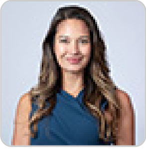
Hong Kong: An Exciting Week Ahead

September 20, 2019 | Issue No. 46



By **Danielle Roman**
Partner | Mourant Ozannes

Media coverage worldwide of the recent protests in Hong Kong has told a story of civil unrest and occasionally violent tension between protesters and the police (in their own right and as a proxy for the government). The protests were triggered by proposed legislation that would have allowed extraditions from Hong Kong to mainland China, but in reality a broader set of issues fuel the protesters' discontent, hence the continuation of the protests following the Chief Executive's commitment to withdrawing the extradition bill.

The vast majority of protests and protesters have been peaceful, and Hong Kong's day-to-day life carries on with remarkable continuity. In light of this, the Fund Finance Association will be pressing ahead with its 3rd annual Asia-Pacific Fund Finance Symposium in Hong Kong next week. Keynote speaker Goodwin Gaw, chairman of Gaw Capital Partners, is expected to be a particular highlight of the conference, much as Judith Li, partner at Lilly Asia Ventures, will be as the keynote speaker at a pre-conference breakfast hosted by Women in Fund Finance.

The fund finance market in Asia has evolved significantly over the last three years. Most of the partnership agreements we review now include express provisions for borrowing and the granting of security and are (for the most part) bankable. However, there are still sticky points frequently discussed between lenders and funds, such as limitations in partnership agreements on overcalls following default of an LP and consent requirements for transfers of LP interests.

In terms of lenders, the Asia-Pacific market is certainly more crowded than it used to be, with activity centred in Hong Kong, Singapore and Australia. Some banks are offering capital-call facilities on a relationship basis only, whilst others are focusing on it as one of their key lending products. We have noticed more funds utilising such facilities and openly comparing term sheets to optimise deal terms.

As fund sizes have grown in Asia, so too have the size of capital-call facilities, and we are seeing club and syndicated deals on a regular basis, particularly for funds which have taken out smaller facilities for their second and third funds and are now setting up their subsequent funds. We have also noticed a rise in the use (and availability) of GP and LP financing.

It is an exciting time in Asia, both for fund financing and from a macro-economic and political perspective. The Asia-Pacific Fund Finance Symposium in Hong Kong is sure to raise some interesting discussions this year. The panels will be addressing trends in the Asia-Pacific fund finance market, the legal and regulatory hurdles which lenders and fund managers have been facing, views on fund financing from sponsors, and a look at the opportunities and challenges in, for and in respect of China.

We look forward to seeing you there!

Introduction to Singapore VCCs

September 20, 2019 | Issue No. 46

By **Calvin Tan**
Partner | Simmons & Simmons

The Variable Capital Companies Act (No. 44 of 2018) of Singapore (the VCC Act) was passed into law in 2018. The VCC Act introduced into Singapore the new legal entity of the Variable Capital Company (VCC).

The VCC is aimed at allowing Singapore to capture a greater share of the economic benefits from the full fund management value chain. The new VCC regime is designed to encourage fund managers to domicile their funds in Singapore, adding fund domiciliation activities to their fund management activities. This, in turn, will help further strengthen and build out the full-service fund management ecosystem in Singapore. To this end, a re-domiciliation facility will also be provided for existing overseas investment funds constituted as corporate structures similar to VCCs.

Singapore-based fund managers who domicile funds locally as VCCs are expected to benefit from potential cost savings and operational efficiencies, such as fewer cross-border administrative and compliance hurdles, through the use of local service providers and professional advisers operating out of just one jurisdiction. VCCs will also be able to avail themselves of Singapore's competitive and conducive tax regime.

Notable Features of the VCC

The VCC may be set up as an open-ended or closed-end fund. This opens up the possibility of utilising the VCC for traditional and alternative fund strategies, including hedge funds, private equity funds, venture capital funds, real estate funds, infrastructure funds, mutual funds and exchange-traded funds.

The VCC can be established as an umbrella structure with multiple sub-funds or as a standalone vehicle. In an umbrella structure, each sub-fund will need to be registered with Accounting and Corporate Regulatory Authority (ACRA) but will not have separate legal personality. Sub-funds within an umbrella VCC will have their assets and liabilities segregated from other sub-funds, such that the assets of one sub-fund may not be used to satisfy the liabilities of another sub-fund. An umbrella sub-fund can share a board of directors and common service providers (*e.g.,* custodian, auditor).

