The Macro in the Spotlight

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By Michael Mascia
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Back in 2008, you had to make a choice. You could either get your work done or you could stay current on market developments. With multiple daily bank failures, mergers, CEO changes and TARP investments, it was hard to do both well. The last few weeks sort of reminded me of that conflict, albeit on less distressing substance. So many interesting macro events are occurring right now that warrant attention and have the potential to impact fund finance. In other *FFF* postings this week, Jeremy Cross has covered the new Prime Minister in the UK and Chris van Heerden has covered the CFA Institute's updated GIPS standards. Below are some thoughts on the other key issues I have been following.

Fund Formation Data. Both *Private Equity International* and Preqin published their 1st half fund formation data in July and the results underwhelmed as forecasted. *PEI* reports $177 billion raised across 240-something funds, down 7 percent from the same period last year and down a full 40% from 2017. Yet, as I mentioned previously, we believe fund finance is up in the 10^{+} percent range from 2018 based on a good number of anecdotal sources as well as our own data. Part of that dichotomy is likely attributable to dry powder, which has been going up in 2019 even as fund formation has gone down. Preqin shows dry powder at a new high of $1.54 trillion as of the end of June. While fund formation drives new deals, dry powder provides collateral, and there is a lot of it in the market right now (query to what extent fund finance contributes to the growth in dry powder by delaying deployment). Both Preqin and *PEI* are forecasting more robust formation stats in the second half and so are we; we are working on a number of facilities for very large funds that we expect to reach final close in the latter half of the year. But this trend does bear watching. If capital does not start getting deployed more quickly, it is going to push back subsequent fundraises for existing managers. My view is that it will be challenging for private equity AUM to grow over the next 5 years consistent with Preqin's bold predictions if we do not start seeing some meaningful deployment of existing dry powder in the near term.

Stop the Looting? Merriam-Webster defines looting as "to engage in robbing or plundering especially in war." And so Elizabeth Warren last week decided to name her proposed private equity regulatory legislation the "Stop Wall Street Looting Act of 2019." The inflammatory language is unfortunate. In addition to entirely gutting the principle of limited liability and eliminating most fundamental tenets of equity ownership, private equity professionals will now no longer be able to feed elementary school children to their pet chupacabras. (Not really, but it is clear that the Bill's proponents have an awfully sinister view of private equity.) The substance of the Bill was succinctly covered in *Buyouts* **here** and Elliot Ganz of the LSTA nicely summarized how the Bill would impact loans and CLOs **here**.

While the Bill is political posturing and not wellâ€'considered legislation, income inequality is tearing at our social fabric and needs to be better understood and thoughtfully addressed. And the effects of a corporate shutdown on a community, particularly in rural areas, can be devastating. I highly recommend the book "**Glass House: The 1% Economy and the Shattering of the Allâ€'American Town**" by Brian Alexander. It is sort of a combination of "Barbarians at the Gate" and "Hillbilly Elegy." While I have no idea if it is factually accurate, the book is a fascinating read about the corporate history and drama at Anchor Hocking Glass Company, once the world's largest maker of glass tableware. It also colorfully details the impact layoffs had on Lancaster, Ohio, from the fundraising falloff at local charities to the increase in opioid abuse by the recently unemployed. These are, of course, real societal issues that need to be addressed, but laying it all on the doormat of private equity is misdirected. But Wall Street is and always will be a popular scapegoat for politicians.

Based on the language of the Bill, I suspect fund finance is going to eventually find itself entering the discord of the 2020 U.S. presidential election. I expect that we will be lumped into the "excessive and risky leverage" bucket and be demonized as a weapon the funds use to wreak havoc. We should all be prepared for our products and businesses to be criticized by name during the election process. The FFA is going to need a public relations firm.

United States Debt Limit. On Monday, President Trump and U.S. Congressional leaders announced a deal for a twoâ€'year extension of the federal debt limit and increases in the federal spending caps. Both the President and the Democrats in Congress seemed pleased with the agreement. The only people not happy about it are the fiscal disciplinarians. But there are only about seven of us left in the United States. The debt limit agreement is good for our markets, though. It is one less thing to worry about, and the last government shutdown did cause us a fair amount of nuisance when we could not get tax ID numbers for AIVs to satisfy banks' KYC requirements.

