## September Reflections

**September 8, 2023**

By **Wes Misson**
Partner | Fund Finance

This past weekend officially marked the end of summer in the U.S. as vacations and Labor Day gatherings have come and gone, and the kids are now back in school. And while I anticipate that everyone's in-office attendance will be positively impacted by this development, it's also a good marker as we approach the end of the third quarter to assess how the year has gone.

Different is one way to describe it – particularly the impacts of the events of March. In our recent **Fund Finance Friday Industry Conservations**, my good friend Mike Mascia gave the analogy of sitting in a kayak on the lake on the Fourth of July. We have all been paddling along in the calm waters for years with each stroke better than the last, and then out of nowhere we are being rocked about in the wake of multiple speed boats.

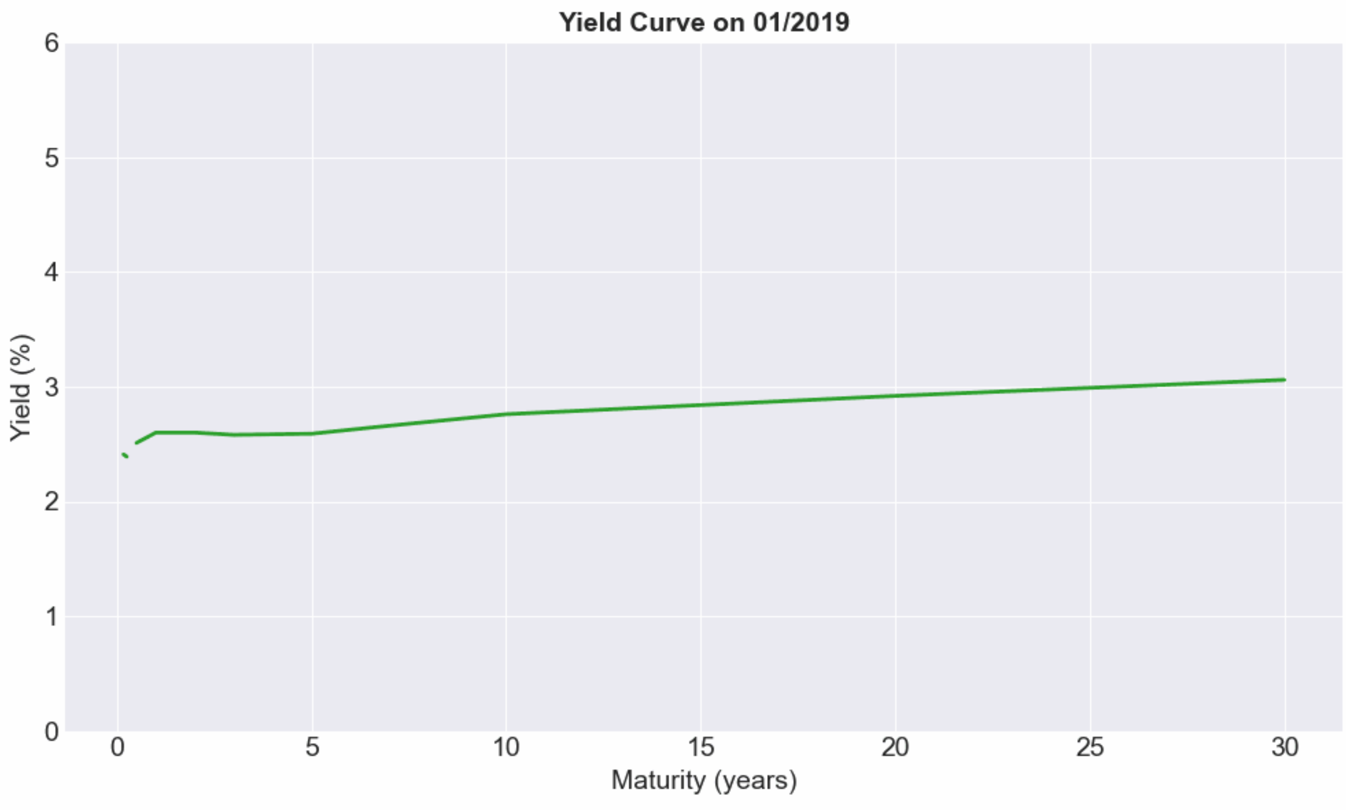
I feel like we can all relate. The last two years especially were filled with non-stop high fives as the fund finance industry soared to new heights – gravity nowhere to be found. In fact, at Cadwalader we found ourselves in what I call the 500 Club – representing U.S. lenders in more than $516 billion of transaction volume by commitments across from more than 500 fund sponsors during this two-year period alone. Our practice grew. We hired more than two dozen practitioners and in terms of total lawyer count exceeded 80 globally for fund finance.

