Fund Finance Market Update, ESG and Macro Developments[1]

By Brent Shultz and Eric Worthington

The "Fund Finance Market Update, ESG and Macro Developments" panel discussed a large range of topics relevant to current fund finance market trends, including pricing, alternative financings, credit utilization, ESG, and new market participants. Several key takeaways from the panel are below:

- **Pricing/Tenor Changes**: After Covid's introduction, subscription line pricing initially spiked but then settled back down in a range that was still slightly higher than pre-Covid pricing. In the last year, due to the dramatic growth of the industry and increased regulatory capital requirements, banks' subscription finance balance sheets have received heightened scrutiny, resulting in banks tightening their allocation of capital to the subscription product and spreads increasing to higher levels, with some increases to upfront fees as well. Subscription lines with 364-day tenors have grown in popularity as they require less regulatory capital reserves than facilities with tenors of 365 days or longer.

- **Alternative Financings**: Non-subscription line fund financing products are growing in popularity, including drop-down financings for special purpose vehicles. The CLO market has also seen increased pricing and, as such, increased activity as these products are becoming more attractive to banks. Finally, the proliferation of NAV financings has seen that product continue to develop, moving from the main credit support being investor interests/commitments and instead seeing more targeted collateral of the underlying collateral of the funds. The panelists anticipated that the NAV market will continue to grow and become more normalized, similar to the subscription line market over the past few decades.

- **Utilization**: Although some alternative lenders in private credit and BDC structures are claiming heavy deal flow at the moment, banks are generally seeing a meaningful decrease in subscription line utilization. Additionally, offshore activity has seen a drop-off, particularly with innovative products such as NAV facilities, and generally has indicated a more conservative market than last year.

- **ESG**: ESG initiatives have staying power. Certain large sponsors look at every investment from an ESG perspective because ESG should be a business principle outside of getting better pricing on financings. Some panelists purport that social responsibility is good business and results in better returns for investors. There are still concerns of "greenwashing" funds solely for the purpose of getting better facility pricing and it is important for lenders to manage that risk. This can mainly be done through the hiring of sustainability coordinators to work with business teams to set KPIs that are challenging and meaningful. While ESG has become much more commonplace in the US, it is still relatively behind Europe in making this framework standard in facilities. The prevailing theory for US lenders is smaller banks will follow the framework established by the largest banks, but larger banks are still hesitant to implement ESG structures without more regulatory guidance. Finally, from a Cayman perspective, ESG is still in its infancy with the framework being established.

[1] The panel was moderated by William Wallace, Managing Director at SMBC, with panelists Pallo Blum-Tucker, Managing Director at State Street Bank, Georgina Pullinger, Partner at Appleby, Patricia Teixeira, Counsel at Ropes & Gray, Samina Sajanlal, Managing Director at CIBC Capital Markets and Derek Dillon, Managing Director at Apollo.

- **Other Market Trends**: From a macro perspective, the fund finance market (and the subscription line product) is seeing more non-bank lenders entering the space (*e.g.*, insurance companies and private credit funds) due to the preferable ROI to investment grade lending even though the risk is similar; these non-traditional lenders are also seeing an increase in alternative fund finance products and structures, including: securitization of subscription lines, the proliferation of rated note feeders, collateralized fund obligations, and an increase in general partner financings.

© 2023 Haynes and Boone, LLP