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Beyond Excel - New Technologies Available to Fund Finance[1]

By Aleks Kopec and Phong Tran

At the Fund Finance Association's recent conference, a panel discussion entitled "Beyond Excel - New Technologies available to Fund Finance" explored how technology is reshaping the industry. Panelists from major lending institutions and technology vendors discussed pain points driving the need for scalable solutions, the market forces driving these changes, and the potential of emerging technologies like artificial intelligence ("AI").

Key Takeaways:

- **Scaling Challenges:** Traditional tools like Excel are insufficient for the volume and intricacy of modern fund finance deals, often leading to undetected errors and potential technical defaults. Lenders need better data quality and real-time insights to manage a growing and increasingly complex portfolio.

- **Drivers of Tech Adoption:** Both the sheer volume of transactions and the rising sophistication of financial products are pushing lenders to embrace technology. Additionally, funds face significant operational difficulties, and tech solutions that streamline processes and reduce friction are highly valuable to lenders. The need to lower costs and remain competitive amidst regulatory scrutiny further motivates the shift.

- **Front Office Leads the Charge:** Those closest to fund borrowers are leading the charge, with portfolio-level analytics becoming vital. Lenders desire deeper insights to broaden their risk tolerance and make informed decisions about their portfolio composition. Lenders are seeking tools that transcend single-deal analysis, providing portfolio-level analytics and enabling more informed risk management and business development decisions.

- **The SVB Effect:** The Silicon Valley Bank failure underlined the urgent need for lenders to have quick access to data on exposures for proactive sponsor outreach and accurate risk assessment in response to disruptive market events. Lenders need to be ready to react quickly to any future disruptions.

- Build vs. Buy: Pros and Cons: While some banks develop internal tech solutions, third-party vendors offer a faster path to implementation. However, challenges like data privacy and the need for standardization across the industry remain. Most agree that the industry has barely begun to

[1] The panelists were Hamid Aguerbal of Natixis, Nake Grewal, Head of Underwriting at Wells Fargo, Steve Markovinovic, Director at Barclays, Bill McMahon, Executive Director at LionPoint, and Rafael Vistan, Managing Director at MUFG. The panel was moderated by Brendan Cahill, Product Manager at Allvue.

leverage technology beyond spreadsheets. An integrated approach across different bank functions is the ultimate goal, though variability in forms and loan offerings pose significant challenges.

- **AI's Potential Role:** AI is being explored for document review and analysis, but experts stress that human judgment remains critical for credit risk decisions. AI's potential lies in optimizing operational work flows and the allocation of funds to better maximize returns.

The Bottom Line: While still in the early stages, tech adoption in fund finance is accelerating, fueled by lenders' desire to stay ahead of both risk and opportunity in a fast-evolving landscape. The panel highlighted a clear consensus that the fund finance sector is ready for technology-driven change. Lenders and fund borrowers alike stand to benefit from solutions that address the challenges of scale, data integrity, and operational efficiency as the market continues its rapid growth.

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Capital Relief Trades[1]

By Courtney Smith and Brandon Spleen

The "Capital Relief Trades" panel covered questions relating to credit risk transfers ("***CRTs***") and their increasing relevance in United States finance markets.

The panel discussed the following questions:

- **Why are U.S. banks dealing with capital constraints, and why is the risk transfer market becoming a more viable solution to deal with this issue?** U.S. banks are facing capital constraints due to increasing interest rates, which result in decreased prices for legacy assets and Accumulated Other Comprehensive Income ("***AOCI***") losses. Banks are simultaneously grappling with the "Basel III Endgame", various changes in the standard approach and advanced approach for different tier banks, and the current recession. In this environment, the risk transfer market has become a viable option for U.S. banks to deal with capital constraints, thanks in part to U.S. regulators providing clarity on how banks can utilize CRTs, synthetic risk transfers ("***SRTs***") and inverse transfers to help alleviate capital constraints. These tools will allow banks to free up some of their debt capital, which may be held back by legacy assets.

- **How can banks achieve capital relief through CRTs, and what are the key regulatory requirements?** Under Regulation Q of the Board of Governors of the Federal Reserve System ("***Reg. Q***"), a bank can use synthetic securitization to tranche a portfolio, then sell the tranches of exposure to investors, which would allow the bank to reduce its capital charges by up to 80%. Under Reg. Q, a bank is not required to engage in a significant risk transfer; it only has to transfer the credit risk of an asset pool, with at least two tranches in the structure (a senior tranche held by the bank and junior tranche(s) sold to investors).

- **Why are CRTs an attractive alternative to other capital optimization strategies such as issuing equity or selling assets?** Banks typically prefer to maintain the customer relationships and fee income associated with a credit facility, and they do not want to sell legacy assets at a loss. Issuing equity comes with other problems from the bank's perspective, including high execution costs, dilution, and negative market perception. CRTs are an efficient way to optimize capital; in addition to avoiding the pitfalls associated with an equity issuance or asset sale, CRTs allow the bank to reduce the risk weighting for a pool of loans to around 20%, while the bank continues to hold and service the assets. CRTs do, however, have a few drawbacks: they require complex documentation that, in many cases, needs to be finalized

[1] The panelists were Kevin Alexander, Partner in the Ares Credit Group; Missy Dolski, Senior Managing Director and Global Head of Capital Markets at Värde Partners; David Lucking, Partner and Head of Global International Capital Markets at Allen & Overy LLP; Angela Ulum, Partner and Co-Leader of Banking and Finance Practice at Mayer Brown LLP; and Bo Weatherly, Managing Director and Head of Structured Credit Group at U.S. Bank. The panel was moderated by Derek Li, Managing Director of the Alternative Markets Group at Goldman Sachs.

and executed in a short amount of time; they require large investor commitments (often funded in cash at closing); and they require investors to evaluate a large bank portfolio for expected losses and returns.

- **What are the potential pitfalls of using CRTs in connection with a subscription line portfolio, and how can they be addressed?** Borrower confidentiality (including borrower identity and the particular terms of a loan) is one of the primary concerns that borrowers have with CRTs. Data rooms with anonymized data are a common tool to put borrowers at ease. Investors focus on concrete eligibility criteria for the assets that can go into the portfolio. Terms are narrowly defined in a way that gives investors the ability to conduct their credit assessment, even if they do not have access to the identity of the borrower. Since most subscription facilities are revolving credit facilities, and the principal note amount in a typical CRT is static, CRTs are structured to incorporate a replenishment feature which relies on the eligibility criteria in terms of what the issuer can put into the portfolio, even after the notes have been issued.

- **What types of investors are active in this market?** The type of investor will depend largely on the structure and asset class, along with the capital stack location. Private equity, hedge fund managers, asset managers, mutual funds, insurance companies pension funds and endowments are often direct investors.

- **What are the most common structures that banks are doing?** The most common structures for U.S. banks are indirect credit-linked notes ("***CLNs***") or direct CLNs. While direct CLNs have been issued by non-U.S. banks for a while, U.S. regulators have not issued blanket approvals for the issuance of direct CLNs. Accordingly, banks are required to seek affirmative approval from regulators for direct CLNs. Four banks have received specific approvals from U.S. regulators to use this direct structure for a fixed number of assets, but other issuances would require additional approvals. If a bank cannot issue a direct CLN or the investor prefers a different structure, banks will follow a more common structure that was recently confirmed by U.S. regulators which is to create a special purpose vehicle ("***SPV***") to issue notes to the investor, with the proceeds of the notes collateralizing the transaction.

- **What guidance have U.S. regulators provided with respect to CRT structures?** In September of 2023, U.S. regulators clarified that the SPV CLN structure would be treated as a synthetic securitization for Reg. Q purposes. However, there are still other regulatory structures and policies that banks will need to be concerned with, including Dodd Frank and Volcker. More particularly, banks seeking a direct CLN need to obtain regulatory approval for a specific structure. If the bank significantly deviates from this structure, it will need to go back and get further approval. Furthermore, for direct CLNs, regulators have indicated that they can impose certain limitations on the amount of issuance that the bank can do.

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Fund Finance Market Updates, ESG & Macro Developments[1]

By Ellen McGinnis and Brandon Spleen

The "Fund Finance Market Updates, ESG and Macro Developments" panel covered questions relating to the evolution of the fund finance market including market updates on deal economics, the resiliency of the product, the competitive landscape and ESG market developments.

The panel discussed the following questions:

- **What is the market's perspective on the continuing evolution of the fund finance market?** The market is experiencing growth in various financial products; however, net asset value and asset-backed facilities have had the most significant growth in more recent years. Furthermore, due to the large focus on new technologies and products being rated when they were traditionally not rated, the market has seen an influx in new participants and capital into the financial markets.

- **What macro developments are driving non-bank lenders, insurance companies and pension funds into the fund finance marketplace?** The most significant macro development is the current rate environment, which caused a large influx of capital to enter the marketplace from insurance companies. Additionally, recent developments in new technology created new opportunities for non-bank lenders, insurance companies and pension funds to enter the marketplace by utilizing new types of vehicles including evergreen open-ended funds, which includes a mix of both private and liquid assets.

- **What is the market seeing after the regional banking crisis in terms of market spreads, the resiliency of the products and the competitive landscape regarding deal economics?** During the regional banking crisis, the market saw around 25% of the global subscription line business disappear overnight; however, the market has regained about 50% to 95% of this business back. Furthermore, the market saw wider spreads across the industry that continue to stay wide even today with no sign of tightening. With only a few banks seeing increased deposits, banks are exercising more discipline on how they want to deploy their capital. Despite the regional banking crisis, the market saw the financial product demonstrate significant resilience, banks finding ways to reduce their portfolio risk, the liquidity of these portfolios and the entry of new participants.