Then came the headwinds, which ultimately culminated in the events of March. The regional bank mini-crisis took down a few of the fastest-growing lenders in fund finance. Fortunately, the six months that have passed since that market distress feels more like six years. Everyone, and by no surprise in our industry, has been incredibly resilient. At least seven new bank entrants have become active in the U.S. this year. Product evolution has accelerated. It's an exciting time to be in fund finance. As was the case 15 years ago, many of the transactions we do today have the potential to be precedent-setting.

Some of the themes of 2023:

- While we often talk about "the fund finance market," we're seeing fundamentally different trends in Europe compared to the U.S. The European market experienced less of an interruption in the spring, and deal velocity has only added momentum since.
- Overall, servicing portfolio volume has accounted for the lion's share of work allocation over new money origination.
- We have served 76 lender clients globally this year. This number has expanded despite bank market volatility. It will be interesting in the coming months to see if further bank consolidation reduces this number or if it continues to increase with the addition of more non-bank lenders to the space.
- On the same note, a number of new bank players are putting oars in the water and will begin contributing to origination volume in Q3 and Q4. A few established fund finance lenders could also see expanded mandates. Fund finance will continue to be a career-advancing market.
- YTD fundraising totals $832.5 billion according to the latest from Preqin, suggesting a significant full-year shortfall from the $1.5 trillion raised last year. Average fund size is up 51% to $510 million.
- As fundraising gravitates to the larger platforms, the middle market feels under-banked. Pitchbook data showed about 120 sub-$1 billion funds closed in the first half, and we suspect a number of these sponsors found it more difficult to line up financing.
- More established lenders (and larger banks) have been beneficiaries of subscription borrowers moving deposits away from their historical lending bank.
- Despite concerns in the credit markets, overall loan growth for the year across U.S. banks has totaled just over 2%—still a very healthy mark. Loan growth is higher at banks below the top-25 in assets. And if you dig in further you will find that loans to non-depository financial institutions, often the category for fund finance loans, have grown at a rate of nearly 5%.
- The addition of term loan tranches into traditional revolving subscription structures have provided an avenue for new institutional non-bank lender liquidity in a market starved for a capital injection.

- The rise of credit risk and liquidity management transactions and other alternative capital market-oriented structures continue to grow. Basel End Game planning supports further momentum.
- The ratings process for sublines has meaningfully entered the conversation.
- Median subline margins are up by more than 100 bps over market lows, with some facilities pricing at a multiple.
- Lender unused fee toggles are back *en vogue* with wide variation of structure.
- MFN provisions on lender fees and market flex language are entering the fray in a very active syndications market.
- U.S. dollar deals have been almost entirely SOFR indexed post-LIBOR transition and due in part to disruption in the prime rate lender segment of the market.
- NAV lending volume in our practice tracked about 15% ahead of 2022 pace for the first half of this year in terms of overall lender commitments. We have seen nearly 30 active lenders (bank and non-bank) in the space this year.
- We are seeing more LPAs and deals for continuation funds. It makes sense given the current environment because it enables the fund to hold onto the asset longer and dispose of it at the opportune time.
- Continuation funds have generally had NAV financings but as of late we are seeing a number of hybrid deals come in and are aware of others that are in the works or being considered by our lender clients.
- There is greater deal complexity in the space as lenders and funds think creatively about how to create liquidity solutions for fund borrowers. We have a number of bespoke hybrid and other highly structured facilities underway.
- In the hybrid space, the collateral package seems to be shifting. Previously most deals had a security interest in the proceeds of investments and the related collection accounts, or alternatively, just the collection accounts with a negative pledge on the investments. We are now seeing hybrid deals where the NAV segment of the transaction has greater complexity and lenders are more often taking security over the assets.
- Fund finance still benefits from what it’s not. The product continues to offer bank lenders an opportunity to recycle balance sheet into higher-yielding assets while avoiding potential credit issues that are emerging in other asset classes.
- It’s a great time to originate at the front-end of the curve.