Additional features include:

Variable capital structure: In the case of open-ended funds, this provides flexibility for the VCC to issue and redeem shares without having to seek shareholders' approval, enabling investors to exit their investments in the VCC when they wish to, in accordance with the terms of the fund and, more generally speaking, redeem shares and pay dividends using its capital.

Redomiciliation: Foreign corporate entities set up as collective investment schemes could potentially be re-domiciled as VCCs in Singapore. This could be a potential "game changer" as it is intended to encourage fund managers in Singapore with existing funds domiciled in offshore jurisdictions to co-locate their fund domiciliation with their fund management activities in Singapore. There are obvious cost benefits and other efficiencies to this.

Tax Treatment: A VCC set up as an umbrella structure will be treated as a single company for income tax purposes such that only one set of income tax returns needs to be filed. The tax exemption schemes under Section 13R and Section 13X of the Income Tax Act of Singapore will be extended to VCCs. The 10% concessionary tax rate under the Financial Services Incentive - Fund Management scheme will be extended to approved fund managers managing such incentivised VCCs. The existing goods-and-services tax remission for funds will also be extended to such incentivised VCCs. For VCCs set up as an umbrella structure, goods-and-services tax will apply at the sub-fund level.

Player Profile: Fi Dinh

September 20, 2019 | Issue No. 46

Player Profile

FFF: Tell us a bit about how you ended up in fund finance and then in Singapore?

I joined banking from a background in fine arts and political public relations – hence, I spent the early part of my banking career in various risk and middle-office functions at Barclays UK and Dubai to learn my way around a bank. Finally, in 2012, I was ready to make the move back into the front line, and joined Barclays London's NBFI coverage group. At the time, Barclays was looking for more innovative solutions to service the private equity sector than the traditional acquisition finance and cash management products.

I started to go to as many conferences and seminars as I could and talked to people to learn about the sector, as well as made myself a bit of an expert in fund-level hedging/derivatives, treasury, liquidity management and trade finance to complement my boss' deep expertise in fund-level lending. I can remember the hundreds of cold-call emails, LinkedIn stalking and pavement pounding we did in those days. In combination with referrals internally and externally, we started to gain traction. I then learned about subscription financing, starting with small bilateral deals and then went on to lead large syndicates across multiple jurisdictions. And the rest is history. We built a very successful private equity franchise at Barclays and expanded the business from London to New York and Hong Kong.

I will always remember those days with a warm heart and be grateful for the opportunity to develop my technical and entrepreneurial skill set in fund finance, which put me in a great position to take on my current role at ING to help build out the business across the APAC region. ING has offices in 14 markets in Asia, with Singapore being the regional headquarters, hence I moved over to Singapore in January this year.

FFF: How does servicing funds in your current role differ from your prior roles focused on EMEA and U.S. funds?

In my experience so far, the Asian market is much more fragmented and dynamic than the U.S. and Europe. The main centres of Hong Kong, Singapore and Sydney continue to influence terms, but domestic markets in Japan, Korea, China and developing Southeast Asia are catching up fast, each with their own individual flavour. I was thankful for having the experience serving both the U.S. and European markets previously. In Asia, there is no such thing as "standard market terms." It is just growing so fast. The market here always strives to leverage best practice elsewhere and then add its own requirements. Having a wide range of experience and established teams across the world enabled us to respond quickly to the need for tailored solutions for each client in the region.

On the other hand, given the nature of the market, funds tend to have a more concentrated investor pool. It is not uncommon to have funds with less than ten investors, or SMAs and co-investment vehicles raising hundreds of millions, or even billions. Perhaps in line with the U.S. and European funds markets, given the amount of capital looking for yield, time in fundraising for funds seems to have significantly shortened over the past few years. Whilst private equity and private real estate continue to dominate, other asset classes such as credit and secondaries have gained traction, albeit more opportunistic in nature.

When I first moved over, I drew a distinction between U.S./Europe sponsors with Asian funds, and local sponsors. From my observation, many of the former continued to leverage on the terms driven out of the U.S. and Europe, which was my comfort zone. Local players tend to be more nimble, and they expect a much more tailored approach and are less driven by precedents. However, over time, this distinction became more blurred, and the local operations of global sponsors became more autonomous with their own set of relationships and challenges. Even at term sheet version number 10, one can never really take anything for granted, which definitely keeps me on my toes.

It is challenging to compete against well-established, generational relationships and cheaper cost of capital, but the sheer burst of entrepreneurship means that there is always room for new players who strive to add value. We are closing our 12th deal since starting to book fund finance transactions locally in Asia since this past January.

FFF: The growth in the Singapore asset management industry continues to impress. Total AUM approached $2.5 trillion last year, but the rate of growth — almost 20% on the year — has been even more remarkable. The new variable capital company fund structure could add further momentum. Do these trends translate to real opportunities for fund lenders?

