

Fund Finance Friday



FFA European Fund Finance Symposium Review, Part 1

June 23, 2023



On Monday, nearly 850 fund finance professionals from all over the world attended the FFA's 7th Annual European Fund Finance Symposium at the Queen Elizabeth II Conference Centre in London. The event was one of the most well attended of all the FFA's European Symposiums which, aside from generating a fantastic atmosphere, created networking opportunities for all attendees.

Topics for the various panel sessions were thoughtfully curated, allowing attendees to hear the perspectives of lenders, GPs, lawyers and other advisors active in the fund finance market on the key trends in and challenges faced by the market today. Discussions touched on areas such as liquidity and pricing, ESG, non-bank lenders and trends in NAV/sublines, as well as diversified collateral and risk management in 2023 and beyond (to name just a few). We summarize below some of the key themes that we saw emerge during many of these discussions, and hope you find this useful. With so much content to cover, a concluding summary will follow next week.

Many thanks to the FFA and all of the event's sponsors and panelists for putting together such a topical and informative agenda and for creating a great opportunity to spend time with friends, colleagues and clients from across the industry.

Key Themes We Heard at the Conference:

Market Changes

A common theme was that one of the main challenges our market faces today is supply vs. demand. Higher interest rates, a reduction in the number of banks that are currently able to actively participate in the market, and increased regulation, to name a few, are the some of the challenges that attendees heard are facing the supply of bank liquidity.

The trend the panels reported was of bank lenders having to be more selective about new deals, with increased focus on product cross-sell as part of banks' appetite to fund new deals, and it was commented that this is more pronounced with subscription facilities. A panel also discussed that commercial banks operate a fee-based business and, generally speaking, subscription facilities, particularly if the utilization profile is not supported by high drawings, need ancillary business support.

Pricing

Pricing was widely identified by panelists as an increasing challenge, and although Europe has been seen to lag behind the U.S. in terms of the overall yield for lenders across fund finance products, there is now a commented-on sense that the two may soon converge.

There are some obvious tensions, with the increased cost of these facilities in the current interest rate environment impacting fund returns, resulting in greater scrutiny on their use by both GPs and LPs. Speakers commented on the increase in the proportionate size of the accordion versus the day-one commitment and also, in the context of subscription facilities, that tenors of 1+1+1 are becoming increasingly common.

It was also a subject of some discussion that interest rate hedging and other de-leveraging tools (such as re-insurance or funded or unfunded risk participations) are increasingly of interest.

Impact of Liquidity Constraints on Financing Terms and Alternative Solutions

The changing lending environment was reported as having an influence on the way funds are approaching their fund finance lines, particularly in the sub-line market. Some key points mentioned on the panels were that funds are having to:

- actively manage their lender group and bring forward discussions with potential lenders, approaching a larger bank group and priming potential lenders for the upside as fundraising progresses;
- consider more generous fee levels;
- hedge the finance providers against the reality of the final syndicate or club; and
- look to the past and consider uncommitted tranches while, at the same time, look forward to consider non-bank lenders either as lender of record or in the background.

The other point of discussion, which was present in Miami and very much on people's minds in London, was whether ratings could provide a solution to unlocking liquidity and how that would be shaped for the market.

ESG in Fund Finance

The ESG panel discussed that the adoption of ESG in fund finance has been impeded by the disparate approaches that have been adopted in the market and concerns around the potential adverse publicity and regulatory consequences of "greenwashing." In order to address these concerns, the LMA has, working with industry experts including Cadwalader partner Sukhvir Basran, now published its Sustainability-Linked Loan Model Provisions, which consolidates existing market practice and creates a common framework for ESG Facilities.

A panelist explained that the model provisions are the product of multiple consultations within the market and are intended to create a shared starting point for ESG facilities that will significantly simplify the process of documenting future ESG Facilities. The purpose of the model provisions has been to take the guesswork out of the documentation for ESG facilities, and the industry hopes that the parties will be helped to focus on materiality, impact and alignment with regulation, both across the investment process and up the financing structure.

It was remarked on the panel that recent media and regulatory focus on ESG has demonstrated the need to ensure that the data used to test ESG Key Performance Indicators (KPIs) are sufficiently robust and that such KPIs are ambitious and appropriate in order to avoid any suggestion of greenwashing.

Importantly, ESG is relevant not only in the context of loan facilities but across the entire investment process and throughout the whole financing structure. Participants were clear that consideration needs to be given to regulation.

Bank Loan Distribution Strategies

As discussed above, we heard that bank lenders are increasingly focused on loan distribution strategies, with an increase in sub-participations to non-bank lenders (particularly insurance companies where appetite permits). There were also comments regarding transfers to affiliates, credit risk insurance policies and true sale securitization structures. GPs are therefore having to consider banks' distribution strategies more closely and are carefully considering related protections they might want to include in their loan documentation. It was noted that this may fetter the liquidity constraints GPs face if they don't handle it carefully (look for the re-emergence of the approved lender list).

It was also reported that there is an increase in non-bank lenders being direct lenders of record on fund finance facilities, but this may not work for all funds – for example, due to the lender's inability to issue letters of credit (if required) or its multicurrency limitations.

It was clear from these discussions that bank lender distribution strategies are developing quickly, and it is important for GPs to be in-step and for the dialogue to be an open one.

We'll be back next week with some further observations on the conference – the content was extensive and fully deserving of a sequel! Thank you to everyone who attended, and we're looking forward to seeing you again soon.

(This article is intended as a general recap of the various panels at the 7th Annual European Fund Finance Symposium. The views expressed do not necessarily represent the views of Cadwalader and our Fund Finance team.)