Source: U.S. Department of the Treasury and Cadwalader, Wickersham & Taft LLP.

***The currents have clearly shifted. What will the next four months hold? We are seeing innovation and structural evolution in fund finance at a rate never seen before. If we can be helpful on the solutions side for***

***driving your business or planning forward, please reach out.***

## Updated LSTA Regulatory Guidance – U.S. Sanctions Issues in Lending Transactions

**September 8, 2023**

By **Jeffrey Nagle**
Partner | Finance

The LSTA has regularly prepared and updated the LSTA Regulatory Guidance: U.S. Sanctions Issues in Lending Transactions (the "LSTA Guidance"). The LSTA Guidance contains a comprehensive review of sanctions, including background on sanctions principles generally and a discussion of risks to lenders, an update on recent developments and rundown of current sanctions targets and suggestions on ways to mitigate sanctions risk, which includes example credit agreement provisions. The LSTA Guidance is an excellent reference material for an overview of the sanctions landscape for both lawyers and business team members in the lending space.

On August 23, 2023, the LSTA updated the LSTA Guidance published March 2, 2023, primarily to reflect changes in the Russia sanctions that occurred after its publication. The changes are reflected in the discussion portion of the LSTA Guidance. However, the recent updates have not resulted in any changes to the LSTA's example credit agreement provisions that were offered in the guidance.

The updates to the descriptions of current sanctions rules are summarized below:

- **List-Based Sanctions:** Per the update, Liberia was removed from OFAC's List of Specially Designated Nationals and Blocked Persons.
- **Syria:** Sanctions have been imposed under U.S. sanctions laws, including the Caesar Syria Civilian Protection Act of 2019 and Executive Order 13894, which prohibit the facilitation of the Syrian government's purchase of goods, services, and technologies that further its military activities, or its aviation and oil and gas production industries. Likewise, they impose sanctions on foreign persons profiting from the Syrian conflict through reconstruction activities. The LSTA updated the LSTA Guidance to reflect the May 2022 OFAC general license allowing certain of these activities in areas of Northeast and Northwest Syria.
- **Blocking Sanctions:** In February of 2022 numerous Russian banks and wealth management entities were designated as Specially Designated Nationals ("SDNs") and therefore subject to sanctions. The LSTA Guidance was revised to reflect that since the time of publication the list of SDNs was expanded to include thousands of Russia-related entities or persons.
- **Further Sanctions on Russian State-Owned Entities:** On February 28, 2022, OFAC issued an order (Directive 4 under Executive Order 14024) which prohibited transacting with the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation (the "Russian State Owned Entities"). The LSTA Guidance was revised to reflect that Directive 4 was updated on May 19, 2023, requiring U.S. persons to file annual reports with OFAC disclosing any interest held by any Russian State Owned Entities in property owned or controlled by such person.
- **Certain Russian Economy Sectors Determinations:** Sanctions have been authorized by the Secretary of the Treasury against persons who operate in the Russian financial services, aerospace, electronics, marine, account, trust and corporate formation services, management consulting, quantum computing, metals, mining technology, defense and related materiel sectors. Since publication, the Secretary of the Treasury expanded this list to include the architecture, engineering, construction, manufacturing and transportation sectors.
- **Ban on New Investment; Prohibition of Certain Services:** U.S. sanctions generally ban all new investments in Russia by U.S. persons and authorize the Secretary of the Treasury to prohibit the provision of services to any person located in Russia by a U.S. person or from the United States. Investments include lending funds or committing capital or other assets in order to generate returns. The LSTA Guidance was revised to clarify that U.S. persons may, subject to certain conditions, maintain existing investments or sell or divest debt or equity securities issued to a non-U.S. person by an entity in the Russian Federation. In addition, the Secretary of the Treasury had prohibited U.S. persons from providing accounting, trust and corporate formation, management consulting and quantum computing services to any person in Russia. After publication of the LSTA Guidance, the Treasury Department added architecture and engineering services to that list as prohibited services.
- **U.S. Ports Ban:** The LSTA Guidance was revised to reflect that since publication, with limited exceptions, Russia-affiliated vessels have been prohibited from entering U.S. ports.