There has been quite a lot of talk around the new Singapore Variable Capital Companies (“VCC”) structure for investment funds. Many thought this could be a game-changer for the fund management industry, both in Singapore and across the APAC region. However, from what we are seeing, the adoption rate is still at an early stage. Some took the view that the legislation draws on existing frameworks from other jurisdictions such as Luxembourg, Ireland and Mauritius, among others, and thus simply brings Singapore in line with other international investment fund hubs. Whilst there might be some truth in that, in my personal view, the significance of the legislation is not the VCC structure, in and of itself, but that Singapore has demonstrated to the global LPs/GPs community its willingness to fundamentally change everything about establishing a fund in Singapore in order to support this industry. I think that this has a far more powerful and lasting impact, particularly for an industry which operates on confidence.

In our experience, Singapore has historically been used (particularly by real estate funds) for HoldCo structures. I do think that the various innovative initiatives by the Monetary Authority of Singapore ("MAS") to make the setup process efficient and cost-effective, as well as incentives for re-domiciliation, will make Singapore a much more attractive fund domiciliation location going forward. We have already seen funds setting up Singapore parallel funds in addition to the Cayman or Luxembourg vehicles used in previous vintages. We have closed a number of transactions under Singapore law, and there is a lot of similarity with other common-law jurisdictions that most fund finance practitioners will be familiar with.

This also presents real opportunities for lenders to innovate, particularly those with deep experience in similar structures in other jurisdictions and the imagination to adapt them to the VCC regime and local requirements. The sector has much more room to grow.

FFF: We tend to think of higher levels of uncertainty and volatility in the public markets as helpful to private capital raising. Do you agree? Is this consistent with what you’re seeing from your vantage?

Portfolio diversification is a key pillar in any portfolio manager’s tool box, so the answer to this question is not a binary one. What I would say, though, is that the higher level of uncertainty and volatility in the public markets created an interesting dynamic exchange between the public and private markets. Asset prices have soared, trophy assets seem to be enjoying public-style exposure and there are more public equity holdings by private equity funds than in the past. This poses an interesting question on market correction and whether the public-versus-private market trends have more similarity than one would traditionally expect.

On the other hand, LPs tend to have separate baskets of allocation to the public versus private asset classes. Therefore, whilst there have been some notable increase in institutional LPs’ allocation to alternative assets given the strong performance of the asset class in the past couple of years, public equities and fixed income products continue to make up the majority of capital allocation worldwide. In the meantime, the number of private capital funds looking for commitment has also rocketed. This, combined with the trend where LPs consolidate the number of GP relationships they manage, means that if there is indeed some net gain, it would be the household names with established relationships and track records or those with a truly unique proposition who would benefit more than others.

Having said that, there are definitely opportunities amidst investors’ search for yield. We have seen Korean and Japanese LPs become much more active abroad, particularly in Europe. Longer term asset classes such as infra and real estate are the main beneficiaries of this. From the neighboring continent, we are seeing German investors becoming more active in Asia. Other long-term investors in Asia are also following established principals who have spun out from global PE houses into their own billion-dollar funds. So there are many interesting developments across the markets that we are keeping a close eye on at the moment.

FFF: Another high-profile potential down round IPO is playing out in the headlines. Without naming names, let's just say a number of unicorns have now had down round IPOs in 2019 or subsequently settled into trading below initial listing prices. Is this a narrow issue limited to U.S. tech companies or is it maybe something broader in private market asset pricing?

Ultimately, the price of something is how much someone is willing to pay for it. It seems that investors' confidence is waning, people are expecting the music to stop and they don't want to be left holding the baby. An IPO is only one exit route, and I felt that inflated asset prices are a general trend across the board and it is not unique to the U.S. market or even the tech sector (albeit it is certainly more prone to subjectivity than some others). We have enjoyed a long recovery road. The value of money has eroded over time with various fiscal stimuli, which amplified the effect of inflated asset pricing. This is one of many "stress" indicators that we have seen more and more frequently. It will be interesting to see whether "this time is different."

FFF: Who has had the most influence on your career?

I was lucky to have been mentored, supported and coached by many talented professionals over the years, each having played a significant role in different episodes of my career. However, within the context of fund finance, it's got to be Gavin Rees. He was my first teacher on subscription financing and was a friend, mentor and a big supporter. I learned so much from him – not only his technical knowledge but also his drive, tenacity and the effortless dry humor (I'm still trying to work on this one!). I will always be grateful to Gavin for the baptism by fire all those years ago from where I have discovered my passion for this sector.

