Cadwalader Hosts Finance Forum

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More than 450 leaders from the financial services, investment management, private equity and legal communities attended Cadwalader's fourth annual Finance Forum yesterday at the Ritz-Carlton in Charlotte.

Josh Stein, the Attorney General of North Carolina, gave the opening remarks. For the fund finance panel, Wes Misson, Tim Hicks and Sam Hutchinson presented a data analysis on the 2019 Cadwalader transaction portfolio. We'll provide the substance of the data snapshot in upcoming editions of *FFF*. Mike Mascia also interviewed Judith Erwin, the founder and CEO of Grasshopper Bank, the first *de novo* bank to obtain New York OCC approval since the financial crisis. Other panels covered the LIBOR transition, middle market corporate lending, key takeaways from Volcker 2.0, the bank credit process, CLOs and the commercial real estate space. Images from the event are below.

Recent Observations

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By Michael Mascia
FFA Board Member

The last several weeks have been very active for the fund finance markets: for me, including a trip to London, the Finance Forum in Charlotte, and the FFA finalizing and announcing its headline speakers for the 2020 Global Symposium. Below are some of my observations.

<u>October Closings</u>**.** October has definitely started closing season. We have had nearly a closing a day so far this month, including a number of deals that dragged their feet through the summer.

<u>Finance Forum Data Presentation</u>. We re-ran our deal data analysis for 2019 year-to-date to present it on an annualized basis at the Finance Forum yesterday. The data surprised me to the positive: our U.S. fund finance practice has annualized 213 closings to date in 2019, up a full 15% from 2018. And we have seen 59 lenders lead or participate in deals agented by banks we represented, up materially from 40 in 2018. Our accrued hours are also up 12% as of year-end. Interestingly, though, the $49.5 billion in annualized lender commitments in deals we have worked on in 2019 is down 15% from 2018. This is a direct result of a reduction in the number of new $1 billion-plus deals closing so far in 2019. We do, however, have a lot of large deals on right now, so I expect that the fourth quarter will have a slightly outsized impact (to the positive) on the three-quarter annualized numbers.

<u>FFA Symposium Speakers</u>. I was extremely happy that the FFA secured Hillary Rodham Clinton as a keynote for the 2020 Global Symposium, not only because of her profile but also because she is a Democrat. Following last year's keynote with Republican Anthony Scaramucci, I thought having a Democrat speak this year was important for balance. I really want the FFA to bring speakers from all backgrounds to ensure diverse and interesting viewpoints.

<u>Debt Advisors</u>. Our London team continues to see debt advisors working to put prospective transactions together in Europe. I saw on LinkedIn that Validus has a job posting in the U.S. for a role that includes fund finance advisory. Following the recent announcement of the formation of Fund Finance Partners, our market is clearly evolving. Speaking of Fund Finance Partners, they published an extensive piece on management fee facilities this week, available **here**.

<u>What It Takes</u>. I finished Steve Schwarzman's book, *What it Takes: Lessons in the Pursuit of Excellence*. I loved it, especially the story behind the founding and initial stages of his firm. This is basically required reading in our industry. The book is available on amazon.com **<u>here</u>**.

<u>Banker Hiring</u>. The market for origination bankers in the U.S. remains active. We continue to receive diligence calls on banks by prospective hires.

<u>London Economic Development Event and Panthers Game</u>. I attended an economic development and trade facilitation meeting in London last week co-hosted by the UK Department of International Trade, the Charlotte Regional Business Alliance and the British-American Business Alliance. David Tepper, founder of Appaloosa Management and owner of the Carolina Panthers, was the keynote speaker. I was impressed with the degree of economic connectivity between the UK and the greater Charlotte region. Tepper is a great new addition to the Carolina business recruiting team. And speaking of the Panthers, a big thank you to the UK for the hospitality hosting the NFL matchup at Tottenham Hotspur Stadium on Sunday. The stadium is sensational, and we Panther fans had a terrific time. Sorry, Tampa Bay.

Chase. And my family got a new puppy. Meet Chase.

ING Singapore in World-First Fund Financing Based on Sustainability Performance

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In the 27th September edition of *FFF* we ran an article reporting on the 3rd Annual Asia-Pacific Fund Finance Symposium. Among other things, the article predicted a very exciting future ahead for the Asia-Pacific market. It has not taken long for that future to become reality!