- **What are key trends in ESG in 2023 and what can we expect in 2024?** The market has seen less conversation on ESG in the United States due to recent backlash; however, it is moving forward in the European Union. Despite this backlash, the focus on sustainability continues to grow even with

[1] The panelists were Pallo Blum-Tucker, Managing Director at State Street Bank; Steven Colombo, Managing Director at Goldman Sachs; Jose Liz-Moncion, Managing Director at Bank of America; Georgina Pullinger, Partner at Appleby; and Samina Sajanlal, Managing Director at CIBC. The panel was moderated by Gabby Buckner, Director at EverBank.

the ever-changing regulatory landscape in the United States. From a lender's perspective, the main challenge in structuring ESG deals is to create key performance indicators that challenge the borrowers to do more than what they are already doing, but are not too challenging they cannot meet the key performance indicators.[2]

Not surprisingly, the fund finance market updates have launched off of the lessons we have all learned in the past year. There is so much growth and creativity in the products we are all seeing. And the continued growth is a "symptom" and great benefit of the ever developing collective collaboration of our industry.

[2] For additional guidance, please see "A Guide to the Application of the Sustainability Linked Loan Principles in Fund Finance", published by the LSTA, LMA, and other industry organizations, with Haynes Boone partner Deborah Low serving as project counsel.

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FX and Interest Rate Risk Considerations for Fund Managers[1]

By Todd Cubbage and Dylan Glazier

This panel focused on hedging from the perspective of sponsors, hedge providers and hedge advisors. The discussion focused on certain considerations and market developments over the past year. Key takeaways from the panel are as follows:

1. The market has seen a steady increase in hedging activity considering political and economic uncertainty (emphasized in an election year in the US), as fund managers seek to maintain liquidity in potentially unstable times.

2. Sponsors are holistically revisiting their risk management strategies, focusing more on currency considerations, exploration of new hedging strategies such as direct lending swaps, and shifting towards longer tenors in FX hedging and facilities generally. Sponsors have also continued to diversity their hedging strategies, both in variety of hedging arrangements and counterparties to help offset risk.

3. Basel III "Endgame" regulations on banks and end users are continuing to be adopted across more and more countries, and the effects are noticeable. While not all jurisdictions have adopted Basel III yet, certain countries such as Canada and Australia have, and the standardized models for calculating regulatory capital requirements are working well and we are seeing a greater number of larger banks being required to hold additional capital. While the US aims to implement Basel III by July 2025, many are skeptical this will be attainable, and a pushback of the adoption date seems likely. Overall, there appears to be a consensus that market standardization in this space will be a positive influence and will help smaller market players close the gap against G-SIB institutions.

4. A wide variety of centralized and decentralized hedging programs within entities continues to exist. While both centralized and decentralized models have their advantages, in today's market having a centralized hedging platform is seemingly beneficial as hedging activity becomes more frequent and more personalized – having existing relationships and expertise (particularly in-house) that can be leveraged in the hedging space is proving helpful to many.

5. As hedging activity continues to increase, sponsors must monitor their portfolio and liquidity management techniques more closely. More and more funds are also requesting not to post collateral for hedges or to include a higher credit support threshold, resulting in higher costs for the funds and riskier positions for the banks.

[1] The panelists were Thomas Childs, Co-Head of CIB Corporate FX Sales at Santander CIB; Kunal Dusad, Senior Vice President at Brookfield Asset Management; Sharif Saba, Global Head of Corporate Rates and FX Solutions at Wells Fargo; Scott Sinawi, Managing Director at BNP Paribas; Ciccy Yang, Managing Director at Derivative Path; and Philip Yates, Director at National Australia Bank.

6. The trend toward active hedging is expected to continue in the years to come, with a greater focus on the development of Basel III and the US economy in this election year. Certain hedging arrangements, such as currency hedging, deal capacity hedging and direct lending swaps, are likely to continue at significant rates.

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Global Market Update – Perspectives from Outside the US[1]

By Robin Ladd and LeAnn Chen

This panel at the fund finance conference in Miami featured insights on Asian and European markets from a variety of viewpoints, including general partners, bank lenders and attorneys. The panelists shared their thoughts on issues facing the broader global market, including liquidity, the rise of alternative lenders and fundraising.

Difficulties in Fundraising. While the general perception of the market is that it is tougher and slower to raise funds, that perspective is not necessarily universal. Currently, limited partners are awaiting returns from general partners and funds with which they already have relationships, before committing to new funds with those same general partners. Accordingly, successor funds are being delayed and current funds are being extended.

While the hesitancy to make new commitments exists, the picture is not as negative as is portrayed. Limited partners can use this opportunity to test their general partners and determine how commitments are utilized. The difficulties in fundraising have also indicated to limited partners the knowledge expertise of their general partners. Additionally, general partners are not defaulting on loans. Private credit has grown substantially, and the accompanying fundraising has been buoyant, so while certain classes of assets have declined, there is still opportunity in the market.

The Rise of Alternative Financing and Competition among Global Markets. The panelists also addressed whether banks view the rise of alternative lenders as a threat or a helping hand. Alternative lenders are helpful in the current market, since there is substantial volume and appetite for transactions, but there is also a liquidity squeeze. Due to the supply and demand gap, there is a need for additional capital, which alternative lenders can fulfil. Alternative lenders can drive creativity in the fund financing space, and help develop and mature the industry. But an audience member noted that alternative lenders are both a threat and a helping hand, because while the alternative lenders can address the growth in the market, there will be competition among the banks and alternative lenders in the long term.

In Asia the presence of nonbank lenders is nearly nonexistent, because of the challenges with pricing. Pricing has decreased in Asia and there is a mismatch in the market, however in Australia there is more movement in the NAV financing space. While investor closings in Asia have slowed as compared with 2023, fund financing has been quite busy overall, with an increase of lenders moving into the space. General partners are also increasing their presence in Asia, looking to leverage the lower cost financing.

[1] Panelists included Nicola Germano, Managing Director at Intesa Sanpaolo IMI, Jeff Leung, Director at Lloyds Banking Group, Danielle Roman, Partner at Mourant, Victoria Stewart, Global Head Fund Financing at Partners Group, and Martin Wurth, Partner at Clifford Chance.

In terms of competition among global markets, a panelist noted that the competition is a natural part of the growth of the industry and that local presence is now seen as mandatory for lenders. General partners are also relying on core banking relationships for certainty of completion of transactions and service needs, particularly after the regional banking crises in Europe and the U.S. Banks have been working with lenders in Asia who would like to take advantage of the pricing in the U.S., with liquidity available in different markets supplementing the gap in supply and demand, so while competitive, there is also coalition building.

Challenges Facing General Partners. The panelists were asked to address how capital will be deployed due to the selectivity of limited partners. For certain general partners, the SMA structure is a useful tool, so that investors can determine their own strategies and this determination is not seen as a market change. Successful general partners in the current market usually have a good track record, with commitments going to funds with long term visions. More challenges arise with setting up brand new funds, but that can be assuaged with bespoke products, like healthcare. In Europe, there is a democratization of private equity, which has allowed a new pool of capital to be released, with more investment by retail investors.

An Overview of Asia. Existing general partners are still able to raise capital, but for funds that are China focused or new general partners, there has been difficulty. China-only funds are internally restructuring, with the support of limited partners. India has emerged as a new place for capital deployment, however it has not replaced China in the market, as the allocations in India are more to enter the market, rather than make a full- fledged investment. Japan has also emerged as an attractive market, however, the key challenge will be overcoming regulatory issues. Additionally, Vietnam is doing quite well in infrastructure. While the market in Asia will not be as smooth, there is still opportunity for investment. In the Middle East, there has been a rise in investors, with more SMA structures to address their needs. Investing that is compliant with Sharia law has also increased, and regional banks have been providing lending along those lines.

NAV Financing and Legal Documentation. While subscription secured facilities are still dominant due to reliability and convenience, in Europe, there has been an increase in NAV financings. This increase is seen for large private equity funds, as opposed to secondaries funds, including for follow-on investments and refinancings. Additionally, nonbank lenders want to provide NAV financings, however there is consternation with sharing information on underlying assets with entities that could be competitors. In Asia, there is general mistrust around the product.

While the rise in NAV has created opportunities, some general partners prefer certain other types of nonbank lenders over private credit, like insurance capital. NAV financings are still seen as great for providing liquidity support. Nonbank capital will help drive scale, however there is an issue with general partners using NAV proceeds to make distributions to limited partners.

With respect to legal documentation, in Asia, standardization is not present, so it is difficult to determine what changes will be reflected to address NAV financing for the market as a whole. Changes will be driven by the culture of the deal. In Europe, the language around NAV financing is evolving and fluctuating. Rather than look for direct language, the inclination is take a reasonable approach to determine possibility, check leverage limits and determine terms for outstanding loans, within governing documents.

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Challenges for 2024. Challenges for 2024 will include a flight to quality for both general partners and lenders. General partners will rely more on existing relationships. For Europe, new regulations (including Basel IV) will have an impact on capital returns. European lenders are also entering the U.S. market, driven by new regulations. For Asia, Asia is not China and the market is not homogenous.

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Investor Panel[1]

By Isabella Shaw and Monika Sanford

This panel focused on investment trends and how investors are approaching new investment opportunities. The panelists discussed the following questions:

Are investors interested in investing in private credit?

The short answer is, “yes”. The private credit space has seen impressive growth and is attractive to many investors as both a diversification tool and an income source. Particularly taking into account the interest rate increases over the last year, investors have seen steady returns accompanied by a relatively low risk profile. While some investors are more hesitant and are still weighing the benefits of investing in private credit, for the most part investors appear to be very interested in the private credit market at this moment and expect it will remain strong for the foreseeable future.

Are investors comfortable with funds using NAV facilities?

As more limited partnership agreements incorporate provisions authorizing the fund to enter into a NAV facility, investors are asking questions about how these NAV facilities will be used and doing their own analysis to assess the impact of their use. Many investors are still in the education phase for this product.

Are investors interested in investing in seed capital for RICs and BDCs?

