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What's Hot in Fund Finance?

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My colleague Leah Edelboim and I had the pleasure of presenting a webinar on "Hot Topics in Fund Finance" earlier this week. Special thanks to Mondaq for hosting us. Below is a brief summary of some of the trends and market updates we touched upon.

Market Trends:

What a difference a year makes! In early to mid-2020, we were buckling up for a deluge of pull-forward transactions as liquidity availability and terms tightened and pricing increased substantially over historical norms. Over the last 12 months since Q3 2020, however, we have seen more normalized activity, with deals tracking at a pace dictated more by fundraising and investment activity (and less by market volatility). Margins have come down quite a bit and stabilized – albeit still a good touch higher than pre-pandemic marks. New players have continued to enter the market. Bankers have moved. Those who pumped the brakes or took a timeout have re-entered the market and are closing deals. It's a frenzied pace with non-stop flow, and we should all be super pumped and proud to be a part of this industry.

Transactions are growing hair once again – the bespoke has returned! Since mid-last year the volume of SMAs, equity commitment deals, hybrids, NAVs and other types of acronym-laden fund financings has picked up by a large multiple from the non-existent early pandemic levels. As practitioners, we are happy to see the complexity creep back in and look forward to more novel structures as the market regains momentum.

In addition to all of this, we are seeing exciting new activity on the ESG front and the continued saga of LIBOR phase-out activity. Revlon also continues to be a good educational point for those unfamiliar with why the credit agreement now includes an erroneous payment clawback clause.

ESG:

We have written and presented extensively on this, but the movement continues to deserve more attention. I also refer to it as a movement, because this is something that has immense social, political and economic footing and could become relevant to almost every fund's strategy. Sustainability promotes longer term goals that help us advance core societal needs and values. It has often been referred to as "smart investing," "socially-conscious investing" or "stakeholder preference." I agree with each of these characterizations. The data also supports it.

According to Preqin surveys, 89% of investors think ESG will lead to better returns. Investors want it. Fund managers are listening – 69% of them have already established ESG policies or are currently working to do so. Banks want it, too. The corporate and reputational benefits of making money while advancing the greater good is compelling.

What are the challenges and how do we get there? So far, the U.S. market has picked up steam as we are nearing double-digit transaction closings for ESG facilities and across multiple clients. These include a variety of performance and use-of-proceeds based facilities and with a near-balanced focus on social and environmental outcomes. The challenges are aplenty. To some degree, this is still the Wild West. The market continues to operate with limited published guidance on how to structure these deals. Consolidation of standards and objectivity concerns persist. We are seeing enhanced reporting and transparency to achieve greater accountability and more effectively measure progress. Be patient. We will get there. Doing nothing serves no purpose and fails to advance the ball. The facilities that are currently closing are trend-setters and will help guide the market and set precedent for years to come.

Of late, we are seeing a push for a two-way ratchet on pricing. A corresponding increase up if the borrower fails to meet its goals gives both parties skin in the game on the loan economics. This makes good sense, particularly where (and rightfully so) failure to achieve goals does not result in any other consequences such as an event of default. Also, look for deals going forward to contain more robust reporting and rights for third-party verification.

My top 10 ESG structuring considerations can be found **here**.

Revlon:

What a beautiful topic. Well, unless you are on the wrong side of an erroneous payment. You see, historically, when facility agents made a payment in error to syndicate lenders and then asked for the money back, the money was promptly returned. In the case of the Revlon financing, the agent mistakenly wired nearly $900 million to the lender group. A syndicate that included many non-bank lenders refused to send back more than $500 million of the mistaken payments.

Long story short, the district court ruled these lenders could keep the money under a “discharge-for-value” doctrine because the payments represented exactly the amount of money due under the loan (the agent intended to only wire out $7 million in total payments representing principal and interest but mistakenly paid out all the obligations. Oops – this is like a tailor-made Southwest commercial: Want to get away??).

Because of this case, our syndicated credit agreements now include a lengthy erroneous payments section that effectively requires lenders to return any erroneous payments. Failure to do so results in an automatic assignment of the loans to the agent (but not the commitment obligation of the paid-out lender).

As a result, we have seen some reflexive striking of the new language (not okay), some borrower-specific carve-outs (usually okay) and some sunset periods on the right to request a return of the money (maybe okay – but interestingly very rare in a survey of credit agreements done by the LSTA).

Leah has really set herself apart on navigating these issues. If you need help or even a simple tutorial, please reach out.

LIBOR Remediation:

They should make a sequel to the movie *Groundhog Day* with Bill Murray, but instead of being a weather man in Punxsutawney, Pennsylvania, he should play a BigLaw finance attorney working on LIBOR remediation amendments. The sheer volume. The technical nature. The regulatory pressure. Can’t stop. Won’t stop.

Mike wrote a fantastic article in last week’s *FFF* with practical tips on how to communicate and address the difficulties of this issue – you can find it **here**. This really says it all.

Good luck the remainder of the year as we head into the home stretch.

*To view the on-demand recording on the Mondaq site, visit **here** and log into your account (or create one for free) to access the “View Webinar On Demand” option.*