

CADWALDER

## What an Event

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The 11<sup>th</sup> Annual Global Fund Finance Symposium just wrapped up in Miami, and what an event it has been.

We are sharing some more detailed takeaways from a few of the panels in today's *Fund Finance Friday*, but we can say this: This was a high-energy event, and everyone was tremendously excited about seeing “old friends” for the first time in more than two years.

The exchange of information was first-rate and incredibly valuable, as always, and special events – like the Women in Fund Finance luncheon on Wednesday – were well attended and very successful.

Special congratulations and a big thank you to the FFA team, headed by Michelle Bolingbroke, who worked behind the scenes for months and months, and in Miami, to make the Symposium happen.

We'll share some additional observations and takeaways next week.

## **Panel Recap: 'Underwriting and Due Diligence Lessons Learned'**

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Cadwalader partner Tim Hicks participated on the Symposium panel titled, “Underwriting and Due Diligence Lessons Learned,” which focused on best practices for completing due diligence in the wake of recent developments in the market and COVID-19. Others on the panel were Keenan McBride, an Executive Director at Morgan Stanley; Michael O’Connor, a Partner at Conyers; Brent Shultz, a Partner at Haynes and Boone who served as moderator; Guy Simpson, the Head of Equity Fund Resources at Bridge Bank; and Storey Whalen, a Director at First Republic. The key takeaway from the discussion was that recent litigation has caused lenders to reevaluate their due diligence processes, and some lenders have implemented additional safeguards in terms of independent verification of investor commitments. However, the market has not made any drastic changes for a product with an incredibly strong track record of performance.

## Panel Recap: 'Hot Topics in Fund Finance'

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By **Joe Zeidner**  
Partner | Fund Finance

The Thursday afternoon panel on “Hot Topics in Fund Finance” was chock full of interesting insight on the latest trends in our industry. Subjects included ESG, rated note feeders, continued LIBOR transition and the competition for talent in the market.

### ESG

The last couple of years have seen an explosion of Environmental, Social and Governance (ESG) subscription lines, but early predictions of meteoric growth have recently been tempered to some extent.

LPs are putting pressure on sponsors to implement meaningful ESG in their fund investments. Banks are interested in participating in ESG deals to make sure that the obligations of the bank to make a profit and to do good in the world align with what's happening in the global landscape.

The U.S. market is starting to evolve over time but hasn't had the same kind of regulatory pressures as in Europe that have significantly moved the needle there. The European market has felt a huge rush of ESG regulations that, rather than serving as a deterrent, have been having a positive impact on increasing ESG activity. The legislation has included the taxonomy and low-carbon benchmark regulations, as well as sustainable finance disclosure statutes that have had a broad effect on ESG being factored into investment decision-making.

One key for ESG in fund finance is making sure that the credit facility tracks the risk that a bank is trying to address. To date, ESG credit facilities have typically been structured either using key performance indicators (KPIs) of the fund or using a use of proceeds approach (UoPs). But on the legal side, there is still no set market determination for how to govern this or standardization on what metrics will end up in the loan agreements. One observation from the panel was that it will be important to keep an eye on how our industry develops consistency of documentation.

The audience was polled by the panel on several ESG-related questions. In 2021, nearly 35% of audience members had firms with at least one ESG transaction, while just under 20% of audience participants were at firms with three or more ESG deals. For percentage of overall book of business, half of the audience responded that its fund finance portfolio comprised 5% ESG, while less than one-tenth of firms had portfolios of 10% or greater ESG. An overwhelming majority expected those percentages to be from 5-25% three years from now, with just under a quarter of audience members predicting that amount to be over 25%.

### Rated Note Feeders

The use of rated note feeders has grown significantly in our market over the last few years. They are a tool to more easily permit insurance company LPs to participate in funds. Rather than providing an equity commitment like a traditional LP, the insurance company will be issued debt by purchasing notes from a feeder fund.

Insurance companies can use this structure to mitigate regulatory pressures that would otherwise diminish their opportunities for investing in private funds. Their regulators rate the risk of the investments held by insurance companies. Insurance companies have more favorable risk treatment for debt investments, especially debt investments that are rated by a ratings agency, than they do for equity commitments.