Investors are a little more cautious about these types of investments. Most are interested and see the potential, however there is a recognition that money tied up in these investments is illiquid, and capital may become stuck in the private market for a longer period of time than is ideal for some investors. A common structure for BDCs and RICs is that a small number of institutional investors will provide the seed money for the investment, and the remainder will be raised from high net worth investors. It is very important to the institutional investors that their goals and priorities align with the goals and priorities of other investors on the project, particularly with respect to timing. However, despite strong reservations from some investors, investors and funds generally feel confident that creative solutions exist for liquidity concerns and that wealth management, particularly BDCs, will be a major point of interest for many institutional investors this year.

[1] The panelists were Derek Fricke, Managing Director at Churchill Asset Management; Amanda Gray, Director of Capital Markets at Invesco Real Estate; Verena Kempe, Head of Investment Management at KENFO; Ken Miranda, Chief Investment Officer at Cornell University; and Petya Nikolova, Deputy Chief Investment Officer and Head of Infrastructure Investments for the New York City Comptroller’s Office. The panel was moderated by Dee Dee Sklar, Global Co-Chair of Women in Fund Finance.

What tools do investors have at their disposal to be able to take advantage of investment opportunities?

The consensus seems to be that investors are not borrowing against their portfolios. Instead, investors are focusing on diversification, constant review of portfolios, determining the right time to buy versus the right time to sell, and monitoring cash flow. Some investors in the industry were constrained over the last few years because they did not have sufficient capital to allocate to private equity. Investors that saw success focused on diversifying their vintage years – ensuring that capital becomes available in waves – and maintaining constant liquidity so they could commit capital when the right opportunities arose.

Do investors feel optimistic about the future?

Several of the panelists noted that they feel quite optimistic that these next few years will produce excellent vintages thanks to the active secondaries market, repricing of investments, and the favorable terms available to investors given the difficulty that funds have had raising capital.

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Legal Update[1]

By Isabella Shaw and Lindsey Hughes

The "Legal Update" panel discussed lessons learned with respect to last year's banking crisis as well as jurisdictional legal updates from 2023 that will carry forward into 2024. The panel addressed the following questions:

How were NDAs and confidentiality provisions in credit agreements treated during the banking crisis last year?

In the early stages of the bank failure and receivership process, investors and funds were heavily focused on what steps they could take to preserve the confidentiality of their information. One of the frustrations for funds throughout the receivership process was that most funds specifically negotiate non-disclosure agreements ("***NDAs***") and confidentiality provisions throughout the process of putting a subscription facility in place. However, the FDIC did not take any of these confidentiality provisions into account when uploading data for potential buyers to review, and lenders were forced to disclose information. As a result, data rooms included significant amounts of information that funds and investors considered confidential and did not want to be shared. Notwithstanding these disclosures, NDAs and confidentiality provisions are not viewed as a futile endeavor – despite their ineffectiveness in this particular situation, they are still an important tool to broadly protect funds' and investors' confidential information.

What can funds do to protect themselves from the risk of bank failure?

"Defaulting Lender" provisions in loan documents came under intense scrutiny during the recent bank failures. Most definitions of "Defaulting Lender" in credit agreements contemplate a lender for whom a receiver has been appointed. However, once the FDIC became the receiver for the defunct banks, a 90-day stay was imposed, and agents and borrowers were unable to enforce the Defaulting Lender provisions they had negotiated. Ultimately, a major lesson learned is that once the FDIC gets involved, the other parties' ability to act is significantly curtailed. This inability to act also came into play when the failed bank was acting as the account bank – funds were unable to withdraw their cash (or have it applied to their outstanding loans) without the FDIC's involvement. However, as with the confidentiality provisions discussed above, thoughtfully drafting the "Defaulting Lender" language in loan documents remains important, as these provisions could be instrumental in a different future scenario.

What was the impact of the bank failures on security documents?

Following the bank failures last March, hundreds of loans were assigned from the bridge banks created by the FDIC to the various banks that purchased the outstanding loans. A large part of the assignment process involved ensuring that the security documents were adequately assigned to the new lenders. This included filing UCC-3

[1] The panelists were Adeola Adeyemi, Partner in the Cayman Islands office of Walkers; Michael Conners, Director at Golub Capital; Richard Facundo, Senior Counsel at Loeb & Loeb; Maude Royer, Partner at Loyens & Loeff; and Maria Strickland, Partner at Morrison & Foerster LLP. The panel was moderated by Jad Nader, Partner at the Luxembourg office of Ogier.

financing statements assigning the security interest to the new lenders, as well as control agreement assignments whereby the account bank was put on notice that the rights under the control agreement had been assigned to a new lender. In many instances where the account was held with the agent bank, the lenders may have relied on perfection by control and not required a control agreement. In these cases, the funds had to open new accounts and negotiate control agreements as part of the assignment process.

What are the investor notification requirements in the Cayman Islands with respect to a lender assignment?

In the Cayman Islands, priority of liens is fixed by sending investor notices to the investors of a Cayman Islands fund notifying them of the security assignment. These notices are typically sent within the first few days of closing a new facility. Following a lender assignment, some assignee lenders request that the fund send a second round of investor notices notifying investors of the assignment. This request developed into a point of controversy on many transactions. Lenders feared that without the new investor notices, investors might fund their capital contributions to the wrong account or might even refuse to fund a capital call from a lender they did not recognize. Funds argued that capital calls would include the account information and that the waiver of defenses language in the limited partnership agreement or investor letter would prevent investors from refusing to fund. The driving factor behind the pushback was the administrative burden involved – investors pay close attention to these notices, and particularly in light of the bank failures, such a notice could result in dozens if not hundreds of inquiries from investors. Ultimately, this was a business point that funds and lenders had to negotiate on each transaction.

Are new Luxembourg investor notices required after an assignment?

Investor notices in Luxembourg do not perfect a security interest or confer priority, but they do give a lender the right to challenge investors for failing to fund a capital call. However, it is rare for funds to send a secondary notice to investors notifying them of a lender assignment.

What were the major legal updates for 2023 in the U.S., the Cayman Islands, and Luxembourg?

United States: The Corporate Transparency Act went into effect on January 1, 2024.[2] The Act will require increased transparency and disclosures on the part of both large and small businesses, including private equity funds, in order to further anti-money laundering and anti-terrorism goals. The rules are complex, and funds will have to work with their compliance teams and attorneys to ensure they are complying with all applicable requirements.

Cayman Islands: The Cayman Islands are celebrating being removed from the Financial Action Task Force's Grey List – a list of countries under increased monitoring by the Financial Action Task Force which are working to address any deficiencies in their AML or anti-terrorism regimes. After being added to the Grey List in March

[2] Note: This panel was held several days before the issuance of an opinion by the U.S. District Court for the Northern District of Alabama (Northeastern Division) that the Corporate Transparency Act is unconstitutional. As such, the panelists did not discuss the ramifications of such judgment.

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2022, the Cayman Islands implemented stricter sanctions and AML rules and regulations, resulting in removal from the Grey List in October 2023.

Luxembourg: On August 7, 2023, Luxembourg passed a law relating to business preservation and bankruptcy modernization as a measure to help distressed companies avoid bankruptcy. The good news is that under this new law, the Luxembourg security interest in capital call facilities remains fully enforceable in the event of a restructuring. However, credit facilities will almost always include the initiation of insolvency or reorganization procedures as an event of default, and under this new law, the right to terminate the loan or accelerate the debt may be restricted. Enforcement of the security interest hinges on the occurrence of a trigger event, and if the trigger event is the acceleration of the underlying debt, the restrictions of the new law may apply, and the security interest may not be enforceable until the restructuring proceedings are complete. Luxembourg lawyers can avoid this pitfall by drafting the security documents to provide that filing for reorganization proceedings under the new law is an enforcement trigger.

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Lessons Learned from the Regional Banking Crisis[1]

By Mitchell Heyland and Javier Martinez

The panel opened by sharing perspectives of what it was like being at banks directly impacted in March (and the law firms working for those banks) and followed with lessons learned, chief of which was the resiliency of the industry. The panelists more specifically explored the following:

- **What were the key concerns for funds during those first few days of the crisis?** It wasn't just subscription line facilities that were impacted, these banks were involved in every aspect of the fund finance ecosystem and were the primary and sometimes sole banking relationship for many VC and other private capital funds. One of the biggest initial concerns was payroll funding and whether they would be able to access the necessary cash from accounts and lines of credit. There was also general confusion about the status of existing loan facilities with impacted banks, and a reluctance to fund anything into accounts held at these institutions or fund advances to these banks when serving as agent and in receivership. Many funds exercised borrowing requests under impacted facilities to test whether the banks in receivership would fund and they did.

- **What were the key concerns for other lenders and agents during this time?** From the banks' perspective, the primary concern was ensuring clients had access to liquidity via their credit facilities. This entailed detailed risk analysis on the exposure to any bank in receivership as a syndicate lender, as agent, and as deposit bank for collateral accounts. There was also a continual monitoring of other lenders and an updating of this exposure as additional institutions were impacted. While always important, open lines of communication among borrowers, lenders, and lawyers was essential to ensure liquidity needs were able to be met.

- **What about for the lawyers?** The first task was understanding the scope of the problem. The broad powers of the FDIC was quickly identified as a major issue. The next issue was keeping up with the ever-changing flow of information and landscape. Finally, law firms were making sure consistent and correct information was being shared and answering specific client questions. Many of us lived and worked on deals and advised clients during the 2008 financial crisis, but that was very different from what happened last March. One major difference is simply the speed at which things moved this time around. More experienced practitioners at firms that dealt with FDIC-specific issues in the late 1980s Savings and Loan crisis were also able to lend their expertise. The information was coming from multiple sources and was often piecemeal and incomplete or ambiguous. Many of the questions from clients were not of a legal nature, but they were looking for comfort and market intelligence on what law firms were seeing. We were also reminded of the value of relationships in the industry, not just between borrowers and

[1] The panelists were Thomas Byrne, Managing Group Director at Signature Bank, Michael Franks, Head of Alternative Asset Banking Group at Citizens Private Bank, Catherine Gylfe, Director at Sumitomo Mitsui Banking Corporation, Aditi Iyer, Partner at Kirkland, and Javier Martinez, Partner at Haynes and Boone, LLP.

agent and lenders but among all parties. Law firms were talking to other law firms and everyone was sharing information and working towards the same goal of stability.

