CADWALADER

FUND FINANCE FRIDAY

A Fantastic Forum

November 4, 2022 | Issue No. 199

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A Big Thank You

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A big thank you to the more than 500 industry leaders who participated in last week's 2022 Cadwalader Finance Forum in Charlotte. And a special acknowledgment to the nearly 50 speakers – both industry experts and Cadwalader attorneys – whose perspectives made the Forum so valuable for all attendees. See our full list of speakers **here**.

Finance Forum Panel Recap – 'Heading Into the Storm: Preparing to Survive and Profit from Turbulence in Finance Markets'

November 4, 2022 | Issue No. 199

By Bryan Barreras
Counsel | Fund Finance

Last week's Cadwalader 2022 Finance Forum included a panel titled "Heading Into the Storm: Preparing to Survive and Profit from Turbulence in Finance Markets," which brought together a panel of industry experts to discuss the current market environment and the opportunities and challenges it presents for finance markets. The panelists included: Scott Bynum, a Managing Director and Portfolio Manager at Mudrick Capital Management; Bryan High, a Managing Director at Barings; James Kim, Head of Distressed Investments at Nuveen; Mike Rupe, a Financial Restructuring partner at Cadwalader whose practice focuses on lender-group representation; and Casey Servais, a Financial Restructuring partner at Cadwalader whose practice focuses on municipal finance and bankruptcy litigation. The panel was moderated by Cadwalader Fund Finance partner Brian Foster.

The rapid growth of many sectors of finance markets since the Global Financial Crisis ("GFC") of 2007-2008, including and especially fund finance − which has seen substantial increases in capital call facilities and, more recently, NAV facilities over the past several years − has created opportunities for new lenders to enter the market and for existing lenders to significantly expand their lending desks. One result of this growth, however, is that a large number of lenders, bankers and lawyers currently in the market have never seen or gone through a downturn, and a primary goal of this panel was to pass on the knowledge of professionals who went through the GFC and other downturns.

The discussion kicked off with the panelists providing anecdotes from their specific experiences during the GFC. These included spending the Sunday before Lehman's collapse negotiating contingent trades (to replace Lehman as counterparty in case Lehman wasn't rescued), to an inability to perform credit analyses because no one knew where asset and securities valuations were headed, to just a sudden slow-down (and, in some cases, a complete stop) of lending activities. The panelists broadly painted a picture of the GFC as a time of great uncertainty. In some cases, the panelists noted, the GFC shaped the direction of their careers, at least in the short term, towards financial restructurings and distressed lending products.

When asked to compare the GFC to the current state of higher interest rates, increasing capital charges facing banks and other challenges facing the market, the panelists described the current market as less disorderly, with lenders having a different playbook available and being willing to use it. The panelists noted that actions that in the past would have been characterized as aggressive are becoming more common, with lenders and lender groups taking advantage of loose loan documentation to provide senior debt and/or obtain access to valuable borrower assets to the disadvantage of other lenders, using drop-down transactions and other tools (though some of these actions have recently been challenged by the displaced lenders in court, with some success).

This has led to changes in the way lenders do business, with lenders balancing where in the capital stack they enter a transaction against the looseness of the loan documents, and focusing more on whether lenders, sponsors and/or companies in the transaction are known to be aggressive. There is also an increased focus on interest coverage and liquidity constraints of borrowers, with the rise in interest rates, and cost of capital to lenders, especially with pensions and other non-bank creditors entering the market. The panelists explained how these new tools have led to an increase in the use of out-of-court restructurings, with bankruptcy only being pursued if there is a tangible benefit (such as getting liens released, dealing with environmental liabilities, rejection of certain contracts, etc.).

The panelists wrapped up by looking forward at the market. Geopolitical risks, in the form of inflation, potential recessions and supply chain issues, among others, create some uncertainty. The panelists expressed a general view that a cycle of valuation downgrades could present an attractive market, but that it may take time for the new normal of higher interest rates and, accordingly, the top of the capital stack taking more value, to sink in. There continues to be a lot of dry powder on the sidelines waiting to enter the market, panelists pointed out, with lenders looking for the right time and opportunity to deploy capital. One panelist may have said it best: "The opportunity set is huge."