- **Export Controls on Russia:** The LSTA Guidance was revised to note that since publication, the U.S. export controls, which impose licensing requirements for exports to Russia, have been expanded to include Crimea and Belarus. In addition, the list of non-controlled items that require a license to export to Russia has been expanded.

# The Imitation Game – Insurance, Reinsurance, Reinsurance Access Funds ... and Fund Finance

**September 8, 2023**


By **Derek Stenson**
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For many years, most bankers and finance lawyers assumed that any involvement in insurance or reinsurance projects meant venturing into the dark arts of financial services and exercising a degree of alchemy that only a Hogwarts education could have prepared them for! However, the past number of years has seen insurance in many ways become the “it” thing of the moment, with a host of names we most commonly associate with private equity now actively involved in the insurance world - both in terms of strategies they pursue and capital they court.

Conyers advises a majority of all new reinsurers on their establishment in the Cayman Islands and Bermuda, and we have recently witnessed a new form of the insurance imitation game, being what we call “reinsurance access funds” – funds established in the Cayman Islands to allow investors to gain exposure to an equity investment in, and thereby the underwriting activity of, a reinsurer (typically also established in Cayman or Bermuda). With a fund comes fund finance of course, and this note shares some thoughts on Cayman Islands reinsurance-connected transactions and our experience on fund finance deals in this world.

**What is reinsurance?**

In short, reinsurance is insurance for insurance companies. It allows insurance companies (for example, those that many readers would have life or home insurance policies with) to ensure that they are not at risk of being over exposed to a singular event (for example, a hurricane or an unexpected global pandemic) by allowing them to pass on the risk of some of the insurance contracts they have issued to another insurer (a reinsurer!). The reinsurer isn’t doing this for fun of course, and an ocean of actuarial and quantitative analysis goes into calculating both the premiums charged on the original contracts and then the premiums paid by insurers to reinsurers, but plenty have gotten it correct and are successful household names (Berkshire, Munich Re, Swiss Re, Hannover Re).

**Why would a reinsurer be established in the Cayman Islands?**

Whilst traditionally the Cayman Islands has deservedly been recognised as a leading captive insurance jurisdiction, around 70% of all insurance licences issued by the Cayman Islands Monetary Authority (“CIMA”) in recent years have been for commercial or affiliate reinsurers, with private equity groups, traditional reinsurance and insurtech increasingly selecting Cayman for the establishment of side cars and reinsurance platforms.

The ideal jurisdiction of domicile for a new reinsurer is driven by a multitude of factors, and there is no “one size fits all,” but some of the reasons we are seeing clients consider Cayman to be not only a viable option, but also a premier jurisdiction for establishing a new reinsurer platform are:

- **Regulatory Capital**: CIMA will consider tailored capital and/or accounting models and is not tied to EU Solvency II models;
- **Flexibility on Staffing**: certain reinsurers may engage a local insurance manager as a service provider rather than having to put “boots on the ground” on day one (but if they do have employees in Cayman they get to enjoy the benefits of year-round sunshine and first world infrastructure!);
- **Speed to Market**: much like CIMA’s approach to funds, CIMA’s approach to licensing a reinsurer is thorough but predictable - published timeframes for the approval of a new insurance licence is 6 to 8 weeks from the time of

submission of a complete application; and

- **Financial, Political and Economic Certainty**: Cayman's stability (financially, politically, economically), particularly relative to other offshore domiciles (for example, the Cayman Islands runs an attractive budget surplus), is especially attractive to reinsurers.

**What has this got to do with fund finance?**

Over the past two to three years we have seen an increase in bespoke fund products established above reinsurance companies in order that sponsors related to major reinsurers (which is now commonplace) or forming their own reinsurers can offer investment opportunities and exposure for their investors to a reinsurance platform. These funds often seek to put in place subscription-based and/or asset-based facilities (in the latter case where the Cayman fund is more likely to be guarantor or pledgor alongside a subsidiary borrower – the reinsurer).

