CADWALADER

Managing Risks and Maximizing Leverage – Thinking Outside the Square

February 19, 2021 | Issue No. 114

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There has been considerable discussion in the market over the last 12 months about how lenders can increase liquidity and manage the risks that can arise through over-exposure to a particular sponsor, sector or product.

In this industry discussion, Nathan Parker, a partner in our London fund finance team, considers the options that might be available to lenders from credit insurers by speaking with Rob Lewin and Brad DeLamielleure from the New York office of Tokio Marine HCC.


Rob has joined Tokio Marine HCC in an advisory role in the Guaranty Group, while Brad is a lead underwriter of the Guaranty Group.

FFF: Rob, Brad, thank you for your time today. Let's start by having you give us an overview of the product you offer in the fund finance space.

Rob: Thanks, Nathan. Tokio Marine HCC's guaranty team offers non-payment insurance to financial market participants across the spectrum, including banks, broker-dealers and asset managers. We assume both asset value risk and credit risk of funds and other obligors.

Brad: That's right. We guarantee the payment of principal and, in some cases, interest on a date certain basis. By doing this, we assume negotiated risks from the insured party to create both generic and customised risk solutions for balance sheets, risk management and financial leverage/enhancement. It's also worth mentioning that we work both directly as well as through intermediaries.

FFF: And you offer these products in the fund finance space?

Brad: It's probably helpful to start by talking about what we mean by "fund finance." Within our business we define "fund finance" broadly to encompass any type of risk transfer transaction involving asset managers/owners and their lenders and creditors. In structuring solutions for our clients, we see many of our transactions overlap concepts from both the insurance/reinsurance sector and capital markets. We have been together as a team for over 25 years and, over that time, we have offered every conceivable form of execution for a risk transfer product – insurance, reinsurance, CDS, TRS and other customised derivatives.

Today, more than in the past, we see growth in demand both from asset managers for larger working capital lines and from lenders seeking to digest such high demand. We are also seeing increasing demand for customised solutions to some of the inefficiencies caused by regulatory or risk reform. Another driver of demand is counterparty credit management and diversification – the Tokio Marine HCC balance sheet is strong and counterparties typically have no overlapping credit exposure to the group insurance companies.

FFF: What fund finance products do you support and how do see the insurance being an attractive option for lenders?

Rob: As Brad mentioned, we are active in all corners of fund finance, including NAV and hybrid NAV facilities, co-invests, margin lending (both recourse and non-recourse), receivables monetizations and others (the universe for structured fundings seems to be expanding constantly these days). Clients that purchase insurance from us are generally hedging for regulatory or risk capital reasons, and we also deploy our balance sheet to improve the fundability of challenging asset classes.

In answer to the second part of your question, lenders view Tokio Marine HCC to be an attractive partner as we are not a cash lender and will never become competitive with them. We also bring an appetite for duration that equals or exceeds our lending partners.

On the asset management side, our asset management clients typically work with us to improve the fundability of assets that have limited markets for financing or to hedge bespoke risks they have on their balance sheet. They are able to achieve optimized financing where the strength of our balance sheet allows them to source cheaper capital. Also, we are not a cash buyer of assets, so are viewed to be non-competitive by asset managers as well.

FFF: When you're considering a trade, do you have requirements that need to be met by the underlying financing documentation or structure?

Brad: A key benefit to being part of the Tokio Marine group, in addition to a large and solid balance sheet, is that we execute transactions globally. That said, we see more flow out of the

U.S., the UK and Europe but also transact in Asia, Latin America, Australia and the Middle East.

We generally don't insure over poor transactional diligence or jurisdictional legal deficiencies, so we will require choice of law in established legal jurisdictions (the U.S., EU, UK and former Commonwealth countries are all examples of acceptable jurisdictions).

Depending on the type and nature of the risk transfer, the typical deal size runs between $25mm and $250mm. We execute in larger size on highly risk-remote transactions and also by bringing in our insurance/reinsurance partners. A demonstrable alignment of interest also facilitates larger risk participations.

FFF: Thinking about this more specifically, two of the most common fund finance products are capital call facilities and NAV facilities. Do you have any particular requirements around these?

Rob: In our experience, each deal is different and will present its own challenges. Rather than imposing one-size-fits-all requirements, we work with our ceding partners to align economic interests. We piggyback many of the same underwriting techniques that our lending partners utilize in their own structuring – legal opinions, reps and warranties, positive and negative covenant protection.

FFF: And how does the deal timeline for your transactions tend to play out? Do you need to be there at the start of the transaction or can you come into a deal after it has closed?

Brad: We structure insurance transactions with our partners both during their execution and also after risk is on their books. For bespoke transactions, it will always be better for us to be involved earlier, but we are comfortable underwriting other's processes. We move quickly and have a great deal of discretion over our business. Flow transactions can be approved and executed in a matter of weeks; more highly structured, or those that are large in size or unique in risk, may take a month or two. In either scenario, we work to the schedule of our clients.

We are believers in relationships and find that once a "first transaction" is completed, repeat deals are much easier to agree and the time frame is materially shortened.

FFF: Once the trade is in place, how does this work in terms of practicalities such as reporting and renewal?

Brad: Ongoing reporting feeds into satisfying our risk management requirements and constituents, but this reporting is generally a subset of what the lenders themselves are entitled to from the borrower and so does not place a greater onus on the risk cedent. Our policies typically run for a fixed duration but may have evergreen and revolving periods as a component of their term if that is suitable for the underlying transaction. If material changes occur in the underlying risk, we typically require a consent right to mitigating actions taken by the lender such as waiving a material breach (except for situations where it is practically impermissible for the cedent to give us that right). With that said, we have many policies on our books that renew annually – we've been doing this a long time, so the process runs smoothly in our experience.

FFF: What would you suggest a lender or asset manager do as a next step if they are looking for a way to diversify or minimise their exposures?

Brad: We are seeing interest in the market to access the more flexible platform that an insurance company offers as a risk cedent (as compared to capital markets or syndication solutions). We deal with our clients as principals and are available to discuss and agree changes and new developments to prior risk share programs.

Notionals seem to keep getting bigger, competition more fierce and the time frame for execution shorter. These factors play into our strengths, as we have the ability to deploy large capacity limits, are not competitors to our clients, and our decision process is straightforward.

Rob: That's right. I would add that clients will often fail to recognize that that they can deploy insurance as a risk mitigant. We would both recommend they contact us even where they have not crystallized their thinking – we find in the more structured risk transactions that we play the role of advisor as much as risk counterparty.

For any further questions, feel free to contact ***Rob*** *or* ***Brad****.*