Home Thoughts from Abroad…Some Reflections on the 3rd Annual Asia-Pacific Fund Finance Symposium

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Writing as the dawn breaks and looking out from Hong Kong Island over the harbour, Kowloon and the mountains beyond (without a doubt, one of the most spectacular city views anywhere in the world), it is great to have had the opportunity to come back to this beautiful, vibrant city and to now offer some comments on the just completed Fund Finance symposium and to reflect on what was said about the market in Asia Pacific and the opportunities and challenges that lie ahead. In spite of the recent media coverage, overseas participants were more than happy to find the city as charming and efficient as ever.

The Symposium was well attended (with over 300 attendees, an increase from the previous two years) and kicked off when representatives from 30 local and international sponsors gathered at the China Club the night before the conference to enjoy a traditional Cantonese dinner.

The conference itself kicked off with an excellent fireside chat with Goodwin Gaw, Chariman of Gaw Capital Partners, who set a positive tone with confidence about future growth in China and, specifically, in the Greater Bay Area, with a focus on healthcare, technology, manufacturing and logistics. This was followed by the usual fascinating contributions and statistical analysis from Preqin and a number of excellent panels. There were great opportunities for networking, and it was an extremely well-organised conference (with due credit and thanks to the organisers). Overall, what struck us above all was that Fund Finance in Asia Pacific (and, as with all generalisations, with some significant exceptions) is at a place in its evolution which is in many ways similar to where the European Fund Finance market was 10 or more years ago. So, as we reflect on the spectacular growth in the European and U.S. markets in Fund Finance in that period, this would predict a very exciting future ahead for the market in Asia Pacific, with massive potential for significant and exponential development.

It is perhaps worth pausing to elaborate on why this reminds us so much of the European market in an earlier stage of its development. There is a very significant (and almost exclusive) emphasis on Capital Call/Subscription Finance as the main lending product, with other parts of the industry which are now familiar in Europe and the U.S. being almost entirely absent. So there is very little asset based/hybrid financing and a fairly nascent GP/Manager financing market. The latter was something that was frequently requested in the Asia-Pacific region, but there had been little evidence of transactions being concluded in this area to date. The comment was made on various panels that the core credit or facility documentation is not that settled and also that (although the core structure of the facilities in terms of security documentation are the same as those in U.S. and Europe) there is sometimes only limited due diligence carried out on Fund constitutional documents and side letters, with a greater emphasis on a Fund's general track record and relationship with the Lender. There was also a view that, given the size and growth of the market, significant and specific Fund Finance experience was thinly spread. Finally (and, in this, Asia Pacific appeared to mirror both U.S. and Europe), there had been notable growth in SMA and other fund of one structures and some growth in the provision of hedging products as a risk management strategy rather than (although this was increasingly requested) as an optimisation strategy.

But while there may be differences in the approach (and while the expertise is perhaps less universal), the awareness and sophistication of those involved in the market (and the deals that are being done) are at least on the same level as (and informed by) the U.S. and European experience.

Perhaps the most significant challenge in the Asia-Pacific market, which was touched on a number of times, was how the product was relevant to the region's most significant economy – China – and it was interesting to hear the challenges (and potential solutions) that were identified here. For "offshore" (*i.e.*, non-Chinese) Lenders, there are issues among others with RMB-denominated loans and with determining the precise structure and make-up of a Fund's Chinese "limited partner" base. For Chinese Lenders (banks), the situation is more challenging still as there is effectively a prohibition under Chinese law on Chinese banks lending to Funds to make investments (so where Chinese banks are involved this has to be and is generally structured around by lending at a different level of the structure). And finally, for all, there was an issue of a Chinese Fund's appetite (or need) for Capital Call/Subscription Facilities. In a number of cases, it appears that Chinese "LPs" will often fund "up front" so the traditional use of these Facilities to bridge or smooth over calls from Investors does not necessarily apply. However, it was clear that all participants felt that these were problems to which solutions could be found and where the potential demand for Fund Finance facilities in general could potentially be extremely high.

All that said, there was considerable optimism at the potential for growth in the market generally in the region, and the comment was rightly made that it is no more valid to treat “Asia Pacific” as one homogeneous region for these Fund Finance Facilities as it is to refer to “Africa” as if it is a single country. It was clear that significant growth has occurred in the Asia-Pacific market even over the last year or two and there was a consensus that this growth would continue. While there are fewer Lenders specialising in the area than currently in Europe, or possibly the U.S., the numbers are growing as are the number of industry experts and advisers who are looking to service that growing market. An interesting aside here is that one member of a panel commented that there may currently be more specialists looking to enter the space than the Asia-Pacific market currently justified, but we suspect that with the huge potential for growth in this market, both in terms of number of deals and product areas which are currently not really touched in the region, this is a very temporary problem. Rapid growth in the Asia fund finance market is and will continue to be driven by a combination of i) local fund sponsors becoming more well-informed about capital call facilities, ii) accelerated growth in fund-raising and fund size due to increasing investor interest in the region in the alternatives asset class, and iii) robust macroeconomic development of the region.

