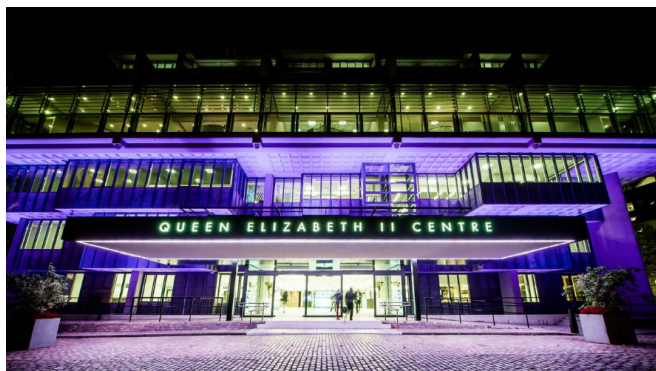


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FFA European Fund Finance Symposium Review, Part 1

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.)

In the Discretion of the Holder

June 23, 2023



By **Tim Hicks**
Partner | Fund Finance

A search of the term “discretion” in virtually any credit agreement will yield numerous results. It is the word or words preceding that result that often is a point of much consternation. Many borrowers prefer the use of “reasonable,” which connotes the idea that an objective standard must be utilized in making a determination and such standard would be applied in a manner that is consistent with the standard a lender employs in exercising rights and remedies with other borrowers and loans of similar structure, size and complexity. Most lenders, on the other hand, favor the use of “sole” or “sole and absolute,” which implies that the lender has the ability to exercise a greater degree of preferential discretion in deciding whether to approve an action (or inaction). Preferences aside, what does this distinction really mean when a contract vests the right to make a determination in a party to that contract? That answer lies in a small body of case law that varies by jurisdiction.

Many credit agreements are governed by New York law. As such, the manner in which the New York courts have adjudicated the issue seems particularly pertinent. The phrases “sole discretion” and “in its sole discretion” are often used in contracts to refer to an instance when a person or entity is given the right to make a decision or take certain actions based on its own independent assessment and determination. It has been argued that these phrases grant a party complete latitude in making decisions or exercising rights, and the use of these terms relieves a party vested with such discretion from exercising it in good faith.

The court in *Southern Telecom Inc. v. ThreeSixty Brands Group, LLC*, 520 F.Supp.3d 497 (S.D.N.Y. 2021) reiterated that exercising discretion in good faith is an underlying principal of contract law. According to *Southern Telecom* court, a determination as to whether a particular standard of conduct has been met and whether a party has performed its contractual obligations requires that such determination be made honestly, with due consideration of the applicable facts and not on some dubious, insignificant basis. In other words, the exercise of discretionary decision making (even when qualified by such terms as “sole discretion” and “sole and absolute discretion”) by a party “mandates that an action authorized to be taken for a particular reason actually be taken for that reason.”

However, the benefit of the words “sole discretion” and “in its sole discretion” are not without importance. The *Southern Telecom* court stated: “Where a contract allows one party to terminate the contract in ‘its sole discretion’ for ‘any reason whatsoever,’ the covenant of good faith and fair dealing cannot serve to negate that provision.” This statement stands for the proposition that as long as the party vested with a “sole discretion” standard of decision making authority considers the applicable facts, a resulting decision based upon the consideration of those facts may not be challenged by the affected party based upon whether the resulting decision was fair or reasonable in the view of the affected party. Instead, the party vested with sole discretion authority is simply prohibited from basing its decision on a predetermined reason unrelated to an actual consideration of the facts. In other words, a determination must be based on something other than simply “I don’t want to” and must be made after giving consideration to facts and standards that dictate that the decision is not being made on a preplanned basis. If the deciding party proves that there is no standard against which its exercise of discretion is being measured (*i.e.*, there are no facts or reasons to believe a course of dealing dictates how the party should act), the covenant of good faith and fair dealing would not deprive the party holding the discretion from utilizing that discretion in whatever manner it desires.

In summary, many states have case law indicating that a covenant of good faith and fair dealing is implied in every contract, and that standard prevents one party from engaging in conduct that would deny the other party the benefits of the contract. The determination of whether a party acted in good faith and the applicability of that principle hinges on an analysis of facts. However, the courts have held that the implied covenant of good faith and fair dealing cannot be used to trump a grant of discretionary power if the *express purpose* of a contract is to grant unfettered discretion to a party and the exercise of that discretion is rooted in some analysis of the facts and consequences applicable to making a determination.