- **What has changed in the industry since last March?**

    1. From sponsors there has been an intensified focus on more diversified lender bases and lender/banking relationships, especially looking for lenders with flexibility in deposit requirements.

    2. There has also been a subtle shift towards GSIB banks. However, there are still several existing and new regional lenders offering flexible and creative products, with a focus on customer service. The shift towards GSIB banks is in part driven by the underlying LPs, especially foreign LPs, and their nervousness surrounding regional banks.

    3. In the loan documents there has been a lot of attention on flexibility particularly with respect to collateral accounts, requirements for account banks, and processes for creating new accounts and designating new account banks.

    4. Given supply/demand imbalance, lenders are being more selective on which sponsors to onboard, which is typically driven by the broader bank/sponsor relationship and the ancillary opportunities available.

    5. Co-invest programs, management fee lines, and other non-subline fund finance products have been even more disrupted, as several of the impacted banks were the most prominent lenders for those facilities. The market is working to fill this void, but it will take some time for new lenders to build up the infrastructure and internal support to administer these programs in a cost-efficient manner for all parties.

Perhaps what is most interesting is what has not changed. The regional banking crisis last year did not lead to a fundamental change in how these deals are structured or material impairment of the industry. The impacted banks were not impacted because of any inherent weakness in these products, as evidenced by the near par sale price of the Signature Bank fund finance portfolio last summer. The industry pulled together, took a measured approach, and stabilized quickly.

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NAV Lending to Buyout Funds[1]

By Jennifer Passagne and Karina Oshunkentan

Net asset value ("***NAV***") lending, which is a type of financing tool that looks at the net asset value of the fund's portfolio of investments has received some recent negative press. The NAV Lending to Buyout Funds panel explored some of the concerns about NAV facilities and discussed trends and developments.

Among investors, there seems to be a split between those who support NAV facilities and view them as valuable tool that allows deployment of capital at different life cycles of a fund and those who are apprehensive about the use of NAVs. One of the biggest reasons for this hesitation is the perceived lack of transparency and poor communication to investors about the rationale for such leverage and how the financing is being used. It was discussed that many investors often only learn about a fund obtaining a NAV facility after the fact through the fund's periodic financial reporting. This has led to many investors requesting more transparency from the fund even though its limited partnership agreement may broadly permit debt incurred from a NAV facility without any prior consent of or notice to the limited partners.

There seems to generally be a lack of support for NAV facilities coming from larger limited partners, such as insurance companies, who argue that they can provide the liquidity themselves with better terms. For example, if fees associated with NAV based facilities are greater than fees incurred by limited partners to provide more liquidity, then these limited partners would prefer to fill the fundraising gap.

Investors have particular concerns where NAV loans are used to fund early distributions, especially where distributions are recallable. Another reason for caution by many limited partners is that NAV financing could be viewed as a red flag indicating the possibility of mismanagement of capital by the fund and underlying concerns with management of its portfolio companies.

Additionally, limited partners are increasingly focused on how limited partnership agreements are addressing NAV facilities. By way of comparison, subscription facilities are typically addressed in great detail in limited partnership agreements, these facilities as they are secured by the capital commitments of the limited partners. Asset based financing, on the other hand, is usually only generically addressed in these agreements with some parameters on the debt amount but without much specificity otherwise. There have been some discussions among limited partners who want limited partnership agreements to expressly address NAV financing and what level of disclosure or if a consent requirement should be necessary before NAV debt can be incurred.

Institutional Limited Partners Association ("***ILPA***") will soon be issuing NAV-based guidance (it is currently working with firms, banks and investors to produce this) that will focus on education (benefits, risks and

[1] The panelists were Doug Cruikshank, Managing Partner and Founder of Hark Capital; Brian Foster, Partner, Cadwalader, Wickersham & Taft; Neal Prunier, Senior Director, Industry Affairs, Institutional Limited Partners Association (ILPA); Harsh Shah, Managing Director, Head of Fund Financing, Citigroup; and Jasen Yang, Managing Director, Credit, Apollo Global Management. The panel was moderated by Leon Stephenson, Partner, Co-Head Fund Finance, Reed Smith LLP.

mechanics), transparency and rationale in respect of NAV facilities. The guidance will also include questions to raise during the investor diligence process and what provisions to look out and push for in a limited partnership agreement in respect of NAV facilities.

Terms of NAV deals vary between markets (USA & Europe), whether the underlying portfolio is concentrated versus diversified, whether it's a large cap versus mid-market sponsor, the loan-to-value ratio and the cycle of the fund. Sponsors in the large cap and upper middle-market space have been pushing security-lite structures, and this trend is moving down to the middle-market (although with less traction).

A panellist commented that they have seen an uptick of NAV facilities close in the last few months to open-ended private equity funds. There is also a growth of interest in NAV lending to continuation funds that provide optionality for investors to come in and elect to be a funded investor or leveraged investor. However, there are challenges here due to concentrated portfolios of assets in a NAV lending market that prefers more diversified pools.

As the market for NAV facilities develops and matures, one panellist thought this would help with overall transparency as the concepts, forms and documents will become more uniform, as has been the case in the sub line space.

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NAV Lending to Credit Funds[1]

By Karina Oshunkentan and Alexander Grishman

Net asset value-based lending or NAV lending, which is a type of financing that looks at the net asset value of the fund's underlying assets, is typically used by buyout funds for the purpose of addressing specific needs where there is a fundraising gap (such as distributions to its limited partners). Conversely, NAV financing to credit funds (which are also called back-leverage or loan-on-loan financing) is typically used alongside other tools and products available to the funds and is primarily aimed at optimizing its liquidity position. Recourse on these facilities to credit funds is the portfolio of loans owned by such credit funds. While the use cases of NAV financing to buyout funds cover purposes such as distributions to its investors and liquidity for certain portfolio companies, credit funds typically use NAV facilities to enhance the internal rate of return or IRR of its investments rather than to make distributions to its limited partners (as the investors receive steady flows of distributions through cash interest payments on loans in the portfolio). Even a 10-15% leverage on the credit fund level can still meaningfully increase the fund's IRR.

With respect to the underwriting process, financing to private equity funds typically require a deeper dive into the assets as compared to facilities to credit funds, since there is likely a larger, less concentrated, pool of assets of a credit fund. Much of the underwriting process of NAV facilities to credit funds hinges not only on the portfolio of assets but also the track record of the manager as prior performance, which can be a significant indicator of future performance. In all cases, however, assets are still subject to eligibility criteria and concentration limits which may be heavily negotiated in the financing documents. Bank lenders typically target funds with larger NAV even if the facility spread is lower, while non-bank lenders have an appetite for smaller funds but will seek out higher spreads on these NAV facilities.

With respect to collateral, while NAV facilities in the United States market are still generally secured by a pledge of the underlying assets, lenders are likely more willing to go unsecured on facilities to buyout funds than to credit funds. It is important to note that when differentiating between secured and unsecured NAV facilities, lenders generally treat facilities with no pledge of assets though secured by the bank accounts into which asset realization proceeds are deposited as unsecured facilities, because the pledge of accounts only is insufficient to meet a lender's regulatory capital reserve requirement.

The type of fund may also give rise to differing enforcement options. Unlike buyout funds where lenders prefer not to take over the portfolio companies in an enforcement scenario, lenders are more readily able to foreclose on a credit fund's portfolio of loans, as managing such type of portfolio is within their field of expertise. Additionally, unlike lenders to private equity funds that face the challenge of tripping change of control

[1] The panelists were Oliver Dunsche, Managing Director at Deutsche Bank; Gopal Narsimhamurthy, Managing Director, Global Head of Fund Ratings at KBRA; Seth Perlman, Executive Director at Morgan Stanley; Sherri Snelson, Partner at White & Case; and Darren Thomas, Executive Vice President at PIMCO. The panel was moderated by Patricia Teixeira, Partner at Ropes & Gray.

provisions if a pledge of assets is required, such issue is less prevalent in the credit fund space. Further, for certain portfolios of unsecured loans or unitranche loans, there is no active secondary market for them so a pledge of such assets may be less critical to the NAV lenders. Rating agencies are also more focused on other features that offer protection against value decline, deterioration in asset diversification and management of refinancing risks than collateral package. Cash sweep and loan-to-value triggers are put in place before a default is triggered with the intent of bringing all the stakeholders to the table when early signs of issues appear with the goal of avoiding a default and the need to liquidate its assets. These early pre-default triggers could be set-up to trigger early amortization or initiation of a plan to cure the breach.

Generally, the back leverage market in NAV space to credit funds is fairly flexible. Unlike limited partners in private equity funds, there appears to be less aversion to NAV facilities among limited partners in credit funds, though some institutional limited partners in single-asset funds are not willing to grant recourse back to the fund.

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Post-Regional Banking Crisis Market Update[1]

By Robin Ladd and Holly Loftis

This panel discussion focused on the lead up to and aftermath of the regional banking crisis of 2023, with viewpoints from sponsors and regional bank lenders. After briefly recapping the beginnings of the bank failures and their initial reactions thereto, the panelists opined on current trends, uncommitted credit facilities, and the role of regional banks in the broader financial market.

Post-Crisis Trends. Panelists noted that some bank lenders had already planned to exit syndications and focus on bilateral relationships. The general consensus was that bank lenders were looking to pursue full relationships with clients, including depository relationships. Accordingly, these bank lenders chose not to pursue relationships with larger private equity funds that had high usage rates but did not have benefits related to depository relationships and instead lean into venture capital funds. One panelist noted that although pricing has increased, the increase has not been as large as in times past, and the market feels settled. However, another panelist noted that there appears to be a tale of two markets emerging, due to the pricing disparities between top tier and mid-tier managers.