In a world first, ING's fund financing facility to private equity fund Quadria Capital has its borrowings' interest rate pegged to its sustainability performance – specifically, to a set of ESG (environmental, social and governance) performance targets on its Fund II investee companies and investment portfolio. Those metrics are, in turn, based on key performance indicators provided by B Analytics following the Global Impact Investing Ratings Systems (GIIRS) and further mapped to the Fund's own internal ESG frameworks which follow the United Nations' Principles for Responsible Investment (PRI), then tested using an independent materiality assessment. Performance against the targets is assessed annually and, if pre-determined targets are met, the following year's interest rates will be reduced.

Given the worldwide trends towards sustainable investing and financing, it is great to see funds financing solutions now being brought to bear in this area, and no doubt there will be much more to come.

The deal has been widely reported in the regional and international press (coverage from *PEI* **here** and *The Straits Times* **here**.

Q3 Fundraising Update

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By **Chris van Heerden**
Director | Fund Finance

Fund count up, capital raised down has been the theme for fundraising so far in 2019 based on Q1-Q3 data from *Private Equity International*. 494 funds closed in the first three quarters, up from 368 over the same period in 2018. Capital raised, however, is off by 7.7%, reflecting fewer closings for large funds year-to-date.

PEI's observations foot with our experience. Cadwalader representations measured by deal count in the U.S. is on pace to end the year 15% higher, while aggregate lender commitments in the first three quarters trended below the prior year. *PEI* signaled optimism that a number of large funds may cross the fundraising finish line in Q4.

Law360 separately reviewed the largest fund closing in Q3, highlighting China's growing stature in the private equity industry and the overall continued gravitation of capital to technology strategies.

China Integrated Circuit Industry Investment Fund II represented the largest fund to close during the quarter, raising $29.06 billion. The state-sponsored fund plans to focus on semiconductor development in China. According to the *South China Morning Post*, the fund operates under China's Ministry of Industry and Information Technology and Ministry of Finance.

The top 10 funds raised during the quarter included three technology-focused funds, two Asia-focused funds and two secondaries funds, according to *Law360* data.

PEI's Q3 fundraising report is available **here**; the *Law360* report is available by subscription **here**.

Subscription Finance Loan Agreement Series, Part 10: Considerations, Limits and Exclusions

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An essential part of any facility (many would say, the fundamental part) is the question of what utilisations under the facility are actually going to be utilised for. In facility documentation, this is always addressed in the “purpose” clause, and versions of this clause are common across all types of facilities. Also common are certain caveats or exclusions related to this. In terms of what all facilities have in common in dealing with the facility’s “purpose,” this will in almost all cases be, first, a summary (either in general or more specific terms) of the purpose or purposes for which utilisations under the facility can be employed and, second, a general statement to the effect that while the purpose may be specifically stated, no lender is bound to monitor or verify that the facilities are actually utilised for the stated purpose.

It's probably helpful to deal with the second part of the above first (as this is a feature of any subscription/capital call facility in exactly the same way as it is of other facilities). Lenders will, of course, be extremely interested in the way in which utilisations are applied by their borrowers, for all sorts of good reasons. But the primary intention of this statement is to ensure that the lenders do not themselves incur any liability (or be held in any way to be contributing to) any use of the facilities that does not comply with the purpose or purposes set out. The statement is relatively effective in helping to achieve that objective, but note that Lenders will also look for additional protections around sanctions and other regulatory or other matters relating to the use of the facilities. So this statement alone is not the whole story.

Turning now to the first part, namely, the summary of the purpose or purposes for which the facilities can be utilised. In a subscription/capital call facility, the stated purpose will consist of one or more of the following. First (and this will almost without exception be at least one of the purposes, as it is the fundamental *raison d’etre* of a subscription/capital call facility), utilisations may be applied to fund investments (or follow-on investments) of the fund. Second, utilisations may be applied to pay fees, costs and expenses incurred by the fund as they arise. Often these will include management or similar fees (more on this below). Third, utilisations may be made to pay interest (and perhaps other ongoing expenses) in relation to the facilities themselves. And, finally (often expressed in a more general reference to “other purposes” or to “working capital purposes”), utilisations may be made to fund other purposes (not specifically identified) permitted by the fund documents. Although not always specifically referenced, this may, for example, include collateral or other expenses payable in respect of hedging arrangements entered into by the fund. It’s important to note also that in any “purpose” clause for a subscription/capital call facility, all the stated purposes (whether specific or general) should be required to be compliant with the fund documentation of the borrower.