Interest Rates. The Federal Open Markets Committee meets next week, and the market is widely forecasting a 25 basis point reduction. I did not agree with the December hike and, coming off the June job numbers, I am in the sit still, wait and see camp for next week. (I spend about 20 minutes a month thinking about interest rate policy, so I'm entirely qualified to criticize Jerome Powell.) While I think the Fed should save their dry powder for a real rainy day, a rate reduction would probably be positive for fund finance transaction volume and facility utilization but negatively impactful for net interest margin at many of the banks. We will see where we end up next week.

Cadwalader fund finance enjoyed a solid first half, and we are grateful to our clients and counterparties. Enjoy your weekend.

Equity Commitment Letters under English Law: Beware of the Pitfalls!

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Equity commitment letters (or ECLs) have become an increasingly common feature of the fund finance landscape, providing flexibility for private-market funds which, for a variety of reasons, either cannot or do not want to assume a primary debt obligation in respect of a particular transaction. We see this particularly with funds in jurisdictions where the incurrence of a financing at fund level may result in adverse tax consequences for the fund (and/or its investors) and where the fund has reached its borrowing/guarantee limits in its fund documentation.

With proper structuring and documentation, the ECL can both address the fund's particular legal/tax/constitutional requirements and provide clear recourse to a lender relying on the ECL for credit support. However, there are certain provisions which might, on first glance, appear to be entirely harmless but which can make a drastic difference to a lender's recourse under an ECL. Below is a sample of some of the many pitfalls that we see with ECLs.

Claim for damages: If the ECL provides that the claims of any counterparty (including the lender if it has third-party rights) are limited to requiring the ECL provider to comply with its obligations under the ECL, the effect of this is likely to be that a claim for damages by a party that has suffered the loss under the ECL is specifically excluded by virtue of this statement under English law. The English courts will generally always award damages where they are a sufficient remedy, rather than specific performance which is always a discretionary remedy for English courts. This simple statement could have the effect of depriving the lenders of any remedy at all under English law. If a lender accepts this statement, an English court -- in exercising its discretion as to whether or not to award specific performance -- is very likely to take into account the sophisticated nature of the financial institution involved and its advisers and consider that the lender should have been aware of the implications of agreeing to such a statement.

Remoteness: In order to be able to sue for damages, a lender will need to be able to demonstrate that it has suffered a loss as a result of a breach of the ECL. That claim for loss could be contested on the grounds that the loss was "too remote." Clearly, the point of structuring the ECL as an equity commitment is to create something which isn't quite a guarantee. However, the problem with that is that it then distances the lender from the transaction and leaves open a potential defence that the lender's loss is too remote. Including a statement to the effect that the parties acknowledge this is not the case is helpful in evidencing the commercial intentions of the parties in the event of a dispute.

Right of set-off, counterclaim and defence: As the lender is seeking to take the benefit of the ECL, usually either by way of assignment or third-party rights, the lender will take subject to defences which are available to the ECL provider by virtue of its contractual relationship with the direct beneficiary of the ECL under the terms of the ECL. Whilst the lender can contractually restrict what the direct beneficiary can and can't do to mitigate, so far as possible, defences becoming available to the ECL provider, the lender is unable to completely prevent this. Therefore, it is imperative that the ECL provider agrees that it will not exercise any right of set-off, counterclaim or defence.

There are several other aspects of ECLs and the enforcement thereof which need to be addressed/considered by a lender in accepting this type of recourse as credit support. We recently closed a large transaction and had the benefit of our litigation team working alongside us, which proved to be invaluable in identifying the risks inherent with these types of transactions. To have our colleagues' insight prior to an actual litigation was extremely insightful in how to frame the structure and terms of the ECL in order to mitigate risk. They now have a pile of our fund finance precedents for review, so watch this space!

Brexit . . . the Story Continues

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There is a new Prime Minister in the UK -- Boris Johnson -- who swept to power on the back of the votes of less than 1% of the UK electorate, with the enthusiastic support of the "hard" Brexiteers in his party and with an apparent intention to Brexit (yes, it is now a verb) by the current deadline of 31 October, a plan he intends to execute, despite serious obstacles, with a mixture of a "can-do" attitude, "optimism" and the appointment of a cabinet made up of fellow Brexiteers who share the Prime Minister's unbridled enthusiasm. A cautionary note for those on either side of this historic debate: Optimism, a can-do attitude and enthusiasm are all admirable qualities but do not by themselves alter the political and economic realities of the Brexit process.

What happens next (despite the current noise) with Brexit is anybody's guess, from a "hard" Brexit on the 31 October, to an adoption of the existing "Brexit" deal currently on the table, another extension, or even a general election, but right now the odds have probably shortened on either a "hard" Brexit and/or an election. We can pretty safely predict, though, a continuation of the political instability that has dogged the Brexit process from the start and that has knocked the financial and currency markets certainly in the UK and also in Europe, and that is likely to continue for a while yet.