Another trend panelists discussed is that the bar for new business has been raised, with bank lenders now requesting more fees and deposits. From the sponsor side, one panelist noted a change in its suite of bank lenders' reactions to renewal requests, with some bank lenders wanting to condition renewal upon the sponsor making large cash deposits. Additionally, panelists commented on personnel changes across banks, with many former employees of lenders that failed moving to different banks, creating a "same face different bank" relationship.

Uncommitted Credit Lines. One panelist noted that their institution was already trending toward providing uncommitted credit lines, due to internal repositioning, before the regional banking crisis. While clients took time getting comfortable with the model, all borrowings were fulfilled, and the economics of not passing on an unused fee were seen as beneficial. The panelists disagreed on the utilization of uncommitted lines for subscription secured facilities. One panelist noted that, from their perspective, demand continued to be focused on committed lines, and where they do see uncommitted lines, it is mostly for separate tranches. Another panelist agreed, noting that for uncommitted lines, there is not a huge capital charge difference, and that a bank would need infrastructure to respond to borrowing requests.

Role of Regional Banks. In the fund finance space, regional banks play an important role; they have a competitive advantage in their creativity and ability to provide funding for SMAs, smaller facility sizes, and funds with more nuanced borrowing bases (including high net worth investor pools). Sponsors often find that these types of

[1] Panelists included Jeff Feinberg, Senior Vice President at City National Bank, Trevor Freeman, Managing Director at Axos Bank, Ashley McCoy, Vice President at Crestline Investors, Shana Ramirez, Partner at Katten, Michael Sinclair, Senior Managing Director at M&T Bank, and Brad Smith, Head of Fund Finance at Banc of California.

facilities perform better with regional banks. In addition to creativity with bespoke products, client service is a differentiating factor for regional banks. As they work to build out and expand relationships, regional banks can provide more flexibility and responsiveness to sponsor needs. Broader relationships can lead to GP line work and funding for legacy funds, and regional banks can also help with diversification of lenders. Panelists noted, however, that fees have increased, and regional banks will often look for more support from the investor side (such as investor letters). Additionally, one panelist noted that they are seeing initial capital call requirements for facilities where the borrowing base is unique or smaller.

Future of the Market. Subscription secured credit lines are still seen as beneficial, particularly for urgent cash needs, and the panelists did not foresee a diminishing use of these credit facilities. One panelist noted that the requirement for deposits will continue, and lenders will continue to focus on having a full relationship with sponsors. It will take time for the market to relax the deposit requirements or allow a depository relationship to exist outside of the applicable bank. Generally, panelists have seen higher pricing, tighter covenants, and more emphasis on relationship. New entrants into the space may end up playing a role as market disruptors. Non-bank lenders, for example, are solely focused on the lending business and do not care about deposits.

Another panelist predicted that there would be a diversification in successor funds due to limited partner demands. Financing costs may lower in the latter half of the year, and more financing will be given to SMAs and retail investors.

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Private Credit Panel[1]

By Justin Keller and Deborah Low

This panel discussion offered insights into the current trends and dynamics shaping the private credit market, a market that has markedly expanded over the last decade and a half, having grown from roughly $100 billion in 2008 with expectations to exceed $2.5 to $3 trillion by 2028. Private credit is an asset class defined by non-bank lending. Drawing upon historical perspectives, the panelists addressed changes in deal structures, the role of private equity sponsors, the increasing complexity of transactions, and the growing influence of retail investors, among other topics.

- **Growth in the Private Credit Market**. Beginning with historical perspectives, the panelists discussed the evolution of the private credit market over the last ten to fifteen years. Private credit has gained 10 to 15% of the leveraged loan market over the last half decade, today comprising about one quarter of the $4 to $5 trillion dollar market. There is increased lending capacity of direct lenders today, and there has been a development of financing structures beyond the traditional first lien/second lien or senior-secured/mezzanine structures that historically have dominated the space. The panelists also noted the likelihood of continued expansion in product offerings as private credit funds seek to offer greater flexibility to investors with differing strategies and needs.

- **Evolution of the Investor Base**. Evolution in the private credit investor base is a salient theme. A number of panelists noted the growth of retail investors in the private credit space, which has traditionally been dominated by institutional investors, as retail investors seek alternatives to traditional equity and fixed income investments. They emphasized the high-touch nature of retail fundraising efforts compared to institutional fundraising, highlighting the need for comprehensive education and engagement strategies. There was also a recognition of the importance of innovation and diversification in fundraising efforts. Finally, there has been an expanding effort to reach investors in Europe, Asia, and the Middle East, indicating a global trend towards embracing private credit as an investment option.

- **Role of Private Equity**. The importance of private equity sponsors within the private credit market was another significant theme of discussion. Private equity sponsorship impacts deal flow, credit risk assessment, and overall market dynamics. Private equity sponsors play a significant role in the private credit market as both borrowers and investors. As a result, the panelists noted the importance of strong relationships with private equity sponsors, who are integral to sourcing deals and tend to control the composition of lender groups in the private credit market. Additionally, private equity sponsors bring

[1] Panelists included (1) Fazillah Durante | Managing Director, U.S. Financial Sponsors & Fund Finance | Scotiabank; (2) Laurie Lawler | Managing Director, Head of Capital Call Financing, Deputy Head of FI Origination | Société Générale; (3) Monica Kelsey | Chief Financial Officer | Antares Capital; (4) Kelli Marti | Senior Managing Director, Head of CLO Management | Churchill Asset Management; (5) Meenal Mehta | Managing Director | Blue Owl; and (6) Karina Stahl | Managing Director, Chief Financial Officer – Investment Funds | Monroe Capital.

valuable industry expertise and operational support to portfolio companies, which can enhance the creditworthiness of the underlying assets. This deep industry knowledge enables private credit lenders to assess risks more effectively and structure financing solutions that align with the sponsor's strategic objectives.

- **Competition Between Traditional Bank and Non-Bank Lenders**. The panelists acknowledged that traditional bank lenders have re-entered the leveraged loan market, leading to headlines about the resurgence of banks in the space and the effects of the resulting competition. However, they emphasized that this shift is more cyclical than structural, with direct lending being an established part of the leverage loan universe and the return of traditional bank lenders being an indicator of robust and healthy capital markets. The panelists highlighted that sponsors have options between the syndicated loan market and direct lending, with pros and cons to each approach. The panelists also downplayed the effect of competition between direct lenders and traditional bank lenders on loan documentation, arguing that this competition has not eroded the quality of financial covenants. On the contrary, the panelists argued that private credit loan documentation always includes at least one financial covenant, is tighter than in the bank syndicated loan market, and includes protections against collateral leakage that do not exist in the bank syndicated loan market.

- **Financing Solutions for Private Credit**. There are a number of considerations and challenges with respect to obtaining financing throughout the lifecycle of private credit funds, highlighting the importance of optimizing leverage at different stages of the fund's development to maximize returns while managing risk effectively. During the initial ramp-up phase, the panelists noted the use of warehousing facilities to provide seed capital for investments. As a fund matures and assets accumulate, the panelists emphasized the need for flexible financing solutions that can adapt to changing asset mixes and investor preferences. This may include leveraging subscription lines of credit heavily in the early stages to build a critical pool of assets. There is also importance in diversifying financing sources and structuring options to match the evolving needs of the fund. This involves considering various options such as SPV financing or corporate-level revolvers based on factors like asset mix, fund size, and investor preferences. Furthermore, the panelists highlighted the importance of building strong relationships with lending partners who can provide tailored financing solutions and adapt to the fund's changing requirements over time. This involves proactive communication and collaboration to ensure alignment between the fund's investment strategy and its financing structure.

The landscape of the private credit market continues to grow and evolve – with expectations of operations in the trillions within the next five years. Such growth will bring new and different opportunities in the fund finance space. Not surprisingly, strong relationships and ongoing discussions will be common features of the continued success of the private credit market.

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Rated Note Feeders and Collateralized Fund Obligations[1]

By Mei Zhang and Charles Zang

The panelists on the "Rated Note Feeders and Collateralized Fund Obligations" panel discussed the invention of the Rated Note Feeders and Collateralized Fund Obligations ("***CFO***s"), along with their structural intricacies, current regulatory landscape, the market trends and future outlook. Here are the key insights from their discussions:

- Rated Note Feeders were developed to facilitate investments in private equity funds, particularly for investors constrained by regulatory capital requirements, such as insurance companies.

- CFOs are structured transactions supported by a pool of interests in private equity funds. Insurance companies can leverage the debt classification of CFOs for favorable risk-based capital ("***RBC***") treatment, which, for U.S. insurance companies, depends on whether the investment is categorized as a bond under statutory accounting and RBC rules, benefiting from more attractive RBC charges compared to equity investments.

- Recent regulatory changes include (i) the adoption of a "principles-based approach" by the National Association of Insurance Commissioners ("***NAIC***") for determining bond treatment (if the CFO is mainly supported by equity interests, there is the presumption that it is not a bond, which assumption can be rebutted by steady cash flow, subordination and/or overcollateralization), (ii) revisions to risk-based capital charges for asset-backed securities from 30% RBC charge to 45%, to take effect for 2024 year-end insurance company financial reporting, and (iii) potential discretion for NAIC's Securities Valuation Office ("***SVO***") to challenge investment ratings if the SVO determines that the assigned rating does not provide a reasonable assessment of risk for regulatory purposes.

- Despite tightening regulatory scrutiny, insurance companies remain active in the market, focusing on well-structured deals. The clarity provided by evolving regulatory frameworks enables insurance companies to navigate investments more confidently, finding solutions to become comfortable with principles-based bond treatment.

- Rated Note Feeders and CFOs have historically enjoyed decent reception among insurance companies in North America, with emerging interest from the Korean market. However, challenges persist in the European market.

