**Fund Manager Developments**[1]

By Robin Ladd, Karina Oshunkentan and Courtney Smith

The panelists provided mixed reports on the current fundraising climate: while fundraising for some flagship funds has seen an uptick due to a diversified pool of investors, other funds have seen a more challenging fundraising period in recent months. As investors have searched for yield, there has been a turn toward private credit to supplement their portfolios. Additionally, the "Denominator Effect" may be causing a slowdown in fundraising as certain investors and asset managers find themselves over-allocated to specific assets. However, sponsors have been able to mitigate the Denominator Effect through the use of mezzanine funds and entry into the business development company space or, in some cases, rebalancing to target allocation levels by selling certain portfolio assets.

For lenders, the push by sponsors to mitigate the Denominator Effect has led to more transactions to rebalance allocation levels and a more robust market for secondary transactions. The use of general partner-led secondaries and continuation funds is a significant part of the fund practice, but it is getting some pushback from some investors who prefer to take advantage of the timing and traditional exit on funds. Many institutional investors are decreasing the number of managers they are investing with or the amount they are investing in each fund. Rather than raising new funds, some sponsors are instead turning to other avenues, which means we are seeing a rise in co-investment facilities with some sponsors entering the public market.

Sponsors are also looking to employ NAV based facilities as part of their overall financing and liquidity strategy, a trend that began in 2020. Delayed realizations in the current market have led to an increased interest in NAV facilities as an effective tool for returning capital to investors. The panelists noted that there are more non-bank lenders (such as specialty finance companies) entering this market. Although NAV margins have gone up, the product remains attractive as funds search for creative ways to raise funds in a stale fundraising market. Hybrid facilities may also come to forefront for 2023.

The rising popularity of NAV facilities is also resulting in amendments to limited partnership agreements. Limited partnership agreements typically include restrictions on debt ratios tied to NAV or only explicitly permit subscription credit facilities. With the rise of these amendments to permit (or more explicitly address) NAV facilities, many investors are raising questions with sponsors in the fundraising diligence process regarding how the fund intends to use various credit facilities, and they are seeking to negotiate detailed debt limits up front. The panelists noted that in newer vintage limited partnership agreements, there is a trend toward including more robust language to permit NAV facilities.

One other area of focus among fund managers is how returns are presented to investors, especially in light of the new Marketing Rule which took effect in November 2022. The Marketing Rule prohibits the presentation of gross performance without also showing net performance. The gross and net performance must be presented with at least equal prominence, represent the same time period, and use the same calculation methodology and present the same type of return. The performance must also be accompanied by applicable disclosures.

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[1] The panelists included Matthew Chase, Partner at Latham & Watkins LLP, Flora Go, Partner at Fried, Frank, Harris, Shriver & Jacobson LLP, Ariel Goldblatt, Partner at Stepstone, Steven Hopchick, Managing Director at Barclays Bank PLC and Kevin Miller, CEO and Founder of Thorofare Capital. Vanessa Lawlor, Partner at Maples Group, moderated.

Increased regulatory scrutiny of private funds will likely continue in the coming year. For example, one proposed rule prohibits certain preferential treatment for private fund investors, which will heavily impact the use of side letters. Side letters are an important part of the fundraising process, so there is significant pushback on the adoption of this rule, the comment period for which is currently underway. Other proposed rules on continuation funds and reporting further demonstrate the more active regulatory monitoring of the private fund space.