Insurance companies are starting to take notice of this technology, and GPs have begun to provide this approach as a solution for insurance companies to be LPs. The goal is to get the overall construct to function in a similar way to an LP that was committing in the more traditional approach via equity. The use of a rated note feeder tends to be more prevalent when there is a more concentrated borrowing base.

The panelists discussed issues of enforcement with requiring an LP to purchase notes in the event of a bankruptcy by the feeder. While European practitioners generally are less concerned that such enforcement may be estopped by a court, fund finance professionals on the U.S. side of the pond typically take the view that a lender would have

diminished ability to enforce. To mitigate that risk, credit agreements will generally require the debt held by an LP to be converted to equity if there is any bankruptcy or insolvency of the fund.

## **LIBOR Transition**

While we've all experienced the ocean of LIBOR transition amendments, panel members observed the interesting dynamic in the current state of play. The U.S. market still has a long lead time to when LIBOR truly falls away in mid-2023, yet banks are being required to shift to SOFR now to avoid risk of regulator-imposed penalties. Banks are assessing how to appropriately determine what is "new money" for purposes of when SOFR needs to be implemented. Funds sponsors want to ensure that their assets and liabilities match. If their underlying portfolio assets use a certain flavor of SOFR, GPs (especially for credit funds) desire that their credit facility liabilities match that same type of SOFR.

There is a sense that all parties may be waiting to see what the market evolves to on spread adjustments. Some market participants on both the lender and borrower side prefer new deals to have a flat margin, while other players would rather the loan documents separately list a spread adjustment for SOFR. When a credit adjustment spread is used, lenders and borrowers alike are negotiating over what those numbers should be.

On the Europe side, there was a much swifter move to the fallback rates. Given the end of 2021 deadline for non-USD LIBOR imposed by the UK benchmark regulatory supervisor, European credit facilities were forced to flip to the new benchmarks by December 31. Thus, LIBOR transition activity there has now largely been finalized.

## **Competition for Talent**

Panelists noted that the fund finance space hasn't been immune to the Great Resignation. Competition for talent has therefore become rampant. Organizations are considering how flexibility and mobility add to recruitment and retention. At the same time, the pool of potential recruits may have widened because of the ability to have remote teams. Because there has been less emphasis on face time, firms are concerned that there is less relationship-building and mentorship. This can be especially challenging when bringing people in at the more junior levels. Our industry thrives on training new recruits, and many of the panelists expect their companies to focus on the education and coaching of their new professionals to fund finance.

## Panel Recap: 'Secondaries'

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By **Patrick Calves**  
Partner | Fund Finance

There has been an evolution of the private equity secondaries market, and the Global Symposium addressed key issues in a panel that featured Tony Colarusso, Global Head of Private Capital Advisory at Morgan Stanley; Meyer Dworkin, Partner at Davis Polk; Steve Lessar, Managing Director at Blackrock; Christina Marsh, Head of Sales Fund Financing and Solutions, Americas at Nomura; Pramit Sheth, Senior Managing Director, Funds at Kroll Bond Rating Agency; and Sherri Snelson, Partner at White & Case.

The “Secondaries” panel (on Thursday afternoon) was a big draw, as it had a standing room-only crowd that spilled out into the hallway. This seemed prescient as each of the panelists highlighted the continued growth of both secondaries funds and their use of financing. In addition to growth of the secondaries market, the other overarching themes were continued evolution in the market’s need and use of liquidity and leverage, and innovation in the structures and products that banks and sponsors (and their lawyers) are employing to meet those demands. One of the more notable predictions from the panel was the expected emergence of private credit secondaries funds to provide liquidity to LPs, given the private credit market’s continued growth and maturation.

## Panel Recap: 'Fund Finance Market Update'

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The “Fund Finance Market Update” panel focused on the current state of the market. Moderated by Laurie Lawler, Managing Director at Société Générale, the panel included the following: Roshan Chagan, Partner at Ares; Christopher Galletta, Director at SMBC; Julia Kohen, Partner at Simpson Thacher; Micaela Mastrogiannis, Principal at KKR & Co. Inc.; and Georgina Pullinger, Counsel at Appleby.