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[1] Moderated by Duncan McKay, Partner at Fried Frank, Harris, Shriver & Jacobson LLP, the panel included the following: Robin Gibb, Associate at Maples Group, Matt Ruggiero, Partner at PJT Partners, Pramit Sheth, Head of Structured Products, at Whitehorse Liquidity Partners, Ramya Tiller, Partner at Debevoise & Plimpton LLP, and Richard Wheelahan, Managing Director and Co-Founder at Fund Finance Partners.

- Differential pricing among the CFO tranches is not a concern when debt and equity are bundled together as a single package. It only becomes an issue when the debt is sold separately.

- Lenders exhibit increased confidence in the debt component of Rated Note Feeders while note purchaser is getting more comfortable with principles-based bond treatment.

- While the market is getting more clarity from NAIC on the regulatory framework, discussions with insurance companies increasingly center on transaction substance rather than regulatory nuances, with a growing emphasis on large-scale deals exclusive to sponsors with strong track records.

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Secondaries and Continuation Fund Market Update[1]

By Laura Whitley and Maria Parker

The "Secondaries and Continuation Fund Market Update" panel covered topics relating to the evolution, current state and outlook of the secondaries market and continuation funds from the perspectives of investment advisers, the LP community, fund counsel and credit providers. The panel discussed four general topics:

1. **Overview of the Secondaries Market**

   a. **Quick Facts about the Current State of the Market**

      i. Reports estimate that total AUM in the secondaries market is over $500 billion.

      ii. 2023 was the biggest year on record for fundraising at a little under $20 billion.

      iii. 2023 was the second highest year on record for deal volume, which was a little over $110 billion (with 2021 being the highest year on record). Out of these deals, a little over 55% were LP-led deals and roughly 45% were GP-led deals.

   b. **Brief Evolution of the Secondaries Market**

      The secondaries market for private equity has been developing for over 30 years. Development was initially slow, but tight liquidity in 2008 resulted in a groundswell of activity. The activity around 2008 was largely driven by investors needing access to liquidity and needing to manage large unfunded commitments. Over the past decade, the LP side of the market has transitioned to a portfolio management tool. Around that same time, GPs started to look at the secondaries market as a way to develop liquidity for their older funds. Coming out of the pandemic, the GP-led secondaries deals became driven by top sponsors that had great successes with portfolios wanting to provide DPI liquidity for investors while also holding onto their top performing portfolio companies.

   c. **Differences between GP-led and LP-led Transactions**

      i. One of the only ways investors are able to get liquidity is if they sell their LP interest to a secondary buyer. An LP-led transaction is between the current investor, the fund and

[1] The panelists were Scott Beckelman, Co-Head of the Private Capital Advisory practice at Jefferies, Will Carpenter, with the Teacher's Retirement System of Texas, Lauren King, Co-Head of the Fund Transactions practice and Finance Partner at Simpson Thacher & Bartlett LLP in New York, Ray Meyer, Co-Head of the Fund Finance, Advisory and Origination at Natixis CIB, and Ram Rao, Managing Director at Macquarie. The panel was moderated by Jinyoung Joo, Finance Partner at Proskauer in New York.

the secondary buyer (who assumes all rights and obligations of the seller) and doesn't typically involve the GP (aside from the GP agreeing to consent to the transfer).

ii. On the GP-led side, the GP is facilitating the transaction. There are a number of types of GP-led transactions, but the panel focused on continuation funds. In continuation funds, the sponsor obtains liquidity for their LPs by taking an interest in an asset (or the entire asset) and selling it to a new vehicle that the same sponsor has formed, which is called a "continuation fund". The continuation fund buys the interest in the relevant portfolio company or companies (depending on whether the transaction involves a single asset or multiple assets) and the capital used to acquire such asset(s) comes from investors who are committing to the continuation fund. These transactions usually involve one or more lead investors. The lead investors set the pricing and negotiate the terms of the transaction. The "syndicate" of investors in such transactions are the other investors that are investing capital into the continuation fund but are not negotiating any specific terms of the transaction.

2. Recap of 2023

a. In 2023 was there a notable increase or decrease in the use of leverage in the secondaries market (particularly given the high interest rate environment we're currently in)?

i. Some credit providers forecasted that given the high interest rates, the need for leverage was going to decrease. However, there was consistent deal flow. Some of that is due to structural considerations (e.g., transactions that already had financing in place for deals where funds and/or investors had deferred obligations led to a natural need for refinancing regardless of the interest rates).

ii. More relevant with respect to larger secondary buyers and larger transactions, there were no discernable changes in demand for financing or leverage. There was an increase in the number of deferrals or seller financings being provided on deals in the secondaries market. With respect to pricing, pricing was a bit higher last year than previous years. Another trend that was seen in 2023, was more participation in the market from non-bank lenders (such as insurance companies).

3. Continuation Fund and GP-led transactions

a. How does a financing for a continuation vehicle differ from a traditional fund finance product?

i. There are two major differences between a continuation vehicle and a traditional subscription facility, and the first is concentration. In a continuation fund, there is greater investor concentration and/or asset concentration. The other big difference is blind-pool risk. In a continuation fund, there is no blind-pool risk, the investors know

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exactly what they're investing in. In terms of pricing between the two vehicles, the pricing in continuation funds tends to be somewhere between a traditional subline deal and a NAV facility.

b. **When a GP is structuring a continuation fund transaction, what types of conversations is the GP having with lenders and the lead-investor in the deal?**

   i. In a typical commingled fund, the limitations on borrowing or credit facilities are addressed in the limited partnership agreement and the investors are not involved in negotiating the terms of the credit facility. In the context of a continuation fund, lead-investors are focused on whether there will be leverage and heavily involved in the negotiation process. Lead investors expect to have consent rights in certain situations and want insight into the terms of any leverage.

c. **Has anyone seen any unique or creative structures used by GPs to fund these types of transactions?**

   i. The deferred purchase price mechanic is becoming very common, although not really creative (the upfront percentage of the purchase price paid at closing and time periods for remaining payments vary). In other words, the lead investor, the syndicate investors and the continuation fund are not funding 100% of the purchase price on day one to close the transaction.

   ii. Some continuation funds have borrowed money from the selling fund by having the selling fund drew down on its credit facility, which still had borrowing base capacity, to lend the money to the continuation fund and those funds were used to purchase the asset(s). The interest expense was considered a transaction expense, as without this mechanic, there would not have been a transaction because the lead investors were not willing to fund the purchase upfront.

4. Outlook for 2024

a. **Can you give us an outlook for 2024 in the secondaries market space?**

   i. All of the fundamental basics for increasing volumes of transactions are present: strong need for liquidity, low amount of distributions and a lot of dry powder ($225 billion of dedicated capital that has been raised). Currently, there is a slow exit environment, distribution levels are low and investors want liquidity – these are all "good" things for the secondaries market. All panelists predicted that deal volume was going to be higher in 2024 compared to 2023, noting that some advisors in the space have predicted a 20-25% growth in deal volume.

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Securitizations and Ratings in Fund Finance[1]

By Mark Nesdill and Tim Powers

The "Securitizations and Ratings in Fund Finance" panel provided perspectives of lenders, ratings agencies, counsel and GPs on how the fund finance market has become increasingly focused on finding a capital markets solution to demand for fund finance products outpacing supply and the important role ratings play in facilitating such a solution. The changing regulatory landscape has accelerated the need for a capital markets solution as lenders are having to address both internal limits on types of loans/loan portfolios and regulatory capital constraints. Ratings play an important role in relieving both types of pressure as rated loans and portfolios of the same are viewed as less risky, which can relieve both types of pressures, and open up the market to alternative sources of capital and liquidity. Ratings do this in several ways, such as: (1) enabling many foreign (i.e. European, Japanese and Canadian) banks to better manage their capital; (2) facilitating an influx of institutional capital into the market by providing rated term tranches or securitizations; and (3) applying a consistent standard across transactions.

Public vs. Private Ratings

The panel discussed the difference between public and private ratings, as market participants have different views on the topic. Whether a rating needs to be public or not is generally driven by the regulatory regime that the relevant market participant is subject to because regulators dictate what is required, but the nature of the rating must ultimately be agreed to by the relevant parties. Lenders generally prefer public ratings because they are transparent, portable and provide a more consistent standard. However, a competing consideration is what level of disclosure the GP and the related fund's investors are comfortable with. GPs are comfortable with disclosing their performance and track record, as that information is readily available, but investors commonly have confidentiality concerns and GPs may, therefore, prefer private ratings to alleviate these concerns and prevent the investor base from being disclosed.

These concerns have resulted in private ratings being far more common in the market, however, GPs are getting more comfortable with public ratings due to the benefits associated with them. One of these benefits is to help fill a syndicate, as ratings are required by some non-bank lenders and preferred by some banks. A panelist even noted one instance where a lender saw a publicly rated facility and reached out to the GP with an offer to join the syndicate.

[1] Panelists included Vicky Du, Global Head of Fund Finance at Standard Chartered, Greg Fayvilevich, Global Head of Funds Group at Fitch Ratings, Dan Marcus, Associate at Latham & Watkins, Michael Orphanides, Managing Director at BMO Capital Markets, and Kevin Purcell, Managing Director at Blue Owl Capital. The panel was moderated by Ana Arsov, Managing Director at Moody's Investors Service.

Standardized Terms

A major and recurring topic of discussion was the need for standardized terms to facilitate transactions being rated and securitized. A panelist noted that commercial real estate loans that will be distributed through CMBS transactions all include standard terms and something similar was needed in the fund finance market for securitizations to become common. This lack of standardization in the fund finance market makes rating a transaction a much more involved process and a true securitization model extremely difficult, with one panelist predicting that the market is at least a couple of years away from such a model.

The fund finance market has been difficult to standardize for a multitude of reasons. Standards, practices and credit policies vary from bank to bank, the relationship nature of the business, differing strategies and practices of GPs and their funds and the desire of market participants to have facilities address the needs of specific lenders and GPs/funds all work against standardized terms. Despite the variance among banks, the panelists generally agreed that banks and other lenders prefer standardizing terms, but GPs generally resist to make sure their aforementioned concerns are addressed. However, the panel was hopeful that ratings will help institutionalize the market, standardize terms and, correspondingly, standardize the ratings and related process, which will be capital accretive and foster a robust syndication and distribution market.