Finance Forum Panel Recap – 'NAV'igating the Secondaries Market'

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By Linda Filardi
Counsel | Fund Finance

NAV lending and its progeny garnered great interest at Cadwalader's annual Finance Forum, bringing together industry experts on the cutting age of structuring creative solutions for the ongoing liquidity needs of private fund managers. Joining the panel were Akhil Bansal, Managing Director and Head of Credit Strategic Solutions at Carlyle; Robert Camacho, Senior Managing Director at Blackstone; Phillip Titolo, Head of Direct Private Investments at MassMutual; and Michael Vasseghi, Managing Director and Head of Insurance Solutions at Morgan Stanley. Cadwalader Fund Finance partner Angie Batterson served as moderator.

The so-called net asset value ("NAV") credit facilities took center stage as the theme of the panel, familiarly known as financing that "looks down" from the fund level to the net asset value of the underlying portfolio of investments in determining borrower availability for credit purposes. NAV facilities are particularly useful for mature funds in which investors have already funded a majority of their capital commitments (often utilizing a subscription facility that "looks up") and the fund has deployed this equity into a portfolio of investments.

Insurance companies are no strange bedfellows to NAV lending, having spent the last five years providing liquidity solutions to investment managers and their private funds. Insurance companies' appetite for investment grade risk at above market spreads, coupled with their experience in investing at the LP level based on their knowledge and expertise in underwriting managers, uniquely positions them with the requisite expertise to lend to private fund managers with more customized solutions than a traditional bank loan product. Insurance companies access these fund financings in two main legal forms: a bilateral bank loan type facility or through a true securitization format, both of which are assigned ratings by one of more of the rating agencies. The rating is based on the expertise and the track record of the manager and the process applied when selecting and monitoring investments. The application of this technology has also been applied to support the financing of a pool of limited partnership (or other) interests in investment funds.

These structures incentivize a broader set of investors (including regulated institutions) to participate indirectly in the investment strategy of the investment fund with enhanced returns. Titolo pointed out that insurance companies understand how to underwrite LP investments, as they are typically LPs themselves in other private funds. Titolo added that these lending transactions require a team experienced in both fund underwriting and private debt structuring, not an easy task in today's market. Looking at more challenging economic markets ahead, the panelists noted that their strategy would be to focus on the GPs that they know best and with whom they have worked and underwritten already on NAV financings. The panelists predicted that a broader range of alternative investors would be amassing investment teams to enter this space over the next few years and that these investments can be tailored to a bilateral execution as well as a multi-lender club. Should market values of the portfolios decrease, the unique aspect of NAV financing is the embedded lender protections that accelerate amortization if certain LTV ratios are not met.

Panelists see this trend of non-bank lenders entering the space as an extension of traditional “private placement” debt, broader bank disintermediation and alternative asset manager’s need for fund finance solutions. In this environment, where borrower leverage can be difficult to obtain and the capital markets are challenging, sponsors are increasingly looking at financing solutions at the fund level. Vasseghi noted Morgan Stanley’s involvement in the fund finance market is both as an on-balance sheet lender as well as a lead structuring agent. He sees that each of these transactions tends to be bespoke, but are becoming more mainstream, as he has seen over 40 insurance companies participate in the fund finance space in some form over the past several years, with more inquiring each quarter. The panelists uniformly agreed that creative structures are particularly attractive when the asset-backed lending markets are suffering from margin compression. When regular way financing playbooks become challenged, keep an eye out for the incoming innovation leaders.

For more information on the key issues and considerations in PBNs and Rated Feeders, review our recent **presentation**.

Finance Forum Panel Recap – ‘Behind the Numbers: The 2022 Fund Finance Market’

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By Jason Hessel
Associate | Fund Finance

At last week’s Finance Forum, panelists Bryan Kearns, Managing Director at Bank of America, and Michele Simons, Managing Director at Wells Fargo, discussed the 2022 Fund Finance Market in a panel hosted by Cadwalader’s Tim Hicks and Leah Edelboim. The aim of the panel was to dive into an analysis of Cadwalader’s raw data from its 2022 transactions, with these leading industry experts weighing in on trends and providing their insights and outlooks for 2023.

The discussion kicked off with the panelists discussing the 2022 fund finance market, and the theme of the panel quickly came to light: *the fund finance market remains active and record-setting*, even in a year of uncertainty in the economy. Early 2022 brought the emergence of the “Mega-Fund Movement,” with seven mega-funds raising over $100 billion in commitments in the first half of 2022 alone. In fact, estimated fundraising is expected to surpass $1.3 trillion for 2022. With the average syndicated facility in 2022 amassing over $1 billion in lender commitments, the conversation shifted to the growing demand for capital, which the panelists all believe has helped additional players enter the space. Although the large-caps still represent over 81% of the source of capital, the emergence of the “Mighty Mid-Caps” became a theme in 2022 as mid-cap lenders excelled at generating loan growth, with subscription lending playing a large role. The panelists noted that middle-market players were very useful in meeting growing capital demand this year, especially as many lender balance sheets reached their limits.

