CADWALADER

Happy FFFourth!

June 30, 2023

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Have a Fantastic Fourth

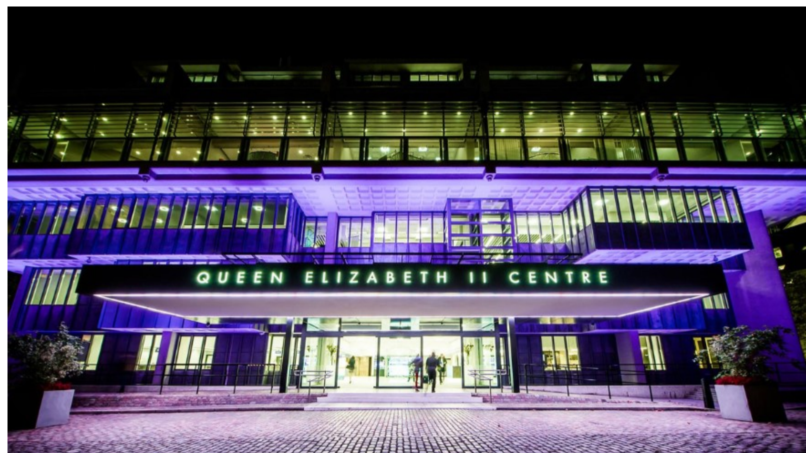
June 30, 2023

Whether it's a trip to the beach or dip in the pool, a bike ride or hike, or a barbecue with family and friends, we hope everyone in the U.S. has fun plans for the Fourth of July Weekend and a celebration of Independence Day on Tuesday.

Happy 247th birthday to America!

FFA European Fund Finance Symposium Review, Part 2

June 30, 2023



We reported in **last week's edition** of *Fund Finance Friday* on some of the significant themes and topics at the FFA 7th Annual European Fund Finance Symposium.

Given the breadth and depth of panel sessions and conversations, we could not do the Symposium justice by attempting to include all of our key take-aways in one article, and so we continue our summary below.

As always, many thanks to the FFA and all of the event's sponsors and panellists for putting together such a topical and informative agenda, and creating a great opportunity to spend time with friends, colleagues and clients.

Key Themes We Heard at the Conference (Part 2):

Increased Use of NAV Lines

It was widely reported at the conference that the market is seeing increased use of NAV facilities as a solution to current liquidity constraints, with some funds now turning to NAV facilities at an earlier stage in their life, including in circumstances where the fund had exhausted its subline facility capacity. An increasing number of banks and non-bank lenders are expressing an interest in participating in NAV facilities, but there was a reported concern for sponsors around potential execution risk when dealing with new entrants to the market.

One panel discussed that funds are beginning to turn to NAV facilities as an alternative to leverage financing at the asset level. It was discussed that where NAV facilities are being used for the purpose of acquisition finance or for follow-on investments or to cure covenant breaches at the portfolio level, execution risk is a key concern for funds, and concepts more typically associated with the leverage finance market, including certain funds, commitment letters and first/second lien financing, are now starting to make their way into NAV financing structures.

Perhaps unsurprisingly there was also a discussion around the risk of financial covenant breach being high on the agenda with NAV facilities, owing to investment performance in recent years and current valuations. (It was remarked that the commercial real estate market was particularly affected.)

The overriding message was that the NAV space is expected to continue to grow, with the flexibility afforded by these deals making them a key addition to the toolkit, particularly at a time when assets are being held for longer and fund terms are being pushed out.

Liquidity

As mentioned last week, one of the key topics of conversation at the Symposium was the increasing demand and decreasing supply of debt solutions in the market (especially in the subscription line financing market).

There was a wide discussion around some of the options available to lenders to help alleviate the drag on balance sheets caused by risk weighting of assets.

As you might expect, one of the main points of discussion around liquidity was the potential benefits of obtaining credit ratings on subscription line facilities, both from a risk weighting perspective and the possible positive impact that it would have by allowing non-bank lenders (including insurance companies) to participate in subscription line facilities as a lender. Others recognised that non-bank lenders will have an increasingly important role to play in the fund finance ecosystem.

