Another Great Fund Finance Symposium

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The 12th Annual Global Fund Finance Symposium just wrapped up in Miami, and from all the buzz we observed – and experienced first-hand – it was another wonderful opportunity for the industry to come together for some serious learning, valuable networking and enjoyable socializing with friends both old and new.

As our team's pre-event "countdown" videos conveyed, expectations were running high, and we're thrilled that the event delivered all that we had hoped and more (view countdown remarks from Cadwalader's **Wes Misson**, **Leah Edelboim**, **Sam Hutchinson**, **Tim Hicks**, **Nathan Parker**, and **Patrick Calves**).

We also took this opportunity of being together in person to launch a studio version of *FFF!* It was both fun and informative to sit down with our first studio guest, Malindri De Alwis, Executive Director of Fund Finance at Standard Chartered Bank, to hear her thoughts on the current state of the fund finance market and its professional community. Tune in **here**.

We will be providing our attorneys' recaps of several panels from the event, kicking off this week with Linda Filardi's review of "Titans in Finance – The Rise in Private Debt," with more to follow in next week's issue.

In the meantime, a huge thanks to the full FFA team, headed by Michelle Bolingbroke, for all its work over many months to organize and execute another very successful and highly-anticipated event. We are also grateful to everyone who attended the Wednesday night Welcome Reception that Cadwalader co-hosted with Carey Olsen and KBRA. We hope you enjoyed the opportunity to mix and mingle, as we certainly did!

Cadwalader Fund Finance Team at Welcome Night Reception

“Women in Fund Finance” @Cadwalader (from left to right): partner Angie Batterson, counsel Renee Fischer, partner Leah Edelboim, partner Danyeale Chung, special counsel Katie McShane, counsel Linda Filardi

Cadwalader Fund Finance partners Leah Edelboim and Danyeale Chung

(From left to right) Cadwalader Fund Finance partner Chad Stackhouse, FFA board member Mike Mascia and Cadwalader Fund Finance U.S. head Wes Misson

FFA “Women in Fund Finance” (WFF) luncheon

Been There, Gonna Do That

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By **Tim Hicks**
Partner | Fund Finance

At the outset of every credit agreement negotiation, the implicit goal is to reach an agreement on representations and covenants that allows the Fund to operate as needed while also protecting the lender(s) against current and potential risks. Despite these best laid plans, there are times when the Fund is unable (or will be unable) to comply with the credit agreement. Virtually all credit agreements have a reporting covenant that requires the Fund to provide notice of any potential default or event of default at such time that a covenant has not been complied with or a representation was inaccurate when made. It is at this point that the Fund will inevitably ask for a waiver or a consent. These terms are often used interchangeably, but they have differing uses in different contexts. As one seasoned practitioner once told me, a waiver is for the depravities already committed and a consent is when you need forgiveness for what you are about to do.

When a Fund breaches a covenant or makes a representation that turns out to be inaccurate, the need for a waiver is the appropriate ask. The waiver requires the approval of a prescribed percentage of the lenders depending on the action or inaction in question. That percentage is easy to determine in a bilateral deal, but it may be a majority, a supermajority or all lenders in a club deal or more broadly syndicated transaction. A breach of a negative covenant, a deferment or delay of payments or generally anything collateral related would require all lenders to get on board with the approval. A representation or an affirmative covenant requires a majority of lenders to approve in most circumstances.

On the other hand, a consent is forward-looking and is a request to agree to an action before that event has happened or before an inaction will occur. An example would be a scenario where a Fund desires to prematurely release an investor from its commitment or cancel an investor’s commitment altogether. Such an action would almost always be a breach of a negative covenant; however, if the Fund gets the release or cancellation preapproved via a consent, it can undertake the action without a resulting event of default. Much like the waiver scenario, the percentage of lenders that must approve is determined by the type of action desired to be taken or avoided.

The distinction between waiver and consent is one that is often given little focus, but understanding the difference allows a person to speak the language of the deal in a way that may not materially gain credibility but certainly does avoid potentially losing the audience by using these terms out of context. Being cognizant of the difference also allows for clearer communication with credit officers and in discussing asks with members of a syndicate.

The next time an ask for a waiver is presented, ask yourself if the Fund has already been there and needs a cure for acts already committed. If the ask is for permission to take an action in the future, a consent would be the correct tool to select from the toolbox. Knowing the difference allows a lender to better understand the need and work toward a mutually acceptable solution.