All of the above, you will be thinking (rightly), will give the fund borrower considerable flexibility in the purposes for which it may use the facilities, and it does. However, there will also be specific uses that are not permitted (even if allowed under the fund documentation). For subscription/capital call facilities, the standard restriction (or prohibition, in some cases) will be on using the facilities to benefit the fund’s investors directly (whether by repaying or paying their subscriptions or otherwise providing loans or other financial benefits to them). There may also be (depending on the terms of the fund documentation) limitations on the amount of or proportion of the facilities that can be utilised for certain specific purposes. For example, payment of management fees is often treated slightly differently in terms of investor commitments in fund documentation to funding investments, and the facilities will reflect that.

A couple of final comments. First, management or similar fees have been mentioned a number of times above, and it is very common to see payment of these being one of the permitted purposes for which subscription/capital call facilities can be used. There are good reasons for these to be included, but lenders should at least consider whether funding management fees in isolation from investments may lead to different impacts on investor commitments. Second, in a subscription/capital call facility, the purposes for which the fund actually utilises the facilities (and, particularly, that the utilisation is in compliance with the fund documentation) is probably even more important than in many other sectors. In most other sectors (particularly where facilities are made available to corporates – for example, for leveraged acquisitions or in the real estate sectors), if the corporate does go outside its stated purposes in utilising the facilities, this will generally leave the lenders’ recourse to any security provided for those facilities intact, and that security (whether over shares in a corporate entity or corporate or real estate assets) will generally remain enforceable. In the subscription/capital call context, however, utilisations outside the purposes authorised by the fund documents can impact adversely on the security, because the security is over investor commitments and those commitments may be less “sure” if the terms of the fund documents have been breached.

So, as with almost everything else we are covering in this series of articles, even where certain terms of facilities seem relatively standard and uncontroversial, there are issues which need to be considered and carefully addressed in the subscription/capital call environment.

Making the Case for a Flat Advance Rate

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Jeff Maier, Managing Director of Private Equity Finance at First Republic Bank, authored an article last week arguing for a flat advance rate as an alternative to the borrowing base formula traditionally used in subscription-backed credit facilities. Jeff gives a brief synopsis of the simplicity of a flat advance rate and explains how its use will typically yield a similar result as an investor-by-investor borrowing base formula. Take a look **here**.

PEI Article on PSERS' Unfunded Commitments

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Private Equity International this week ran a fascinating article on PSERS' private equity unfunded capital commitment exposure. The article reports that PSERS' Chief Investment Officer reported this week on their "subscription line exposure," which constitutes about 11% of their total unfunded commitments of $10.3 billion as of June 30.

This presumably refers to the amounts they know will ultimately be called because the applicable funds have already borrowed the monies. There is also discussion of the ratio of their unfunded capital commitments to unencumbered cash. The subscription-required article is available **here**.

Fund Finance Hiring

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Fund Finance Hiring

Fund Finance Partners is looking to hire an Associate or Analyst for its Charlotte office. For more information, click **here**.

Cadwalader's Charlotte office 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**.

Private Funds CFO Articles on Subscription Facilities

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Private Funds CFO recently ran two articles on subscription lines. The first article, titled "Expert view: Why and how to use capital call bridge facilities," was submitted by guest writers Joe Greenwell of Aztec Group and J.P. Harrop of IQ-EQ. The subscription-required link is available **here**. The second article was titled "Subscription credit lines 'are here to stay'" and covers subscription facilities discussion at the BVCA Summit in London last week. The link is available **here**.

Recommended Reading

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“Ten things to do if you are being sued by LPs”: An overview of the most common grounds for disputes between LPs and GPs and practical advice for GPs navigating claims by LPs: [**Private Funds CFO**]

“Bigger is better: Blackstone pulls in record haul”: Large buy-out shops such as Blackstone continue to benefit from investors refocusing on their relationships with GPs, allocating larger slugs of capital to fewer, larger GPs. [**realdeals**]

“It’s, Like, Lawless”: Private Equity firms are cherry-picking talent from the investment banks. [**Vanity Fair**]