To sum up, this was a great conference, with a real sense that the Fund Finance market here is poised, even with the challenges ahead, for significant growth. To paraphrase the very well-known Chinese saying, we certainly are living in “interesting times” for Fund Finance in Asia Pacific.


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Asia Pacific Fund Finance Symposium

European Secondaries Summit: Key Themes

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At the European Secondaries Summit in London this week, delegates from the secondaries world revealed their views on what is driving growth in the secondaries market, challenges facing the market and key emerging trends.

Here is a download on the event:

- Volume. Across all subsets of the secondaries market, it's clear that volume and size are increasing. Delegates agreed that the $100bn figure we've all been waiting for is likely to hit in the next two years, subject to the impact of a major market correction. There are plenty of opportunities across the spectrum of the market, and the main challenge is human capital to keep up with the variety of options and deals.
- The two buzzwords of the day and clearly the biggest evolution of the market this year: the rise of "Preferred Equity" and "GP-leds":
    - Preferred Equity. It's clear that the pref equity houses are doing phenomenally well and are determined to ensure that one bad trade doesn't bring the industry down. A key focus is ensuring that the deals are "win, win, win" for everyone involved and everyone walks away feeling good about the deal. This is still a small segment of the market but one which is growing extremely rapidly. The pref houses are clearly still plugging a gap, albeit it was acknowledged that some financial institutions are getting very creative and potentially starting to close that gap
    - GP-leds. With echoes of the secondaries market itself, the GP-leds have emerged from being a last resort for struggling GPs to deal with troublesome assets to a standalone subset of the secondaries market providing genuine optionality and liquidity to GPs and LPs. It's clear this product is now being used across all types of situations, and delegates said that all GPs are now looking at this, with the suggestion that we may well see GPs providing for this in their LPAs going forward. The jury is still out on how these deals will perform, but they accounted for over 40% of the market in the first half of the year, so the growth trajectory is phenomenal – fifteen fold in the last five years. Delegates expected that the funnel of outcomes would be very broad. Key concerns from the market were ensuring transparency, managing conflicts properly, giving LPs enough time to consider deals and a feeling that LPs are becoming overwhelmed with requests to consider these transactions with small teams not equipped to make the assessments necessary for a GP-led. LPs are leaning heavily on advisors to educate and guide them through the process. Another challenge was the financing of the GP commitment on GP-leds given the time constraints on GPs raising capital and time lag on the carry. An opportunity for our clients providing GP financing?
- Leverage. It's clear that leverage is no longer the dirty word it once was in secondaries, with many GPs agreeing it forms an important part of their strategy when it comes to secondary trades in their various guises. The GPs in the room that didn't use leverage acknowledged they were losing deals to secondary players using it. Interesting that for the first time this year one LP asked a GP to explain why he wasn't using leverage. GPs noted that finance providers were getting more creative advancing against increasingly more concentrated portfolios, LTVs were rising and pricing generally coming down, particularly for the "vanilla" diversified LP interest deals driving financiers to look to be more innovative. So much so that secondary houses now are hiring both bankers and lawyers with credit experience to enable them to bring this expertise in-house.

Although it remains a relatively small subset of the private markets, secondaries really does seem to involve some of the most creative and innovative solutions to GP/LP liquidity requirements. I'm already looking forward to seeing how the market has developed by this time next year.

To Be Continued: Staying Ahead of Financing Statement Expirations

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In the subscription finance space, the secured party's security interest in the right to make, issue, and enforce capital calls on the borrower's investors and to receive the resulting capital contributions is governed by Article 9 of the Uniform Commercial Code (the "UCC") and is perfected by the filing of a UCC-1 financing statement in the applicable jurisdiction(s).

Pursuant to UCC §9-515, a UCC-1 financing statement is effective for five years after the date of filing, and its effectiveness lapses on the expiration of that five-year period. If a deal is still active and the security interest is still needed at the end of five years, the secured party can file a UCC-3 continuation statement within six months before the expiration date. So, for example, if a UCC-1 financing statement was filed on January 1, 2015, then a continuation statement would need to be filed at some point between July 1, 2019 and December 31, 2019.

Though a lender, as secured party, will typically have its outside counsel prepare and file the original UCC-1 financing statements, it is incumbent on the lender itself to track its outstanding financing statements and be aware of upcoming expiration dates. If an attorney at the outside firm becomes aware that a UCC-1 financing statement is about to expire, it certainly is helpful to alert the lender, but the expectation is that lenders are tracking their own financing statements.

2014 and 2015 were active years in the subscription finance market. Lenders might be well served to take a look through their portfolios at deals that closed in those years to get an idea of what UCC-3 continuations need to be filed. Outside counsel will be happy to prepare and file the UCC-3 continuation statements. The vast majority of credit agreements will contain a negative pledge covenant – which prohibits the borrowers from creating any outside lien on the collateral – so in the event a UCC-1 financing statement does lapse, there should not be another creditor that can take first priority. However, obviously it's best to avoid this scenario entirely by timely filing the UCC-3 continuations.