The panel covered a broad range of topics, and here are some of my takeaways.

- As many of us saw firsthand, 2021 was an incredible year in fundraising along with a massive increase in AUM for sponsors of all sizes.
- In addition to 2020 being known as the year the pandemic dramatically altered everything about our lives, 2020 will also be remembered for opening up a lot of opportunities in the fund finance market – as a result, 2021 deal volume was enough to fill up two years' worth of work.
- Although we are only 6 weeks into the new year, there are multiple early indications suggesting that we can expect the same momentum to continue in 2022.
- The Cayman Islands market is seeing much of the same growth and increased year-over-year deal volume as in the U.S. onshore market but at a smaller scale.
- Contrary to what we might have expected and hoped as we closed out 2021, LIBOR amendments aren't over, especially as we begin transitioning to SOFR for rebookings of existing facilities that are extended or upsized, whether or not committed.
- Both lenders and borrowers are increasingly seeing more non-banks acting as lenders, so the question becomes: will this non-bank involvement result in more diversity of fund structures?
- As deal structures become more and more complex and the number of credit parties in any given facility increases, the attorneys have been tasked with simplifying and streamlining documentation.
- The panelists noted that we can expect to see more SMA and co-investment vehicles utilized on a go-forward basis and highlighted how each of these fund structures could provide added value.
- Not surprisingly, innovation is driven by competition, and we are seeing such innovation firsthand in this “Fund Finance 2.0” world.
- Driving the industry and the innovation is a simple proposition: borrowers are always looking for solutions to their borrowing needs, which includes exploring the variety of products being offered by lenders.
- ESG continues to be a hot topic and priority for many sponsors because it is something that their investors are interested in, but a word of caution: the structuring of ESG facilities isn't a one-size-fits-all approach; KPIs should be bespoke and should be linked to economic consequences to ensure sincerity.

## Panel Recap: 'Market Evolution and Industry Perspectives'

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By **Chris Montgomery**  
Partner | Fund Finance

The panel "Market Evolution and Industry Perspectives," featuring Nick Mitra of Société Générale, Tim Powers of Haynes and Boone, Joe Rocco of Blackstone, and Mary Touchstone of Simpson Thacher, discussed the evolution of the fund finance product, from its earliest days in the mid-1980s up to the present.

Nick commented on the robustness of fund finance facilities with strong credit performance (and no monetary defaults) throughout the Global Financial Crisis and the COVID pandemic. Tim provided a detailed analysis of how the collateral package and facilities have become more sophisticated in the '90s and 2000s. Mary and Joe both praised the culture and innovation of the fund finance market, noting that the strong growth in private equity fundraising will drive new solutions in the market, with Nick coining the phrase "Fund Finance 2.0" for the coming era.

All panelists agreed that the culture and relationships on each side of every transaction are a source of strength and innovation for continued growth.



## Photos from the FFA Symposium

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Enjoy some early photos from the FFA's 11th Annual Global Fund Finance Symposium in Miami.



*Fireside Chat with Mike Arougheti, Ares Management Co-Founder, Director, Chief Executive Officer and President, and Jon Weiss (right), Chief Executive Officer of Wells Fargo's Corporate & Investment Bank.*



*Cadwalader's Tim Hicks, 3rd from right, among panelists discussing "Underwriting & Due Diligence Lessons Learned."*





## Diversity in Fund Finance

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The FFA's Diversity in Fund Finance group Q4 newsletter is here! It includes a roundup of the group's Q4 events, profiles of the 2022 FFA DEI Emerging Leaders, and updates regarding upcoming plans and events. The newsletter is available [here](#).

## Women in Fund Finance

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On Tuesday, March 8, Women in Fund Finance Europe will be hosting an hour of yoga and meditation in celebration of International Women's Day. For event details and information on how to register, click [here](#).

## Fund Finance Hiring

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Fund Finance Hiring

Webster Bank is hiring Associates for its Fund Banking group. To learn more, visit [here](#).