On the Move – Citizens Expands Private Banking Team with Additions from FRB

June 23, 2023

On the Move

Citizens Financial Group has announced that it has “significantly accelerated” its private banking growth strategy with the addition of approximately 50 new senior private bankers in Boston, Florida, New York and San Francisco.

All of those individuals and teams were formerly with First Republic, including a number of well-known names within the fund finance community. Joining Citizens will be, among others, teams led by Scott Aleali and Jeff Maier in New York and Sam Heshmati and Mike Franks in California.

You can read the full Citizens press release [here](#).

What We're Reading

June 23, 2023

Here's what we're reading this week.

- Covenant defaults are rising for private equity portfolio companies due to higher interest rates and weakening operating performance, according to a [recent report from Lincoln International](#) based on its database referencing nearly 4,750 portfolio companies. A substantial share of portfolio companies are at risk of falling below a 1.0x fixed-charge coverage ratio based on 12-month forward rates.
- The bulk of floating-rate leveraged loan debt taken out by buyout sponsors in the U.S. and Europe is unhedged, according to sources cited in a [recent Bloomberg article](#). Estimates by Verdad Advisers cited in the article pegs 2022 interest cost as a share of EBITDA at 43% for the median portfolio company. An additional 75 bps increase in Fed Funds in 2023 and the lagged effect in cost of funds increases imply more stress to come. More along the same lines from Verdad [here](#).
- Carlyle Group recently closed on a €1 billion NAV facility backed by 20 portfolio assets in its Carlyle Europe Partners V fund, [according to PEI](#).
- TA Associates [closed fundraising](#) for its flagship TA XV fund at \$16.5 billion, ending oversubscribed and above its initial target. The fund size is up from the \$12.5 billion hard cap for TA XIV, which closed two years ago. The fundraise is a bright spot in what is otherwise expected to be a challenging year.
- A founders dispute at Blue Owl Capital made the news in several places this week, including on [Bloomberg](#) and in [Axios](#), as the firm moves to rebrand units in its post-merger integration. The turbulence comes as the firm recently embarked on fundraising a targeted \$13 billion for its Dyal Capital VI fund.

Registration Open for FFA University 1.0 and 2.0 Programs

June 23, 2023



Save the Date: FFA University 1.0 & 2.0

FFA University is back and better than ever. The introductory 1.0 program is scheduled for September 21, while the more advanced 2.0 program will be held on October 5.

FFA University 1.0

This intensive full-day training session will occur virtually on Wednesday, September 21 from 9 a.m.-5 p.m. EST. The program is designed for both bankers and lawyers transacting under U.S. law that are either relatively new to Fund Finance or those that want an in-depth training course. The course will cover everything from understanding fund formation and structures to subscription facility credit documentation and investor issues. An added feature this year will be an in-person cocktail reception for NY-based attendees hosted by the FFA's Diversity in Fund Finance group and co-sponsored by Reed Smith and Conyers beginning at 5:30 p.m. The cost of the program is \$295.

You can register [here](#) and get more information [here](#).

FFA University 2.0

This intensive full-day training session will occur in-person in New York on Thursday, October 5. The program is designed for mid-level bankers and lawyers transacting under U.S. law and will cover advanced issues in subscription facilities, NAV loan structures and issues, Collateralized Fund Obligations and the PE business model. A complimentary networking reception co-hosted by the FFA's NextGen team and sponsored by KBRA and Sidley Austin will follow. The cost of the program is \$575.

You can register [here](#) and get more information [here](#).

Diversity in Fund Finance to Host Sake Soiree in New York

June 23, 2023



FFA's Diversity in Fund Finance has organized an evening of networking and sake tasting for next Thursday, June 29 in New York.

Austin Power, Sake Sommelier and owner of [Accidental Bar](#), will be leading an informal tasting and conversation about all things sake. Light refreshments will be provided at this event.

The event will be held from 5:30-8:30 p.m. at Accidental Bar at 98 Loisaida Ave in the East Village.

You can [register here](#). Additional information is available through DFF organizers [Fiona Cheng](#) and [Natasha Puri](#) and [Janeesha Patel](#) at FFA.

FFA Networking Event in Sydney

June 23, 2023



The FFA and Corrs Chambers Westgarth will host an evening of networking in Sydney on Thursday, July 27 from 6-8:30 p.m. The program will be held at the Corrs Chambers Westgarth office in the Quay Quarter Tower at 50 Bridge Street.

Space is limited, so be sure to [register here](#) now. Additional information is available by emailing the FFA [here](#).