Real Deals Article on Preferred Equity Structures

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Real Deals published an article earlier this week focusing on preferred equity structures with a case study on the recent EUR105m Palamon/Pomona transaction in Europe, which was supported by leverage from Investec. Attorneys in our London office – Sam Hutchinson, Amrita Maini and George Pelling – advised Investec on the transaction. The article is available **here**.

PitchBook Reports Slower Middle Market Fundraising in 1H 2019

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PitchBook released its quarterly middle market report last week. While deal flow maintained a robust pace in Q2, fundraising is decelerating for middle market funds. We came away with the following takeaways:

- Middle market funds may post a 15% decline in full-year fundraising compared with 2018 if the current pace is sustained, according to PitchBook data.
- First-time sponsors raised three funds in the first half, compared with 19 such appearances in 2018.
- Middle market fund sizes continue to drift higher, with the median middle market buyout fund size reaching a new high of $612.4 million, up from $554.4 million in 2018.
- Large funds of $1.0 billion or more made up 77% of 1H 2019 middle market dollar-weighted fundraising (33% by fund count). Prior to 2018, large funds typically accounted for 60% of yearly capital raising (20% by fund count).
- No middle market restructuring or turnaround funds came to market in the first half.
- Exit activity appeared to slow meaningfully in the first half, which may present a headwind to fundraising in 2020 if the trend is sustained.
- The quarterly report with supporting data is available from PitchBook **here**.

Ropes & Gray Podcast on Fund Subscription Facilities

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Earlier this week, Ropes & Gray released a podcast episode titled “Fund Subscription Facilities: Key Considerations for Limited Partners,” in which asset management partner Isabel Dische and finance partner Patricia Lynch discuss the use of capital call facilities by private investment funds.

Click **here** to listen or read the transcript.

First Republic Bank Article

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Scott Aleali of First Republic Bank published an article on LinkedIn last week, titled "Best Practices for Ensuring GP & LP Alignment When Subscription Credit Facilities Are a Factor."

The article provides an overview of the potential issues that may arise between GPs and LPs when funds use subscription credit facilities (“SCF”) and recommendations for addressing them head-on with transparency and by demonstrating that interests are aligned. Prevalence of SCFs and the length of time that draws remain outstanding have led to LPs having differing opinions on how a GP should utilize a SCF and the Institutional Limited Partners Association (“ILPA”) publishing suggested guidelines regarding SCFs. While ILPA’s guidelines are a useful standard, one size does not fit all and GPs can get in front of potential issues by beginning discussions with LPs about the use of a SCF early in the fundraising process. One potential solution to GP/LP issues related to the use of a SCF is to offer two fund vehicles for LPs – one that uses a SCF and one that doesn’t. However, the article stresses the longer-term problems that could arise from this structure.

The article is available **here**.

On the Move — Fund Finance Tidbits

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On the Move

Stuart McIntosh has joined SMBC Europe. Based in London, Stuart joins from CBA and will be working to further develop SMBC's client coverage of European Private Equity Sponsors focusing on Subscription Financing. SMBC is a global leader in subscription-secured lending to private equity funds investing across multiple asset classes. Globally centralized in New York, SMBC has been originating subscription facilities since 1999.

James Beck recently joined Standard Chartered Bank as an Associate Director on the Loan Syndications team covering fund financing as well as CRE and leverage finance. James is joining from Sumitomo Mitsui Banking Corporation (SMBC), where he covered fund finance syndications, NAV financings and Latin American corporate transactions. He began his career in 2013 at JPMorgan Chase and was hired at SMBC in 2015.

4th Annual Finance Forum to Feature Keynote Address by North Carolina Attorney General

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Our fourth annual Finance Forum at The Ritz-Carlton in Charlotte, North Carolina is just weeks away.

The half-day program, scheduled for Thursday, October 17, begins with a welcome and keynote address at 12:30 p.m. and ends at 5:45 p.m., with a networking cocktail hour to follow.

This year's program will feature a keynote address by North Carolina Attorney General Josh Stein, who will speak about the rising prominence of state AGs in enforcement and how this shifting power dynamic is impacting the financial industry.

We had a record number of nearly 500 attendees last year – all leaders in the real estate finance, financial services, investment management, private equity and legal communities. Speakers will include Cadwalader partners and leading practitioners from across the country.

There is no charge for the Finance Forum, and Cadwalader has arranged for very favorable hotel rates for Forum participants attending from out of town.

Click **here** to register for the Finance Forum.

Contact **Cori Niemann** for general information and hotel reservation information.

Fund Finance Hiring

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Fund Finance Hiring

Standard Chartered is seeking a Director of Fund Finance for its Financial & Strategic Investors Group in New York. For more information or to apply, please click **here**.

The Charlotte office of Cadwalader is seeking an associate for its Fund Finance practice. Qualified candidates will have 3-7 years of experience in syndicated lending, commercial lending, leverage finance, fund formation, CLOs or other relevant experience. Candidates must possess excellent academic credentials and solid law firm or in-house legal experience as well. For more information, reach out to **Wes Misson**.