

## Fund Finance Friday



### Finance Forum Panel Recap – ‘Heading Into the Storm: Preparing to Survive and Profit from Turbulence in Finance Markets’

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Last week’s Cadwalader 2022 Finance Forum included a panel titled “Heading Into the Storm: Preparing to Survive and Profit from Turbulence in Finance Markets,” which brought together a panel of industry experts to discuss the current market environment and the opportunities and challenges it presents for finance markets. The panelists included: Scott Bynum, a Managing Director and Portfolio Manager at Mudrick Capital Management; Bryan High, a Managing Director at Barings; James Kim, Head of Distressed Investments at Nuveen; Mike Rupe, a Financial Restructuring partner at Cadwalader whose practice focuses on lender-group representation; and Casey Servais, a Financial Restructuring partner at Cadwalader whose practice focuses on municipal finance and bankruptcy litigation. The panel was moderated by Cadwalader Fund Finance partner Brian Foster.

The rapid growth of many sectors of finance markets since the Global Financial Crisis (“GFC”) of 2007-2008, including and especially fund finance – which has seen substantial increases in capital call facilities and, more recently, NAV facilities over the past several years – has created opportunities for new lenders to enter the market and for existing lenders to significantly expand their lending desks. One result of this growth, however, is that a large number of lenders, bankers and lawyers currently in the market have never seen or gone through a downturn, and a primary goal of this panel was to pass on the knowledge of professionals who went through the GFC and other downturns.

The discussion kicked off with the panelists providing anecdotes from their specific experiences during the GFC. These included spending the Sunday before Lehman’s collapse negotiating contingent trades (to replace Lehman as counterparty in case Lehman wasn’t rescued), to an inability to perform credit analyses because no one knew where asset and securities valuations were headed, to just a sudden slow-down (and, in some cases, a complete stop) of lending activities. The panelists broadly painted a picture of the GFC as a time of great uncertainty. In some cases, the

panelists noted, the GFC shaped the direction of their careers, at least in the short term, towards financial restructurings and distressed lending products.

When asked to compare the GFC to the current state of higher interest rates, increasing capital charges facing banks and other challenges facing the market, the panelists described the current market as less disorderly, with lenders having a different playbook available and being willing to use it. The panelists noted that actions that in the past would have been characterized as aggressive are becoming more common, with lenders and lender groups taking advantage of loose loan documentation to provide senior debt and/or obtain access to valuable borrower assets to the disadvantage of other lenders, using drop-down transactions and other tools (though some of these actions have recently been challenged by the displaced lenders in court, with some success).

This has led to changes in the way lenders do business, with lenders balancing where in the capital stack they enter a transaction against the looseness of the loan documents, and focusing more on whether lenders, sponsors and/or companies in the transaction are known to be aggressive. There is also an increased focus on interest coverage and liquidity constraints of borrowers, with the rise in interest rates, and cost of capital to lenders, especially with pensions and other non-bank creditors entering the market. The panelists explained how these new tools have led to an increase in the use of out-of-court restructurings, with bankruptcy only being pursued if there is a tangible benefit (such as getting liens released, dealing with environmental liabilities, rejection of certain contracts, etc.).

The panelists wrapped up by looking forward at the market. Geopolitical risks, in the form of inflation, potential recessions and supply chain issues, among others, create some uncertainty. The panelists expressed a general view that a cycle of valuation downgrades could present an attractive market, but that it may take time for the new normal of higher interest rates and, accordingly, the top of the capital stack taking more value, to sink in. There continues to be a lot of dry powder on the sidelines waiting to enter the market, panelists pointed out, with lenders looking for the right time and opportunity to deploy capital. One panelist may have said it best: "The opportunity set is huge."