Innovation in the Market

Once terms and ratings become standard, the panelists identified a number of transaction aspects that could see innovation. An example of a GP with a strategy that provides consistent cash flows was cited as a test case for both ratings and potential securitizations because its funds have high utilization rates across their subscription credit facilities and often leave draws outstanding for the tenor of the facility, both of which lend themselves well to term facilities and tranches and therefore ratings and securitizations. Based on this example, the panelists discussed options for overcoming the challenges related to the revolving nature of subscription credit facilities, such as bifurcating facilities into term and revolving tranches, shorter tenors for certain term tranches to address issues associated with clean-downs and looking to a commercial paper solution and potentially rating the funds and their uncalled capital. Additionally, the panelists predicted that ratings will continue to be refined and developed to expand to specific types of subscription credit facility products, such as facilities that provide borrowing base credit for high net worth investors/feeders and separately managed accounts.

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Subscription Finance Hot Topics[1]

By Justin Keller and Albert Tan

Against the backdrop of a broader market characterized by difficult fundraising, constrained balance sheets, and ongoing regulatory developments, experts from both the lender and sponsor-sides of the fund finance industry engaged in a wide-ranging discussion on the practices and expectations of market participants in the current environment. The dialogue returned again and again to the relationship-driven nature of the industry and the importance of communication and collaboration amongst all stakeholders to optimize outcomes.

Below is a summary of high-level takeaways from the discussion.

- In the context of a difficult fundraising environment and confronting tougher access to capital due to balance sheet concerns, sponsors need to be in communication with lenders early and often in a fund's life in order to gauge potential borrowing base capacity under any future subscription facility. At the same time, sponsors should also remain in communication with capital markets partners in order to evaluate other potential sources of financing.

- Similarly, fund formation and finance legal teams should communicate at early stages in order to ensure that the partnership agreement and/or side letters do not become a hindrance to securing a subscription facility. Because the subscription facility is now a mature product, fund documents and loan documents have evolved together, so fund documents rarely present deal-killing issues. However, the slowdown in fundraising has given investors greater leverage, and as a result, side letters have become more conservative of late. Counsel should be involved in vetting side letters before they are presented to lenders to get ahead of any material issues.

- In addition to early communication with respect to fund documentation and the composition of the investor pool, sponsors also need to be proactive in planning and communicating structuring decisions to reduce costs and deal friction down the road. It may be cheaper to form and activate a feeder or parallel fund into a credit facility at the outset of the facility, even if it is not certain the vehicle will be utilized. In any case, having a discussion proactively and collaboratively will make it more likely that sponsors are able to get full borrowing capacity for all investors. From a lender's perspective, sponsors can structure their funds and the credit facilities that support them in as complicated a manner as they like (provided the lawyers sign off). However, it is important for lenders to communicate and sponsors to understand that increasing complexity is going to increase costs and may increase closing timelines.

[1] Panelists included: (1) Haroldo Ale Filho | Vice President | DigitalBridge; (2) Richard Chiu | Director, Fund Finance | Mizuho Americas; (3) Patrick Hurley | Partner | Goodwin Procter LLP; (4) Justin Schneider | Head of Portfolio | Sumitomo Mitsui Trust Bank; and (5) Katherine Tandler | Associate | Paul Hastings. The panel was moderated by Edward Turowski | Managing Director, Head of US Non-Bank Financial Institutions and Fund Finance | CIBC.

- NAV lines are a specific area where early communication and collaboration can prove beneficial. As NAV lines have become more prevalent, sponsors who want to employ them will likely need to address restrictions in the partnership agreement, most frequently leverage limitations or limitations on the term of the fund's debt. Further, that requires sponsors to have had discussions with investors regarding how and why leverage is going be employed long before the changes to the partnership agreement are addressed.

- The factors lenders are evaluating in determining whether to provide subscription financing in this environment have not fundamentally changed. Lenders look to the credit quality of investors, the strength of lender protections in the fund documents, and the quality of the relationship with the sponsor. This last factor is paramount—the meaningfulness of the facility in the context of the broader relationship will often be more significant than pricing in determining whether it makes sense to extend the facility.

- Sponsors need a diversified pool of lenders to accommodate their different needs as global investors. Different banks have different capabilities, and it is important for sponsors to understand what these different capabilities are in order to leverage them properly and align with the fund's strategy. Sponsors can establish and maintain strong relationships with lenders by engaging with complementary products offered by the banks that may be important to such banks. Depth and breadth of the relationship is very important.

- The three factors most important for sponsors in evaluating subscription facilities are certainty of closing, size, and pricing. An established relationship goes a long way toward addressing certainty of execution, and sponsors may pass on lower pricing to ensure closing with a known lending partner. With respect to size, sponsors want to think about how they intend to use the facility and how quickly they will utilize it, so that they get the size right and do not pay unnecessary unused fees. Pricing always factors in as sponsors evaluate their return hurdle and the extent to which they are able to use a facility for leverage, which is vitiated if borrowing costs are too high.

- The discussion further touched on the evolving regulatory landscape globally, with differences in regulations across jurisdictions posing challenges for fund managers and lenders. Panelists emphasized the importance of staying informed about regulatory developments in various regions to navigate compliance requirements effectively and of maintaining open lines of communication between lenders and sponsors in respect of new pending regulations.

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Syndication Update[1]

By Brent Shultz and Ochuko Hope

The Syndication Update panel provided a comprehensive overview of the tumultuous events of 2023 and their implications for the syndication market going forward in 2024. The year 2023 witnessed significant turbulence, beginning with the market shakiness of Q3/Q4 of 2022 caused by market reaction to rising interest rates, leading to increased cost of funds for banks and challenges in predicting market behavior with players in the syndication markets. The bank failures occurring in March of 2023 marked a turning point, characterized by unprecedented run on the banks fueled by social media and intervention by the FDIC in connection with multiple bank failures.

In navigating the aftermath of the bank failures, legal considerations regarding defaulting lenders and the interplay with the established receiverships added complexity, prompting a flurry of activity in the syndications market and a reassessment of risk exposure for borrowers and lenders alike. The ensuing period saw portfolio sales, changes in bank participations in syndicated transactions, and renewed attention to regulatory capital requirements from a lender perspective. From a borrower's perspective, the evolving syndication landscape necessitated adaptation to shifting lender dynamics, with a focus on fostering long-term relationships amidst market uncertainties.

Insights from various panelists underscored the multifaceted nature of the syndication market. While new entrants injected fresh perspectives and capital into the market, established players grappled with capital constraints and evolving client needs. Questions surrounding facility syndication versus bilateral deals, tenor preferences, and the interplay between fund size and fundraising timelines highlighted the nuanced strategies employed by both lenders and borrowers to keep capital available in the market.

Looking ahead, the panel offered cautious optimism tempered by ongoing regulatory scrutiny and market dynamics. Despite challenges, opportunities abound for collaboration and innovation, as evidenced by the continued interest in fund finance and the resilience of the syndication ecosystem. As borrowers and lenders navigate this evolving landscape, a nuanced understanding of market trends and a strategic approach to relationship-building will remain key in driving sustainable growth and mitigating risk in the syndication market.

Additionally, the panel provided insightful analysis and discussions on current trends and challenges in syndicated deals, particularly focusing on the dynamics of pricing, utilization and facility sizing, structural innovations and rating considerations. Key points highlighted include:

[1] The panelists were William Gonska, Director at Mitsubishi UFG Financial Group; Ann Richardson Knox, Partner at Mayer Brown LLP; Charles Inkeles, Head of U.S. Fund Finance at Industrial and Commercial Bank of China; Maggie Jiang, Senior Vice President at Bank of China, New York Branch; and Debra Abramovitz, Executive Director at Morgan Stanley Investment Management

- Pricing Trends: The increase in pricing, particularly for longer tenor deals, presents a significant challenge for borrowers and lenders alike. The rising cost of capital has led to a preference for shorter tenors and a reluctance to commit to longer-term financing options.

- Utilization Dynamics and Facility Sizing: Usage of facilities has generally been lower, with periodic fluctuations based on market conditions and fund strategies. Due to capital constraints, syndicate lenders typically prefer participating in deals in which the borrower has demonstrated high usage, and Managers are increasingly focusing on higher utilization to optimize returns and avoid unused fees which are increasing. There's a trend towards sizing facilities based on anticipated usage, as lenders are becoming more selective in their offerings and considering capital constraints and risk exposure.

- After-Care Facilities: As funds transition into the harvest period or end-of-life phase, liquidity and facility restructuring considerations become crucial. Options such as uncommitted lines, NAV and hybrid facilities, and bridge facilities are being explored to address reduced facility sizes that continue to meet ongoing fund requirements.

- Structural Innovations: Lenders are exploring innovative structures, such as conduit financing, term loan tranches, and letter of credit issuance on a syndicated basis, to optimize capital costs and manage risk. These approaches require careful consideration of borrower needs, lender preferences, and market conditions.

- Rating Considerations: The potential for seeking credit ratings to optimize capital costs is emerging as a strategy for lenders, albeit with caution due to potential implications on pricing and market dynamics.

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The AI Advantage: Transforming Finance in a Tech-Driven Era[1]

By CJ Donald and Lindsey Hughes

The "AI Advantage" panel at this year's fund finance conference in Miami covered adoption of artificial intelligence ("***AI***"), human oversight, and opportunities for innovation. The panelists encouraged the fund finance community to embrace the potential progress that AI can bring to our industry.

The panel discussed the following topics:

- **Adoption of AI in the financial sector**. The panelists explained that, due to generative AI, it is a uniquely opportune time to apply AI in finance. The gap between companies who use AI well and those who do not is as small as it will ever be. Using AI will increase productivity and expand business capabilities. It may be the wave of the future, so to speak.

