FPCI or an SLP could grant a French law pledge on their investors' undrawn commitments, in accordance with articles 2355 *et seq.* of the French *Code Civil*.

This security is rarely granted in the context of an equity bridge facility as it may raise concerns with the depositary's duties, but may also raise complex legal issues to be anticipated in case of its enforcement.

If accepted, the pledge is validly created between the parties and is effective against third parties (*opposable*) (other than the debtor of the pledged receivables) upon the signing of the receivable pledge agreement. To become effective against the debtors (*opposable*) (i.e. the investors), such debtors must either be notified of the pledge or become a party to it. In the absence of such perfection formalities, debtors may continue to validly discharge their payment obligations to the pledgor.

Under this pledge route, the timing when the pledge notice is served to the investors is key. Indeed, it is important to note that once the pledge notice is served to the investors in accordance with Article 2363 of the French *Code Civil*, the investors are no longer entitled to pay their undrawn commitments into the fund's account, but must pay their commitment on the bank account provided by the agent and the lenders in their pledge notice. The fact that the investors' undrawn commitments are no longer paid into the account of the fund may raise concerns for the depositary and for the creation of fund's shares to be issued in consideration for the investors' contributions. In order to solve this issue, it is possible to provide in the pledge agreement that the payment of the pledged claims shall be made on the fund's pledged bank account.

In addition, it is worth noting that the pledge does not in itself vest its beneficiary with any direct rights to submit drawdown notices to the investors and that a special power of attorney will need to be agreed among the parties.

### **If the fund is a guarantor under the financing, what kind of guarantee is granted under French law?**

If the equity bridge facility or NAV facility is not made available directly to the fund, but to an SPV held or controlled by the fund, the lenders would expect the fund to be a party to the facility agreement as guarantor, and grant a guarantee. The due diligence process would need to verify the absence of any guarantee limit in the constitutional documents of the fund and, if so, that they are taken into account by appropriate guarantee limitation provisions.

The usual English law guarantee and indemnity is replaced by a personal joint and several guarantee, granted in the form of a French *cautionnement solidaire*. This guarantee is strictly accessory to the obligations it guarantees, meaning that the guarantor may raise any exception that the guaranteed debtor may raise to refuse to pay. If several fund entities, managed and/or advised by the same fund manager, are guarantors, the guarantee may be joint, but not always several, between the guarantors to reflect their *pro rata* share in the global transaction and the terms of their co-investment agreement.

When structuring the security and guarantees for a NAV facility, special attention must be paid to up- and cross-stream guarantees (or security) granted by corporate entities incorporated in France, so as to consider corporate interest and benefit issues for such entities in granting such security or guarantees.

It is worth noting that any professional lender benefiting from a French law guarantee (or a French law security interest securing the obligations of a third party) must provide to its guarantor (or security provider) annual statutory information on the total amount guaranteed as of 31 December of each year (including a split between the principal amount, the interest and other costs guaranteed), and this information must be provided within a three-month period and no later than 31 March. Any failure to comply with this information duty is sanctioned by a prohibition to recover contractual interest incurred and due during the period in which the lender did not comply with its information duty.





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