Whilst the strategy pursued by a fund is rarely a material factor from a credit analysis perspective in a subscription-based deal there are, as a result of the particular characteristics of many of these reinsurance access funds, a number of points which can give rise to additional consideration by lenders/funds and their advisers in these deals including:

- the LPA (or limited liability company agreement - LLCA) tends to be much more bespoke in these transactions. While some reinsurance access funds are more broadly offered, in many cases they are created with a particular subset of investors in mind who may actively input on the documentation;
- in some instances the LPA/LLCA may cross refer to or incorporate other negotiated documents applicable to the structure (governed by a foreign law in some cases) which have been used as forums for negotiation of commercial points or to set out governance models. On occasion these need particular consideration as to how they interplay with capital call rights;
- the general partner may have bespoke governance and approval processes owing to certain tax or regulatory structuring either at the fund level or below (the fund vehicle may also be a Cayman Islands LLC with an equivalent bespoke governance model);
- it is much more likely that there will be an existing or contemplated asset-based financing occurring at the reinsurance company level (below the fund) and so consideration needs to be given to the approvals and security which the fund will be asked to grant in this regard and the subordination of one loan to another; and
- timing can be an issue if asset-based security is provided as an equity pledge over a regulated reinsurance vehicle will almost certainly require the pre-approval of the applicable regulator.

None of the above issues have proved to be insurmountable in our experience, but when they do come into play it is of course useful to have a firm experienced in insurance to handle!

**So it's a brave new world in reinsurance?**

For the time being, the trend of insurance converging with private equity and fund finance seems set to continue. We expect to see more and more products and solutions emerge to allow private equity to access insurance strategies and vice versa and with that will come more interactions with the fund finance world – so watch this space!

## Please Join Us! Finance Forum on October 19

**September 8, 2023**

Our seventh Annual Finance Forum is October 19 at The Ritz-Carlton in Charlotte, and we would love to see you there!

Leaders from over 150 of the world's top financial institutions are registered for an interactive day with the industry's foremost experts. We are going to take deep dives into the wide range of challenges and opportunities that will shape the global financial landscape in 2024 and beyond.

Click **here** to view some of the organizations that have registered to attend.

**Current panel topics include:**

- Coming of Age: What's Next for a Maturing Fund Finance Industry?
- What's Really Going On: A Close Look at the CRE Market
- Pessimistic or Opportunistic: A Credit Strategy for Volatile Times
- The New Chapter in Fund Finance
- Market Update: Distressed CRE and Workout Trends
- A Conversation with the Chief Credit Officer
- Worlds Collide: Structured Products Meets Fund Finance in CFOs and Rated Feeders
- Sultans of Swing: What (and Who's) Groovin' in CMBS?
- Refocusing on Restructuring: Distressed Credit and Special Situations
- Not-So-Risky Business: Keys to the Effective Structuring of Capital Relief Trades
- Setting the C-PACE in the CMBS Market
- Financing the Financiers: Bank Leverage of Private Credit Originators
- NAVer Fear: New Approaches in the NAV and Secondary Market
- Getting to Yes: Terms and Trends in CRE Lending

For more information about this event, please contact **Cori Niemann**.

## Join EMEA FFA Diversity for Networking!

**September 8, 2023**


The EMEA FFA Diversity team invites you to join an evening of networking over drinks and canapés, hosted by Goodwin and Carey Olsen. This will be a fantastic opportunity to get together after a busy summer and the start of autumn!

Register **here**.

Date: Thursday, 2 November, 2023

Time: 5:30 PM - 10:00 PM GMT

Venue: Goodwin, 100 Cheapside, London EC2V 6DY

## Save the Date for Cadwalader’s Inaugural European Finance Forum in London

**September 8, 2023**


Cadwalader’s London office is excited to be hosting our inaugural European Finance Forum on Thursday, 12 October 2023 bringing together asset managers, financial institutions and alternative lenders across Europe to network and discuss some of the hot topics facing our industry today.

More details to be announced next week! Register **here**.

## Women in Fund Finance on October 18

**September 8, 2023**


Save the date - October 18!

Cadwalader is proud to sponsor the second annual Charlotte Women in Fund Finance fall forum and networking event in the Queen City. Join us for an exciting and timely panel discussion followed by a networking reception. Additional details to come. You can register **here**.

All members of the fund finance community are welcome!

## Fund Finance Hiring

**September 8, 2023**

Fund Finance Hiring

The Private Bank at Citizens is hiring a Relationship Manager who will be responsible for creating new and expanding existing relationships in the private equity vertical and other business verticals within the Citizens Private Bank. The full listing is **here**.