The panelists also marveled at the growth of creativity in their respective fund finance transactions. Between NAV and hybrid facilities, SMAs, rated note feeders, and the use of insurance lenders and private credit funds – the panelists saw a spike in every possible innovative fund structure and practice, bringing sponsors additional sources of liquidity and securitization.

As for pricing (a hot topic which certainly drew the interest of the standing-room only crowd), while deal pricing drifted tighter in late 2021, pricing was relatively stable throughout Q1-Q3 of 2022. Spread adjustments that veered off of the ARRC (most notably, 10-15-25 bps for 1-, 3- and 6-month SOFR respectively) gained traction in 2022, and the panelists all agreed that it is a trend to bake SOFR spread adjustments into the applicable margin. The panelists also noted a recent rise in commitment and unused fees, and recognized the widening in margins for in-process transactions as available capital shrinks. Further, the Cadwalader data (and recollection of the panelists) highlighted the decreasing frequency of deals with three- and six-month tenors; in fact, they couldn't recall many at all as of late, as sponsors and lenders are unwilling to take on the risk of gambling on interest rates.

Lastly, the panelists wrapped up their discussion with their predictions for 2023, which could be characterized, consistent with our lender survey (**here**), as cautiously optimistic with growth still expected next year. While strong forecasts for 2023 fundraising appear to offset current trends of decelerating deal volume and exit values, the panelists still expect bank balance sheet availability in 2023 to cause lenders to be more selective, which may affect credit availability, facility sizes and pricing (cue the Mighty Mid-Caps). Banks have demonstrated that they can grow loans even as deposits decline and total balance sheet assets shrink, and the panelists expect to see an increase in banks repositioning their balance sheets by substituting deposit funding with other sources in 2023.

The panel discussion evidenced the strength of the fund finance product and the room for growth in the years to come. The panelists were optimistic in the creativity of liquidity-driving innovations and the emergence of new lenders and sources of capital to meet growing demand. Even with an opaque outlook into the future, steady demand remains. Many left the room excited for what may come in 2023.

FFF Sovereign Immunity Series – Part II

November 4, 2022 | Issue No. 199

By Leah Edelboim
Special Counsel | Fund Finance

By Spencer Davies
Associate | Fund Finance

Today we release the second installment of our Sovereign Immunity Series. In this installment, continuing with our alphabetical order format, we provide a high-level overview of the sovereign immunity laws of Colorado, Connecticut, Delaware, Florida and Georgia.

As we have mentioned previously, this is a complicated legal issue. Here is a link to the first installment of this series, which gives a good background on sovereign immunity and provides links to previous *Fund Finance Friday* articles on the subject. As a reminder, sovereign immunity refers to the doctrine that renders a sovereign or state immune from civil suits or criminal prosecution. In short, the government cannot be sued without its consent. Although sovereign immunity was adopted in the United States Constitution pursuant to the Eleventh Amendment, the extent to which it has been codified into law – and the exceptions to those laws – varies from state to state, which is why our coverage of the issue is broken down by state.

Issues with sovereign immunity most commonly arise in fund finance deals in the context of limited partners that are government entities, such as state pension funds. These investors often reserve their sovereign immunity in a side letter, but there is further nuance because applicable laws and certain principles of equity must be analyzed to determine whether the particular entity is actually immune from suit.

Again, we want to stress that these issues can be quite nuanced and vary deal to deal. It is therefore important to consult counsel when these issues arise in a deal because the information herein is only a summary. A deeper analysis is warranted when evaluating a particular investor.

COLORADO

Colorado has generally waived its contractual sovereign immunity, except in contract claims for “injury which lie in tort or could lie in tort.” In such claims, the Colorado Government Immunity Act (the “CGIA”) bars plaintiffs from bringing contract claims against state entities. Colorado courts consider contract claims to “lie in tort” if: (i) the alleged injury arises out of tortious conduct or a breach of a duty recognized in tort, and (ii) the requested relief compensates that injury. For example, if a state pension fund induced contract formation via fraud or the negligent misrepresentation of a material fact, then the contract claim would “lie in tort.” In these examples, (i) the plaintiff's injury was caused by the fund's tortious conduct (*i.e.*, fraud or negligent misrepresentation) and (ii) the remedy (likely contract rescission) would compensate the plaintiff for that tort-based injury. In these cases, the CGIA would bar a plaintiff from bringing a contract claim against a state entity.

