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FUND FINANCE FRIDAY

An E.S.Genius Milestone

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‘Fund Finance Friday: Industry Conversations’ – Bespoke Solutions, D&I and More, with Dadong Yan

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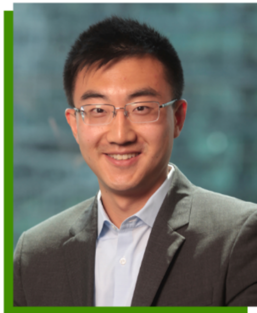
FUND FINANCE FRIDAY
INDUSTRY CONVERSATIONS

Samantha Hutchinson



Dadong Yan

In this episode of *Fund Finance Friday: Industry Conversations*, Cadwalader partner Samantha Hutchinson is joined by MassMutual Portfolio Manager Dadong Yan to discuss trends and opportunities in the fund finance markets and how institutional capital can play an integral part.

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Fund Finance Friday: Industry Conversations

FUND FINANCE FRIDAY | INDUSTRY CONVERSATIONS

Bespoke Solutions, D&I and More, with Dadong Yan

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Managing Risks and Maximizing Leverage – Thinking Outside the Square

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By Nathan Parker
Partner | Fund Finance

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**.*

Cadwalader Advises Bank of America on $4.1 billion ESG-Linked Credit Facility Tied to Board Diversity

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Bank of America, as Administrative Agent and Sole Lead Arranger, working with Cadwalader, successfully closed a $4.1 billion broadly syndicated subscription credit facility to funds managed by The Carlyle Group. Pricing for the three-year revolving facility, the largest U.S. ESG-linked fund finance transaction to date, is tied to progress towards the goal of achieving 30% diverse representation on portfolio company boards within two years of ownership. Carlyle was represented by Latham & Watkins, LLP.

The fund finance market is moving in step with asset managers to respond to the rapidly expanding demand from investors for socially conscious investment alternatives. ESG-linked credit facilities provide funds and lenders the opportunity to advance shared priorities by tying facility pricing to specific sustainability and/or social impact objectives.

“We see a clear runway for growth in ESG fund lending in 2021 for lenders interested in taking a proactive approach,” said Cadwalader partner Wes Misson. “This provides an immense opportunity to shape our market in a socially responsible and impactful way.”

Carlyle issued a press release on the facility available **here**, and *The New York Times* and *Bloomberg* reported on the transaction **here** and **here**.

Fund Finance Association (FFA) Update

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FFA Chairman Jeff Johnston and FFA Secretary Mike Mascia provide an update from the FFA Board on the current state of the FFA and what to look forward to in 2021. Take a look **here**.

Cebile Capital Preferred Equity Panel

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Cebile Capital will host a panel next Wednesday, February 24 at 11 a.m. EST/4 p.m. GMT covering preferred equity for financial sponsors and limited partners. The panel of experts will include, **Fokke Lucas** from **17Capital**, **Scott M. Rosen** from **Ares Management Corporation**, **Vjerana Burleigh** from **AlpInvest Partners** and **Sunaina Sinha** from **Cebile Capital**. Click **here** to register for the webinar.

Arthur Cox (Ireland) Article on Ireland's Investment Limited Partnership

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Arthur Cox published a briefing on the recent reforms to Ireland's Investment Limited Partnership ("ILP") legislation which has resulted in a fit-for-purpose partnership structure being available in Ireland. The article discusses the key features of the recently modernised ILP and how it offers a regulated, tax-transparent structuring solution for private equity, private credit, real asset and other private fund strategies. The ILP falls within the widely used Qualifying Investors Alternative Investment Fund (QIAIF) regime in Ireland and has a number of attractive features, including the ability to avail of the EU marketing passport and to be structured as an umbrella fund. The article is available **here**.

PEI Releases Fund Finance Special Report

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As part of its Fund Finance Special Report, *PEI* has released a series of articles relating to recent developments in the fund finance space. The articles cover a range of topics, from the growth of **ESG-linked subscription lines** to the ongoing expansion of the **concentrated NAV facilities** in the COVID era. In addition, a recent article in the series focuses on the wider market trends which have developed in the wake of the pandemic, noting that increased competition and a rise in product innovation have resulted in higher prices and an **increasingly mature market**.* As a final incentive to encourage our readers to take a look at this report, the series also includes an article featuring Cadwalader partners Samantha Hutchinson and Brian Foster in which they share their views on some of the more bespoke products gaining traction in the fund finance market, including **"PRAV" facilities, preferred equity solutions and continuation financings**. A link to the current articles available in the report is available **here**.

*See this week's additional *FFF* blurb, "PEI on the Maturing Subscription Market," that further comments on this article.

PEI on the Maturing Subscription Market

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The subscription finance market is lined up for a busy year after navigating a challenging 2020, according to a recent write-up in *PEI*. Quoting from a variety of participants well known to *FFF* readers, the article highlights the resilience of fund finance credit performance, as well as the adaptation of funds and lenders to a changed business environment reflected in changes to deal pricing and through the addition of NAV covenants to seasoned deals.

We have to agree on the constructive outlook. In contrast to subscription finance, other assets competing for the bank balance sheet, in many cases, face rising leverage, deteriorating structure and lower returns. We recently came across data showing the first-lien loan market debt-to-EBITDA ratio sitting more than a full turn above its pre-financial crisis peak. In the subscription market, on the other hand, deal pricing, on net, is wider than a year ago and unaffected by the broader market push higher in leverage.

The *PEI* article is available **here.**

ICYMI: Upcoming FFA Next Gen NY Event on LIBOR Transition

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As **noted** in last week's issue of *Fund Finance Friday*, the Fund Finance Association Next Gen's New York team will host a virtual panel, titled *Into the Unknown: A Fund Finance Perspective on "Letting LIBOR Go,"* that will discuss LIBOR transition. The panel will take place on Thursday, February 25 from 10-11 a.m. EST. The event's distinguished panelists will include Jean Lam MacInnes, Executive Director and Counsel at Mizuho Americas; Jeff Nagle, Partner at Cadwalader; and Tess Virmani, Associate General Counsel and Executive Vice President for Public Policy at LSTA. Cassandra Best, Associate at Cadwalader, will moderate. Register **here**.