Another discussion point around liquidity was the increasing appeal that risk transfer has for traditional bank lenders. It was commented that some providers were able to guarantee certain fund finance deals on an unfunded basis, allowing the incumbent bank to deleverage risk on a deal and help relieve capital constraints. It was also noted that the benefit of this approach is likely to be greater for the European market compared with the U.S. market (where the impact of unfunded risk guarantees on a bank's capital position are reportedly more muted). Risk transfer on a funded basis was also discussed, with commentary that this is expected to provide a much greater capital relief benefit to bank lenders than unfunded risk transfers.

Innovation and New Structures

A common theme of the Symposium (which mirrored topics from the Global Symposium in Miami) was the continued evolution in the types and structures of products seen in the market in order to address specific sponsor or lender needs.

Some of these structures (including preferred equity solutions and the increasing prominence of NAV facilities) have been well reported on in the market and continue to attract attention from market participants.

It was noted that the changing regulatory landscape in Europe (including EU Securitisation Regulation) and the U.S. (including the National Association of Insurance Commissioners) require constant evaluation of how existing structures and future structures may be subject to new regulations.

Further, in line with the main topic of greater supply-side liquidity, there was an interesting discussion around how traditional structures may be adapted to help widen access to other market participants (such as insurance companies) who require highly diversified pools of collateral and/or debt to be drawn for a particular period of time. It was also observed that credit rating agencies may have a role in furthering this.

Non-Bank Lenders

There were interesting discussions around non-bank lenders, who have been in and around the subscription market for quite some time. It was remarked that there is often a misconception that their preference is for small ticket, single currency, term lends, but these misconceptions are wide of the mark and the reality is that non-bank lenders have evolved to become relevant across a wide spectrum of products. On the NAV side, particularly concentrated NAV trades, it has been a matter of creation rather than evolution in a space that did not exist in a meaningful way until a few years ago.

Panels discussed that educating the market in how to deploy institutional capital into a bank-led RCF market, predominantly on the subscription side, is the key challenge faced by non-bank lenders. It was commented that in a market looking for additional supply (on the subscription side at least), creating a more homogenised structure for non-bank lender participation is paramount.

Another panellist commented that to date, non-bank lender teams have been small enough to allow sponsors to have a single point of contact who knows the intricacies of what their investors can do. As the space grows, both by way of club deals and the emergence of new players, there is a potential to lose some of that intimacy, which could present an opportunity for agency service providers.

The sense was that while non-bank lenders are not always the answer to the liquidity challenge, what they can offer is definitely a positive for sponsors.

Concentrated Collateral in NAV

A “concentrated” NAV trade was described as a transaction involving fewer than five assets, with more than 10 being “diversified” and anything in the middle being dependent on individual lender appetite. It was commented that these concentrated deals have accelerated rapidly over the last three years and that the result of that recent growth is a product that is more widely understood and accepted by GPs, and (for the leading participants) it has created a bank of large precedent transactions that people are comfortable with as a basis for future deals.

It was also commented that whereas historically it was only a small number of sponsors who entertained the idea of a fund-level asset-backed financing, that number is growing at a speed such that these facilities are moving up the agenda in GP/LP discussions and being factored into LPAs to allow funds more choice in their access to leverage.

It was observed that while sponsors clearly appreciate that NAV-backed lending (especially where a pref structure is used) comes at a premium to subscription finance, a lot of the structural questions have been answered by the chain of recent transactions.

On one panel it was remarked that concentrated portfolio deals are clearly even more relevant in the current environment, and, while they remain largely relationship products, lenders are increasingly finding themselves in beauty pageants based on sponsors wanting to broaden their lender base, which is not surprising given the recent turmoil in the banking market.

Lender Insolvency Risk

Recent events have brought Defaulting Lender and Impaired Agent provisions into sharp relief and, in particular, illustrated the implications for both funds and lenders facing distressed/defaulting account banks, lenders and agents.

It was outlined that under LMA documentation, re-drafted in response to the GFC, the "Defaulting Lender" definition will capture any lender which fails to make any payment when due, any lender which has repudiated or rescinded any Finance Document and any lender which is the subject of an Insolvency Event (which will include the exercise of any of the stabilisation powers under the Banking Act). It was also noted that the Impaired Agent regime will categorise any Agent which is unable to make payments when due or which is a Defaulting Lender as an Impaired Agent.