Alternatively, if a claim arises solely from the contract itself, then the CGIA will not apply. For example, Colorado courts have determined that claims for promissory estoppel – claims requesting performance of an invalid contract – are not covered by the CGIA. The distinction here is that promissory estoppel claims arise from injuries caused by invalid contract formation (*e.g.*, absent consideration), not tortious conduct. Without satisfying the first prong of the test, the CGIA does not apply, and courts consider the state to have waived sovereign immunity.

In cases where the nature of the injury and the requested relief implicate both contract law and tort law, Colorado courts employ the "economic loss rule." Pursuant to this rule, a claimant suffering purely economic loss (*i.e.*, damages other than physical harm to persons or property) from a breach of contract cannot assert a claim that "lies in tort" unless the defendant owed an independent duty of care implicated by tort law. If the contract expressly states the duty of care owed by the defendant, then the CGIA does not bar a contract claim against a state entity because the duty is not independent of the contract.

CONNECTICUT

Connecticut has not waived contractual sovereign immunity. Article 11, Section 4 of the Connecticut Constitution states that "[c]laims against the state shall be resolved in such manner as provided by law." Similar to the sovereign immunity laws of Alabama and Arkansas, which were previously covered here, Sections 4-141 through 4-165(c) of the Connecticut General Statutes provide an administrative mechanism through which a claimant may bring a contract claim against the state.

First, a claimant must file a notice with the Office of the Claims Commissioner, a quasi-judicial agency tasked with hearing and determining most claims levied against state entities. The notice must be filed within one year of the alleged injury, and it must include a short statement explaining the basis of the claim, the recovery amount requested and a request for permission to sue the state. Second, the Claims Commissioner will hold a hearing to determine whether to dismiss or deny the claim, to order immediate payment of a claim requesting $35,000 or less in damages, to recommend to the General Assembly that payment be made for damages in excess of $35,000 or to authorize the claimant to sue the state. Authorization to sue the state is granted when the Claims Commissioner "deems it just and equitable" and finds, in his or her opinion, that the claim "presents an issue of law or fact under which the state, were it a private citizen, could be liable." Lastly, the Connecticut General Assembly will ratify or vacate the Claims Commissioner's ruling.

DELAWARE

Delaware waives sovereign immunity when the contract is authorized by the state's General Assembly. Case law in Delaware indicates that when the legislature authorizes the state to enter into a contract, the state implicitly waives sovereign immunity for a breach of that contract.

In the context of a fund finance transaction as it relates to sovereign immunity in Delaware, when it comes to a state pension fund, Delaware statute authorizes the Board of Pension Trustees to maintain and invest these funds. To that end, the statue permits the Board to enter into contracts in furtherance of these duties, which would relate to investing or advising as to the investments. Given this authorization, it would be expected that an action to enforce one of these contracts may be maintained.

FLORIDA

Florida has waived its contractual sovereign immunity in certain situations. Article X, Section 13 of the Florida Constitution provides that there are circumstances where parties may bring suits against the state. To that end, case law in Florida has clarified that this sovereign immunity waiver applies to contracts that the state is authorized to enter into. Specifically, one court noted that “[w]here the legislature has, by general law, authorized entities of the state to enter into contract or to undertake those activities which, as a matter of practicality, require entering into a contract, the legislature has clearly intended that such contracts be valid and binding on both parties.” Where the state has properly entered into a contract authorized by the powers granted by general statutory law, the defense of sovereign immunity will not protect the state from action arising from the state's breach of that contract.

In terms of fund finance transactions, Florida's statute tasks the State Board of Administration with investing funds of state agencies, state colleges and universities and units of local governments. Provided that investments meet certain parameters, the contract pertaining to such investments will be expected to be one that can be enforced against the state.

GEORGIA

Georgia has waived its contractual sovereign immunity through statute. Pursuant to Article I, Section 2 of the Georgia Constitution, the state waives its defense of sovereign immunity for claims constituting a breach of a written contract. We note that there is case law that puts the burden of proof on the party seeking to benefit from the waiver.

Conclusion

In the next installment of our Sovereign Immunity Series, we will discuss the sovereign immunity status of Hawaii, Idaho, Illinois, Indiana and Iowa.

Cayman De-Listings Update – Close But No (Grey List) Cigar!

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By Derek Stenson
Partner | Conyers

By Michael O'Connor
Partner | Conyers

Observers of the FATF and EU's many lists will be aware that Cayman currently sits on the FATF "Grey List" in respect of increased monitoring for AML and, as a direct result of this, the EU "Black List" for AML purposes (which mimics any FATF greylisting).