Fund Finance Symposium Panel Recap: 'Titans in Finance: The Rise of Private Debt'

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Coming off of the close of a badly bruised broadly syndicated loan market in 2022, it is no surprise that the global Fund Finance Association kicked off its 12th annual conference in Miami with a conversation with the "Titans in Finance" − Jonathan Bock, Senior Managing Director, Co-CEO of BCRED and BXSL, Head of Market Research, Blackstone Credit; Ken Kencel, President and CEO of Churchill Asset Management; and Art Penn, Founder and Managing Partner of PennantPark Investment Advisers. The panel was moderated by Jocelyn Hirsch, Partner at Kirkland & Ellis, and Nick Mitra, Managing Director at Societe Générale.

The Titans were first asked about inflection points and the reasons for success in the growth of their respective businesses. Surprisingly, they responded not by citing market acumen, timing or even luck but as true leaders: emphasizing the ability and commitment to build a talented team and to invest in diligent training and growth of their people. They noted that, when looking back, many people want to get into the private credit space, but few understand the importance of and were willing to commit to invest in the human resources that are required to build and run a successful private credit shop. Fast forwarding to the way these businesses have developed with multiple investment vehicles and strategies, they commented that over 50 percent of their human resources are devoted to investor relations, operations, and finance, thereby reinforcing why talent development is so important. Their longevity in this space was a thread that permeated the discussion, which underscored to the audience why these leaders were selected from a crowded private credit space to address the Fund Finance Association in 2023.

The Titans discussed two major themes: market segmentation of the companies in the middle market (generally companies with under $50MM in EBIDTA) and the diversification of funding vehicles and strategies utilized to fund their respective investments in middle market companies. Private credit has historically targeted the middle market because these companies could not access capital in public markets or the broadly syndicated market. They discussed how the middle market should be segmented into upper middle market ($50MM to $100MM in EBITDA), lower middle market (under $15MM), core middle market ($15 MM to $50MM), and then by specialties, such as healthcare, technology, aerospace, consumer, food and beverage, as well as sponsor and nonsponsored companies. Commenting that experience through economic cycles has shown that lower middle market companies are less able to weather cycles of increased interest burden from rising rates, it was noted that the sponsor-backed companies are favored because of the availability of sponsor equity support. It was also noted, however, that the most recent COVID years are not a good indicator of how these companies and their sponsors will behave in a downturn because, during COVID, the market understood and expected the economic situation to be temporary. More importantly, it was a period of low interest rates that allowed companies significant breathing room. Conversely, the current economic environment of high interest rates, high leverage, and very light or no covenants presents a more challenging lender environment. They acknowledged that sponsors may be less inclined to support the companies they do not believe will survive.

The disrupter of 2022 was the rise of large club deals. Approximately 15 private credit firms in the market, putting their multiple strategies to work, were able to write checks of up to $500MM. This balance sheet strength is benefiting from the current volatile landscape. Public market volatility and uncertainty have also reinforced the popularity of private debt. All of the Titans reflected upon how their businesses diversified their funding vehicles and utilized structures such as BDCs, SMAs, CLOs, and institutional funds, and were additionally looking down the road to retail investors.

Comparing the syndicated lending market as "moving vs. storage," private credit won favor in the "storage" business because banks in the "moving" business − taking large fees to syndicate the loans to other lenders − which proved to be unsuccessful in 2022, now found themselves unable to sell their commitments. Able to negotiate better legal and financial terms with their large checks in hand and negotiating directly with the intention of holding these loans to maturity, private credit moved quietly from the sidelines to center stage to deliver to sponsors the credit they were looking to raise while the stalled syndicated loan market essentially shut down. The efficiency of this "storage" model appealed to sponsors. Larger companies, which traditionally only looked to the broadly syndicated market, were able to tap private credit. Despite negative press reporting the lack of deal flow in early 2023, deals are getting done and valuations are holding steady for higher quality companies. Pricing is up, overall leverage is moderated, and the best private credit firms and their portfolios remain in good shape. Being vigilant about designing and managing the portfolio is key. These market leaders have long histories with certain sponsors and believe they know how these sponsors will behave in a downturn.

"When is a strong M&A market returning"? asked one of the moderators. Possibly midyear, came the response from the panel. With the public markets essentially closed, private credit is well poised with approximately $300BN in dry powder. This, coupled with the potential of a large retail market entering the space to provide additional funding, poses huge opportunities for private credit in 2023.