By way of background it was also explained that amendments introduced following the global financial crisis were designed to prevent a borrower facing an immediate funding shortfall as a result of the issues affecting a single lender, including:

- the ability to term out a Defaulting Lender, so that there would be no periodic right to repayment;
- the disapplication of the commitment fee, as the lender is unable/unwilling to fund its Commitments;
- a right to repay or replace the Defaulting Lender on a non pro-rata basis;
- the disenfranchisement of the Defaulting Lender, at a minimum in respect of its undrawn amounts; and
- the ability to bypass an Impaired Agent in respect of any payments and/or force them to resign.

There was an interesting discussion around the fact that the above provisions were designed primarily to protect the borrower, and it may be necessary to expand on this regime in order to also protect other Finance Parties. By way of example, one panel highlighted that a lender which complies with a payment requirement by 11:59 p.m. on the due date for payment will still count as complying, even though an Agent will clearly not be able to pass on the payment. There is also the practical issue of availability of Impaired Agent signatories to execute the documents required to transfer its roles to a replacement agent or security agent.

The Rest of 2023 and Beyond

It was observed that for many lenders, the near future involves a flight to quality, and the question all lenders will be asking themselves is which GPs, funds and assets are best to support and why. Lenders noted that, in order to succeed in the current market, lenders need to understand their GP clients and what financing solutions they require – a strong relationship is key.

It was also observed that the same can be said for GPs, and it is also a fairly common part of the fundraising process that many LPs will ask about the strength of the GPs' relationship with existing/proposed lenders. Pricing aside, additional considerations now at the forefront of GPs' minds include the question of whether a lender will remain willing to participate for the expected life of the facility.

Symposium discussions highlighted a number of expectations for the future of the fund finance market, including more open-ended funds taking out subscription facilities, an increase in non-bank lenders, greater adoption of term loans to accommodate non-bank lenders, ratings becoming a key risk mitigant, the development of ESG in Fund Finance, and an increase in hybrid and tailor-made financing solutions which will involve more complex structuring and greater interaction between various desks within the same bank.

It is a tougher market out there at the moment, but many Symposium delegates tended to agree that lenders who have a strong balance sheet, strong relationships and strong client lists can look forward to growth in the future.

(This article is intended as a general recap of the various panels at the 7th Annual European Fund Finance Symposium. The views expressed do not necessarily represent the views of Cadwalader and our Fund Finance team.)

A LIBOR Commencement Speech

June 30, 2023

By Lary Stromfeld
Partner | Financial Services

The London Interbank Offered Rate (LIBOR) will stop being published on the basis of panel bank quotes and will be replaced by alternative replacement rates after today. In the spirit of the season, below is the commencement speech I would imagine giving.

LIBOR Commencement Speech
delivered by Lary Stromfeld on June 30, 2023

Ladies and Gentlemen, distinguished guests, ARRC members and, most importantly, the remarkable graduates of LIBOR.

Today we celebrate the culmination of your years of hard work, dedication, and the relentless pursuit of a bright future. You stand before us as the trailblazers, the pioneers, the vanguards of change. Your extraordinary efforts, expertise and unwavering commitment to excellence have shaped the evolution of an industry.

The story of LIBOR transition is not just one of numbers and rates; it is a testament to the power of cooperation, ingenuity, and resilience. But today, as we stand on the precipice of change, we must acknowledge that progress requires adaptation. The transition from LIBOR signifies the beginning of a new era, one that demands your continued leadership and vigilance. It is a call to action, a reminder that the skills you have honed over these several years will shape the future of global financial markets.

As we bid farewell to LIBOR, let us also bid farewell to the limitations of the past. Embrace this moment as a chance to reshape financial benchmarks for generations to come. The world awaits your brilliance.

May your journey be filled with personal fulfillment, professional success, robust fallbacks, and deep liquid markets.

Fund Finance Hiring

June 30, 2023

Fund Finance Hiring

M&T Bank is hiring a Relationship Manager for Fund Finance to be based in New York. Candidates should contact **Michael Sinclair** for additional information.