While neither of these lists has any material relevance in the fund finance world, it's never nice to be included on one due to the connotations that they carry. The listings are particularly unfair to Cayman − a jurisdiction that serves almost entirely institutional-level investors and has been making tireless and constant efforts over the past decade to meet all international requests. So it had been hoped that Cayman would be removed from the FATF Grey List in October 2022 and the EU AML list thereafter.

While it has been acknowledged by all parties that Cayman has now met 62 of the 63 recommendations of FATF in this regard, Cayman was not removed from the FATF Grey List at October's FATF meeting, and so will not be in a position to be removed from the corresponding EU AML list for now either. The main reason for this appears to be that FATF would like to see more progress on AML prosecutions in Cayman.

The current indications are that it will take some time for Cayman to meet this final hurdle (mid-2023 at the earliest) but, for now, Cayman remains on both lists, and we continue to watch this space.

Pricing and Pressures of the Sub Line Market

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Even amongst a battle of supply and demand between GPs and the banks, subscription lines of credit remain resilient. While investment activity is relatively slower than seen in 2021, the capital call process is healthy, nonetheless, with activity growing past double-digits in Q2. Read more **here** about how the sub line market is proving “to be a reliable source of liquidity during good times and bad.”

Fund Fanatics Episode with Rafay Farooqui

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In this week's Fund Fanatics episode, hosts Scott Aleali and Jeff Maier speak with Rafay Farooqui, Co-Founder of CAIS and Founder & CEO of +SUBSCRIBE, and one of the first movers in the democratization of alternative assets. They discus forward-looking trends of the asset class, bold points of view about LP asset allocations, advice for others thinking about starting a firm or company supporting the private markets and more. Tune in **here**.

FFP Wins Private Equity Wire's Award for Best U.S. Fund Financing Solution

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Fund Finance Partners has been named *Private Equity Wire's "*Best U.S. Fund Financing Solution," as part of its 2022 U.S. Awards that recognize excellence among private equity fund managers and service providers in the U.S. Learn more about the recognition **here**.

Cadwalader's Girls in Finance Workshop Gathers NYC Students and Women Financial Professionals

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Cadwalader hosted its 6th Annual Girls in Finance Workshop for dozens of New York City high school girls at the firm's New York office earlier this week. Inspired by the “Girls Who Code” movement, the program is designed for student participants to gain hands-on exposure to elementary finance and investment concepts from women clients who are financial services professionals, along with Cadwalader women attorneys, all of whom helped lead the various exercises.

Cadwalader, as a major law firm with a heavy focus on financial services, saw an opportunity to help develop diverse talent pipelines in our local communities for careers in the vital legal and financial services sectors. In addition to the NYC event, the firm also hosts Girls in Finance workshops at our Charlotte, North Carolina office.

The two-hour afternoon session in NYC featured a range of exercises for the students, including an interactive Budgeting, Saving, and Investing quiz (facilitated through a mobile phone voting app); small-group networking activities that encouraged interaction among the students and women leaders situated at each table, with a focus on their career trajectories and life choices; a stock purchasing game; and an introduction to “Goalsetter,” an interactive finance app that is designed to educate children on saving, budgeting and investing through games, memes, and pop culture.

The dynamic afternoon concluded with a Q&A and pizza party social for the students and an on-site reception for the professionals. Many of our Fund Finance clients attended the event as panelists and table hosts, and enjoyed the drinks reception afterwards. Following two years of COVID-induced Zoom events, it was exciting to welcome many of these clients back after their prior years of attending and contributing to this signature event.

In the past five years since Cadwalader launched the Girls in Finance workshop, more than 350 high school girls in NYC and Charlotte have participated, creating meaningful impact for all involved: the girls leave with solid learnings and some new role models; the female professionals engage in fulfilling mentoring; and administrators from the participating high schools receive key takeaways and insights about their students.

(from left to right) Mary-Carter Stewart and Leah Edelboim (Cadwalader),
Bree Mitchell (National Australia Bank) and Laurie Lawler (Société Générale)

(from left to right) Leah Edelboim (Cadwalader), Jessica Richmond and Colleen Austin (Wells Fargo),
Mary-Carter Stewart (Cadwalader) at post-event Cadwalader reception

Katie McShane (Cadwalader) with Natasha Puri (Lloyds Bank)

Edelboim, Mitchell and Lawler engage with students during the workshop