FFF: What advice do you have for the young fund finance banker just getting underway in the sector?

Actively find where you can add value. It doesn't have to be headline-grabbing, but create something that people will pick up the phone to call you about.

FFF: What is uniquely enjoyable about living in Singapore?

Singapore has so much more to offer than many people give it credit for. Since moving over, I tried swimming, trained in MMA and took up bachata classes. There is a diverse range of communities here to expand your network and experience. It is also a great hub to get to know the region. For a weekend, one can do anything from horseback riding in Malaysia or kite surfing in the Philippines to volcano trekking in Indonesia or simply street-food tasting in Thailand. The world is your oyster, and Singapore is your champagne!

Subscription Finance Loan Agreements Series, Part 8: Key Person Events

September 20, 2019 | Issue No. 46

“Key Person” (or similar) provisions are a common feature of Leveraged Finance Facilities as well as of Funds Finance Facilities. While the fundamental concerns around this are similar in each of the leverage and the funds markets, the way in which they impact is quite different. The fundamental concern in each market (at least for the lenders) is that if they have made facilities available (for whatever purpose) in reliance on there being a particular group of persons within the borrower or – in the case of fund facilities – a related general partner or manager who will deliver the financial or business outcome required to ensure the facilities are utilised and repaid, and if some or all of that group ceases to be involved in the business, then there is a change for the worse in the risk profile of the facilities. At that point, the lenders (in either market) will want to ensure that that risk is mitigated (usually by a combination of giving some time for the borrower or related parties to find suitable replacements and/or by imposing draw stops or even defaults if the requisite action is not effected within a specific timeframe).

So far so similar, but after that the reasons for the approach and the solutions will diverge between the two markets. In the leverage market (very broadly), the lender’s credit issue is primarily only with the fact that the particular “key” persons ceasing to be involved in the business will adversely affect the conduct or the success of that business. In the subscription finance market, the lenders’ credit issue is primarily (although not only) with the impact that the absence of any particular “key” persons will have on the commitments of the investors – so, to a much greater extent than in a Leveraged Finance Facility, the lenders will only have an issue to the extent that the investors have an issue.

As with many other facets of the subscription finance market, if there are specific “Key Persons” that are deemed important enough to affect the nature of the fund’s business and the purposes for which the investor’s commitments can be paid (and this is not always the case), this will be set out in the fund’s constitutional documents. Although the treatment differs slightly from fund to fund, the broad features will be the same:

- The documents will identify those people who are regarded as “key” executives within the fund and thus expected to spend a majority or substantively all of their time running the fund.
- They will then define an issue (often described as a “Key Person Event” or similar) as occurring if a specified number of those people cease to be involved to the extent required in the fund. Occasionally, the “number” will be replaced by a points system (whereby so many points are attributed to each “Key Person” and then people representing a sufficient number of points cease to be involved to the extent required), but the principle is the same.
- Once the “Key Person Event” has occurred, the fund may continue to operate for a period, but the activities that it can pursue are often strictly curtailed. For example, it is common to restrict expenditure on investments to “follow on” investments (or to investments that have already been committed) after a “Key Person Event” occurs. Usually, investors can still be called on to repay fund borrowing during the period but this should be carefully checked. Similarly, the constitutional documents should be checked to confirm whether investors will be required to pay in commitments to fund drawdowns made after the “Key Person Event” occurs. Often, this obligation may only be imposed provided the drawdown is used for one of the restrictive purposes referenced above.
- After a defined period (the period can vary considerably but is usually anything up to 180 days), either the investor committee or another representative body (or the investors themselves) will be required to make a decision as to whether or not to continue the fund while the “Key Person Event” is continuing, or to accept the continuation of the “Key Person Event,” to require steps to be taken to remedy the “Key Person Event” or even to end the fund’s investment period.

Lenders need to be fully informed across these provisions and carefully consider how to ensure that they “match” them to the extent necessary in their facility documentation. Historically, it was quite common for lenders to impose a full-draw stop on the occurrence of a “Key Person Event” and to require termination/repayment of the facility if a specified period had elapsed without the “Key Person Event” being effectively remedied. That period often (but not always) matched the period for a final decision set out in the fund’s constitutional documents. In more recent times, the market has generally moved to an approach that is more directly reflective of the underlying treatment in the fund’s constitutional documents. So the “standard” approach now will involve a limited-draw stop (so restricting the purposes of utilisations after a “Key Person Event” to match the more restrictive purposes for which investor commitments can be called after the occurrence of the “Key Person Event” but not removing the ability to draw altogether), with the full-draw stop (and potential termination of the facility) only when and if the period allowed for the more restricted activities of the fund to continue has come to an end without resolution.