So what effect this all has on the Funds market and the Fund Finance market is also hard to predict. Short of a hard Brexit and a significant economic downturn, the reality is probably not that much, at least in the shorter term. The Brexit uncertainty is probably already "priced in," although a "hard" Brexit may not be, and short of a dead stop, any instability should also create opportunities and demand on which Funds and their Investors (and their financiers) depend.

And, finally, to paraphrase a well-known quote: "A [lawyer] is an expert who will know tomorrow why the things he predicted today didn't happen."

Women in Fund Finance Wit & Wisdom Breakfast at New Mountain Capital

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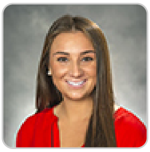

By Lana Papa
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Women in Fund Finance was pleased to hold its third Wit & Wisdom Series meeting, connecting senior women in the fund finance industry with junior members for intimate breakfast discussions. Wit & Wisdom is open to female members of Women in Fund Finance with at least two years of experience working in the fund finance industry and who are not Managing Directors, Partners or C-suite executives. The most recent event was hosted by Saaima Shahin, Director of Finance at New Mountain Capital, who discussed "Advocating for Yourself." Saaima was joined by Mary Touchstone, Partner at Simpson Thacher & Bartlett LLP; Deborah Montaperto, Managing Director at Morgan Stanley; Dana Laidhold, Treasurer, Peloton Interactive; and Dee Dee Sklar, Managing Director, Wells Fargo. The discussion focused on how to build one's own brand and win supporters, and helpful strategies to advocate for oneself in any situation. Participants were from a variety of cultural backgrounds with a range of industry experience, which offered a unique perspective on the group's discussion.

Player Profile: Anna-Lise Wisdom

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Player Profile

FFF: Anna-Lise, how did you end up in fund finance?

As a senior associate on Appleby's finance team, I started working closely with the late Julian Black in 2010 and have not looked back since! Many, many deals later, I am now a partner, right alongside onshore referrers-turned-friends who have followed a similar trajectory. It is probably fair to say that I have been completely wrapped up in fund finance for about a decade. It has had a huge impact on my career and, indeed, my life.

FFF: What trends are you seeing so far in 2019 compared to 2018?

We have worked on more SMA facilities so far in 2019 compared to last year. We have also worked on a couple of true hybrid deals this year, which is probably to be expected as the market matures, capital is deployed and lenders leverage relationships over the longer term by looking to fund-level financing. While there may be some degree of commoditization of the product, we have definitely seen an increase in creative and bespoke solutions being negotiated and offered in the market that we have been lucky enough to work on. On a couple of deals, we have also been brought in at the term sheet stage, which has offered a bit of a wider-lens perspective.

FFF: Taking a longer-term perspective, how has working as a Cayman fund finance counsel changed over the past ten years?

Having been involved with the product pretty much since its inception . . . I can say that there are so many more of us now! The number of new entrants is impressive. On the lender side in particular, as more and more banks become active in the market, law firms are jostling to become lenders' counsel of choice. Given the nuances and complexities in a good number of these deals, I do think that it will take some time for the newer entrants to catch up, but the growth generally in the market is great. As well as seeking out trusted counsel [*insert shameless plug for Appleby*], parties should be availing themselves of the thought leadership in this area, and taking full advantage of the many opportunities available to mix and mingle with the veterans. We applaud the FFA for launching its University Programme this September, with a focus on education and training for bankers and lawyers. One of the challenges at the symposiums, I think, has been to balance the content so that it can benefit those who are new to the product, but remain relevant to those who are a bit more seasoned. The FFA University Programme will go some ways towards addressing this, and its focus on training for all who need it will ultimately benefit all market participants.

FFF: You wrote in *FFF* in May about the Cayman Islands Economic Substance Law. Are there any other emerging issues under Cayman law that might prove relevant for the fund finance markets?

I think that the Cayman Islands has worked really hard to ensure that the laws supporting the finance industry ensure, as far as possible, predictable outcomes for market participants, and this has tended to attract -- and continues to attract -- investment in the jurisdiction. The Abraaj debacle, if anything, has reinforced that there is a clear set of applications and principles for fund finance under Cayman law, which is really helpful for the market as a whole. Globally, however, there is a move towards increased transparency, tax reporting and substance, and we expect that this will affect all offshore jurisdictions in ways that may not be immediately predictable (i.e., this is not a Cayman-specific issue). Tracking reporting obligations and compliance may generally become more of an issue for lenders and GPs alike. Otherwise, we anticipate that business will continue as usual in the Cayman Islands.