- **AI's value creation**. If you invest in AI business tools, there will be value creation in a variety of ways. For example:

    - ***Pricing***: AI models can help answer statistics-based questions accurately and quickly. AI models can help suggest pricing strategy over time, not just the optimal price at a given point in time.
    - ***Document Processing***: AI will increase the efficiency of deal workflow. Rather than investing in manual review of every contract in a given portfolio, AI can review, analyze, and provide detailed summaries of a large volume of contracts.
    - ***Decision-making***: AI tools can help make business decisions based on a risk tolerance profile – whether that be at an individual level or at a company level.

- **Incorporating AI in business flow**. The panelists encouraged attendees to engage with a technology company to learn how AI can be useful in a particular business. These companies can help set an AI strategy, including pain points, use cases, and costs. The market is seeing more and more of these types of companies emerge.

- **Risks to AI**. In order to mitigate risk, AI tools have two key safety features: human oversight and so-called "explainability." These features enhance user safety, but also increase reliability and performance. Through human oversight, technology companies can help set risk tolerance, fine tune the data being input into AI systems, and ensure that the generative AI tools are producing consistent results. "Explainability" is the concept that an AI system and its output can be explained in a way that is reasonably comprehendible by humans. Note that if AI tools did not have explainability, decision making would suffer and the proprietors of the AI tools would ultimately lose in the marketplace. Further,

[1] Panelists included Ilya Feige, Global Head of Artificial Intelligence and Machine Learning at Cerberus Technology Solutions UK Ltd and Sophia Velastegui, Chief Product Officer at Aptiv. The panel was moderated by Ryan Patel.

without explainability, humans would lose trust in the results and outputs generate by generative AI systems. Ultimately, while there are risks to AI, the bigger risk is refusing to understand the features of AI and not learning how to use AI in business.

- **Private equity firms can use AI for diligence and to increase innovation.** Applied properly, AI tools can ease the burdens of manual due diligence. Firms can proactively use AI to assist with pre-investment auditing, analysis of target companies, and review of target markets. Post-acquisition, generative AI can create value in a firm's portfolio companies by increasing productivity and enhancing innovation in supply chains, pricing strategies, and customer service.`

The panel provided various examples of how AI can help in the fund finance industry – whether from the perspective of a lender, a private equity firm or a legal counsel. As the topic develops and safety features are fine tuned, there are a lot of benefits of employing AI into business and continuing discussions will be helpful for all.

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The Rise of Non-Bank Lenders in Fund Finance[1]

By Emily Fuller and Kayla Culver

This panel addressed various topics surrounding the increasing trend of non-bank lenders participating in the fund finance space, particularly with respect to net asset value ("***NAV***") secured facilities.

A common theme throughout the panel discussion was how the growth, adaptation and flexibility of fund finance throughout the years has supported the inclusion of non-bank lenders in the fund finance market. Historically, there has been a need for differing liquidity solutions depending on a fund's requirements. For instance, the panel discussed how increasing regulatory pressure, particularly in relation to capital adequacy requirements, means that the fund finance model has to adjust from banks holding large loan sizes on their own books to syndicating them. The panel highlighted how a non-bank lender may have increased capital availability with less regulatory restrictions as compared to a traditional bank. Due to this shift, the market is seeing an increase in bank lenders partnering with non-bank lenders in order to provide financing solutions.

With respect to NAV facilities specifically, the panel examined how a NAV loan, when used correctly, can be a value tool for a borrower, as well as how a lender should strategize with a borrower from the outset to identify the borrower's objective. It was noted that there are multiple uses for NAV facilities, and that the scope of uses continues to expand due to the widening gap of liquidity (i.e., the timeline between raising capital and limited partners ("***LPs***") seeing returns). Due to this widening gap, general partners ("***GPs***") are having to be more inventive for how they manage liquidity, and in turn the market adoption of NAV lines has spurred growth in this type of financing as GPs witness their competitors using this tool.

The panel acknowledged that there has been some negative press coverage of NAV loans, but also likened this to how subscription lines also attracted bad press before the market became educated about their use. Panelists emphasized that NAV lines are not a new product, but the panel also encouraged borrowers to involve their LPs from the beginning on the journey and be transparent about the structuring of their financing. The panel warned that, in a fragile fundraising environment, it is easy to see a financing fall through if LPs are brought into the fold too late in the process. Panelists acknowledged that it is rare for NAV financing to be considered at the fundraising stage, since a catalyst at a later stage of a fund's life typically triggers the need for additional debt. When raised at a later stage of a fund's life, it is likely that entering into a NAV facility would require amendments to a fund's limited partnership agreement ("***LPA***") or LPAC (LP Advisory Committee) consent.

[1] Panelists included Richard Golaszewski, Managing Director at Hunter Point; Karen Goldstein, Partner at Sidley Austin; Dane Graham, Managing Director at 17Capital; Michael Hacker, Partner at AlpInvest Partners; Steven Kahn, Senior Managing Director at Assured Guaranty; and Richard Sehayek, Managing Director at Ares Management.

In order to avoid the need for future LPA amendments or additional consents, the panel considered how LPAs should be drafted to allow for not only "pure subscription financing", but also for a NAV facility at the outset of the agreement.

The influx of insurance companies in the fund finance space is changing the structure of deals. The panel noted the natural synergy between the fund finance and insurance markets, with insurance companies interested in the low-risk nature of fund finance, and bank lenders interested in the capital benefit that partnering with a non-bank lender could bring. The panel discussed how the rating of facilities is crucial for insurance providers, and how the increased participation of insurance companies in the fund finance market will fuel an increase in obtaining ratings for such facilities.

Overall, the need for non-bank lenders to grow in the space aligns with the story of fund finance in general. The panel hopes to see the partnership between non-bank lenders and bank lenders continue and for NAV financing to become just another tool in the belt of GPs to consider when they have a need for financing, including in reflecting on how much capital they may need and how quickly they may need it.

The panel predicted that market participants will continue to work together to ensure liquidity is available, and panelists referred to the increase in collateralized fund obligations as an example of the innovation in the fund finance market.

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Underwriting Considerations in Today's Market[1]

By Emma Russell and CJ Donald

The Underwriting Considerations in Today's Market panel covered questions relating to how lenders and fund sponsors are reacting to changes in the market following bank failures and what trends they expect to see going forward. Specifically, the panel discussed the following questions:

- **How can banks balance the current regulatory environment with lender desires to service existing clients and acquire portfolios?** At the outset, the panelists discussed how, due to the regulatory environment, banks are facing higher capital requirements. The increased buffers have constrained the amount of capital banks can deploy, compared to previous years. Lenders are also focused on comprehensive operational risk, as opposed to strictly focusing on a borrower's credit profile. So, lenders currently desire strategic client relationships that will be mutually beneficial. For example, most lenders will prioritize deals with existing clients who use other products offered by that lender.

- **How do lenders and fund sponsors collaborate given the current credit environment?** Lenders have proactively met with sponsors to forecast future needs and assess whether availability can be reduced for older vintages. Sponsors must also understand the short-term and long-term needs of their lenders. For example, some lenders leave syndicates because of a borrower's failure to meet internal requirements to provide other banking business. Other lenders might leave a syndicate because they only want to be the lead arranger or because they have left the syndications market altogether. To be successful borrowers, sponsors must understand existing and potential lenders, and work to identify the proper fit.

- **Have underwriting teams changed practices in light of the credit environment and regional banking crisis?** Banks have increased the amount of pre-close and post-close work to make sure clients are monitored appropriately. Specifically, banks are focused on the accuracy of the borrowing base (approval of new investors, recognition of transfers, etc.) and ongoing reporting. Further, for NAV facilities, quality of the general partner is of paramount importance. It is important for banks to understand a general partner's risk profile, borrowing intentions, and past fund performance. Banks also want to understand whether the general partners are business savvy. These questions help underwriters determine whether they can trust the general partner. For lines of credit, underwriters focus more on each limited partner's willingness to timely contribute capital. For rated note feeders, banks focus on the capacity of the feeder to service the debt.

[1] The panelists were Gregg Scheuing, Director of Alternative Funds Lending (Bank of New York Mellon), Mike Elwell, Director of Private Equity Banking Group (Citizens Bank), Mark Egger, Executive Director at J.P. Morgan, Alex Phillips, Managing Director at PNC Bank, Evelyn Pellicone, CFO of Crestview Partners, and Thierry Grunspan, Director at S&P Global Ratings.

Sponsors have also changed their operations given the current environment. Previously, sponsors used to appoint one individual to manage the bank relationship. Now, fund sponsors have enhanced their teams to include legal, fund administration personnel, and accountants. Fund sponsors have developed routine and checklist-based processes to increase communication so the funds can avoid footfaults.

- **What current trends are impacting lenders and sponsors?** Lenders are expanding the definitions of events of default, including fund defaults based on fund performance metrics. NAV facilities and hybrid facilities continue to gain popularity because sponsors generally have capital constraints. Banks have not yet fully invested in growing the NAV market because they are still building out their expertise in the space but, as banks continue to grow their portfolio analytics departments, expect NAV facilities to increase in popularity.

- **What future trends will impact underwriting?**

  - ***New SEC Rules.*** The Securities and Exchange Commission recently updated guidance with respect to the regulation of private fund advisors. The new rules and amendments are designed to protect private fund investors by increasing transparency, competition, and efficiency in the private funds market. Certain portions of these rules relate to or are relevant to fund finance market participants, including new mandated investor disclosure of fund performance metrics without impact of a subscription line.

  - ***Subscription Lines.*** Sponsors will still use subscription lines of credit. However, some limited partners are pushing back on the use of subscription lines because of higher interest rates than we have seen in recent memory. Accordingly, sponsors will increasingly use subscription lines for short-term administration convenience rather than longer term investment management.

  - **Regulatory cost of capital.** Capital requirements will force banks, especially regional banks, to monitor credit more intensely, administer it with more precision, and continue to learn more about the limited partners.

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