That said, and in light of recent events, there are circumstances in which lenders might still want to adopt a more historic approach (and impose a complete-draw stop and even a termination event when a “Key Person Event” occurs rather than only after a suitable period has elapsed). This is particularly worth consideration if the reasons for the departure of “Key Persons” is something other than “normal course.” So, if for example “Key Persons” are departing the fund as a result of allegations of mismanagement or misconduct (not necessarily against them specifically but just generally in respect of the relevant fund or its management), then lenders may want to have the right to take more immediate and drastic action. On a similar theme, lenders may also want to consider whether, if that type of situation were to arise, the trigger should match whatever the definition of “Key Person Event” is in the underlying fund constitutional documents (which may require the departure of a number of “Key Persons” before the event is triggered) or should be capable of being triggered on the departure of any one “Key Person” for these reasons. Finally, it is worth stressing that while these may be “ideal” solutions, this is an area where, for a number of reasons, actually tying down terms that are sufficiently “certain” to be accepted by both sides of the facilities may be problematic.

Axial Article on Subscription Credit Facilities

September 20, 2019 | Issue No. 46

Axial, an online deal-making platform for buyers and investors in middle-market companies, this week published a note on subscription credit facilities. The article covers what will be familiar territory for *FFF* readers. Trevor Freeman, Managing Director at Signature Bank, is quoted and forecasts further growth in subscription finance, particularly among middle-market capital providers. The article is available **here.**

Inaugural FFA University Held in NYC

September 20, 2019 | Issue No. 46

By Annabella Kwei
Wells Fargo

The Fund Finance Association University's inaugural two-day session kicked off earlier this week in New York at the Wells Fargo office. The initiative generated a lot of enthusiasm in the fund finance community and was sold out.

FFA University is a new initiative launched by the Fund Finance Association aimed at bankers and lawyers who are relatively new to the fund finance space or those who want an in-depth training course in our business.

The robust curriculum provided a comprehensive overview of the fund finance business from a legal, lending and fund perspective. Nineteen senior professionals provided insights on a broad range of topics, including "The ABCs of Fund Finance," "History of Fund Finance," "Private Equity Fund Formation and Operations," and "Fund Documentation & Key Issues." Each day ended with an interactive group exercise, allowing the approximately 100 participants to put their knowledge to practice and share their experience with peers. Attendees also enjoyed evening cocktails after the first day of study.

Given the tremendous success of the event, FFA University is expected to be rolled out to other locations.


FFA University
Fund Finance

Fund Finance Association NextGen Event in New York

September 20, 2019 | Issue No. 46

By Alexa Schult
First Republic Bank

The Fund Finance Association Next Generation (“NextGen”) initiative brings together young professionals from funds, banks and law firms from within the fund finance market. The NextGen network was established in 2018, and events include educational seminars, networking socials and industry panels aimed at developing the junior professionals to be future leaders of the industry.

NextGen recently welcomed over 70 FFA University attendees and their colleagues at Haynes and Boone’s offices in New York City ahead of the inaugural University program. Attendees enjoyed an evening of hors d’oeuvres, beverages and a brief history of the Fund Finance Association presented by FFA board member Nick Mitra. The team was thrilled to meet and see the number of up-and-coming new entrants to the industry. The NextGen team also introduced a new mentorship program that will be launching later this year. For those interested in participating or learning more, please reach out to **Jorge Grafal** of National Australia Bank or **Alexa Schult** of First Republic Bank.

Special thanks to the Haynes and Boone team for helping coordinate such a successful event.

Recommended Reading

September 20, 2019 | Issue No. 46

Dave Richards, Managing Partner at Capria, discusses the impact the Abraaj matter has had on GP/LP relations. [**Deal street Asia**]

Certain municipal areas are being deemed eligible as "Opportunity Zones" under the Tax Cuts and Jobs Act of 2017, but they meet the low-income criteria because they are composed largely of college kids? [**WSJ**]

Net cash flows from private equity funds (that is, distributions minus capital contributions) have been in the black for 8 straight years. Investors have to meaningfully re-up to keep their target asset allocations. [**PitchBook**]

Blackstone collects $26bn for biggest-ever PE Fund. [**PEI**]

GPs take charge on “change of control” provisions. [**PEI**]

GPs discuss their approaches to co-investment strategies. [**PEI**]

Vontae Davis retired from the NFL in the middle of a game. Here is his side of the story. [**ESPN**]