FFF: What are the must-read resources for a young professional getting underway in the sector?

I am probably betraying my age when I say that young lawyers today have access to many more resources than were available when I qualified in 1999. The GLI *Fund Finance Guide* is a fantastic publication that includes a country-by-country analysis and articles written by market leaders on current, topical issues affecting the product. Young women would also do well to read the publications by The Ark Group geared towards women. They have done the research and publish really good collaborative pieces that explore what it takes to make great women leaders. Their latest publication, *Career Development for Women Lawyers,* is a must-read primer developed for women by women. Apart from that, I would say to young lawyers that they should read widely (i.e., *outside* the law) and as often as they can. It makes for a better-rounded and more interesting person!

FFF: Do you have any suggestions for the Fund Finance Association?

I would agree with the suggestion from some that the FFA keep switching up the locations for the symposiums every few years to keep things fresh. Generally, I think that the FFA has done a very good job of facilitating discussions around diversity and inclusion and would congratulate Dee-Dee Sklar, Mary Touchstone, Ann Richardson-Knox, Nick Mitra (an honorary woman!) and the other WFFA committee members on taking the lead with the women's initiative, and Natasha Puri for stepping out to lead the diversity initiative. My hope is that this will ultimately lead, among other things, to more gender and ethnically diverse panels at the symposiums.

FFF: Wandering off topic for a minute, tell us a bit about the growth outlook for the tech industry in the Cayman Islands.

Tech is huge right now and the outlook is promising. The Cayman Islands Government has established a "Tech City" in the Special Economic Zone, facilitating the set-up and operation of technology companies from outside Cayman within the jurisdiction. Tech City currently hosts a number of leading fintech companies, and the jurisdiction is a choice domicile for a significant number of investment funds investing in cryptocurrencies and distributed ledger technologies as well as companies conducting token generation events. Tech has the potential to revolutionize businesses and markets in Cayman and, in order to stay ahead of the game, Appleby has put in place a dedicated Technology and Innovation Team to support clients across a broad range of emerging technologies.

FFF: What do you like to do outside of the office?

I practice the ancient martial art of "walking meditation" -- T'ai Chi. It is incredibly centering but also amazing for increasing strength and flexibility. With a jam-packed schedule both in and out of the office, the need for getting centered is real.

I also have quite the love affair with my Kindle, and Sunday evenings will often find me curled up with a bowl of popcorn, reading a non-fiction book of my choice.

FFF: Tell us one fun fact about yourself.

I am currently in training for a second vocation as a Minister of Religion! Over the years, I have been fortunate to have had many spiritual "mothers" who helped me through several rough patches, so it seemed like a natural progression for me.

FFF: Any bold fund finance predictions for the rest of the year or beyond?

No! All of us in this space have been so blessed to see the exponential growth of the industry and how the benefits of that growth flow through to all the service providers, so I will not jinx anything save to say that it will be business as usual. Gotta go and review some documents, please, and thank you!

GIPS 2020: An Incremental Change in Subscription Facility Disclosure

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At the end of last month, the CFA Institute released the latest iteration of its principles for representing investment performance. The Global Investment Performance Standards (GIPS) go into effect on Jan. 1, 2020. For the fund finance market, GIPS 2020 represents an incremental move towards more disclosure on the use of subscription facilities.

GIPS 2020 requires that firms report returns both with and without a subscription line, although ex-facility reporting is not required if loan principal is repaid within 120 days with capital call proceeds and no principal is used to fund distributions. Where subscription line reporting is required, firms must also provide the purpose, size and outstanding balance for the facility.

The GIPS standards haven't made many headlines over the past three weeks, probably in part because these changes were previewed in the earlier exposure draft. The GIPS initiative dates back to the mid-1990s and has been instrumental in advancing consistent and comparable reporting of investment performance on a global basis. Compliance with the standards are voluntary.

The 2020 editions of the GIPS standards may be downloaded at the following links for **firms**, **asset owners**, and **verifiers.**

First Republic Article on Subscription Lines

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Jeff Maier, Managing Director - Private Equity Finance at First Republic Bank, earlier this week published an article titled: "Subscription Lines: Why All the Drama?" The article is available **here**.

Additional Reporting on Court Square

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Buyouts earlier this week provided additional reporting on Court Square in an article titled: "Editor’s Letter: Court Square puts sub lines in LPs’ court." The subscription-required article is available **here**.