HAYNES BOONE

PANEL SUMMARIES

FFA 2024 European Symposium

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CAPITAL CALL FACILITIES[1]

By Zainab Al-Qaimi

The panel explored the capital call facilities in light of the current state of the market – discussing the repercussions of slow fundraising. The challenges and opportunities in managing liquidity and capital constraints in various financing contexts were touched on, as well as the growing importance of ESG and sustainability considerations in finance.

Outlook

In terms of timing, it was suggested that the hostile fundraising environment has come at a convenient time for banks, who are struggling with capital allocation over the last 12 months, which has perhaps provided an artificially buoyant market. However, banks are optimistic looking at the year ahead.

As a consequence of a slowdown in fundraising, the market is seeing multiple different closings happening throughout the fundraising period of a fund. This has a substantial impact from the operational perspective of the bank on the credit side. This could also have pricing implications as lenders joining at the first closing of a facility will be at a disadvantage to those who join later as the lenders coming in at a later date will have the benefit of greater visibility as to the utilisation and workload of the facility's credit.

Despite market conditions and slow fundraising, there has been an increase in demand. While deployment has slowed down to some extent in certain classes, facilities are remaining in place over longer periods of time, which results in an increase in the aggregation of exposure across certain asset classes among most lenders.

The rise of non-bank lenders causes issues for subscription finance. Although there are certain asset classes which lend themselves to more term loan structures, they are more involved in terms of structure and therefore documentation and negotiation.

The position of subscription finance in an evolving market

The continuing consensus is that there will always be a place for capital call finance. It is no longer being used merely for the purposes of an IRR boost or backdoor leverage – they are now truly operational facilities that help GPs with the management of capital calls from their investors. Subscription financing

[1] Panelists included Gül Akad (Simmons and Simmons); Julien Claudel (Société Générale); Nicola Germano (Intesa Sanpaolo); Michael Hubbard (Cadwalader, Wickersham & Taft); and Stuart McIntosh (SMBC).

helps to smooth the initial J curve that exists in the early life of a facility regardless of where interest rates sit at the time, and support with complex equalisation processes. Lenders have been forced to adapt to smaller, more complex LP bases from the inception of a fund.

Basel IV

In the lead up to the regulation's implementation, various approaches have been adopted by bank lenders in the last six months. Uncertainty prevails around interpretation of the rules, with lenders having different interpretations and solutions while working towards the same goal – better capital treatment.

Ratings, uncommitted structures and securitisations are all among the options that bank lenders have as they experiment to find a suitable solution in the next year. Basel IV will mark a turning point for the market when it comes into effect, particularly for bank lenders.

While the interpretation and details remain subject to finalisation, it cannot be said that banks have not had fair warning – having been on the horizon for over a decade, those subject to the regulation have had ample time to prepare.

Ratings

Although there remains a question mark over public ratings against private ones, there is an expectation that this feature will become more common going forward.

It is not necessarily difficult to obtain a rating for an existing facility. The difficulty arises in managing to get a rating alongside initial closings while securing the best offer from lenders. While there are banks that do not require a rating themselves, the syndication process becomes easier from a bank's perspective if that rating is already in place.

This plays into the wider challenge of how GPs are managing their bank group. There needs to be a push for more avenues of conversation between rating agencies and GPs. Narrowing down the number of banks is a significant part of the solution, as it allows the delivery of solutions to come from the lender's side, as opposed to placing pressure on GPs to find these.

ESG

Placing an ESG loan at portfolio company level is relatively simple – but replicating this on a fund level is more complicated. While there is a pool of capital available and a prescribed fund strategy, there is little visibility on where the capital will be deployed amongst the portfolio companies. This means that it is difficult to specify KPIs that are material but also achievable.

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Given that this is an emerging area in the fund finance realm, there is a further challenge of ESG metrics defined by lenders, which have to be broad enough to apply to as many clients as possible – whereas it is likely that funds in the ESG space will be focusing on a certain niche, which could prove difficult to align with a lender's far-reaching metrics.

From an LP perspective, fund finance has yet to reach a point of focus in the ESG space – but this is only a matter of time. Over the past 12 months, the priority has been on asset and house level. In the midst of the liquidity crunch throughout 2023, the focus was on getting the financing in place without adding complications presented by ESG specific strategies. However, we are seeing more funds raising specific strategies – and in order to meet the net zero target, $4.5 trillion will have to be deployed per annum by 2030. There is an incredible amount of focus that public and government agencies will not be able to fulfil – private markets will have to step in here.

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CFOS AND RATED NOTES[1]

By Kirsty Harshaw

The “CFOs and Rated Notes” panel discussed their own experiences of each of rated note feeders and CFOs and what they are observing in the market.

RATED NOTE FEEDERS

Rated note feeders are an old product, and we do still see private funds with certain types of investors which prefer to hold debt rather than classic LP interests (a more conspicuous one would be insurance companies which are looking to get the regulatory capital treatment on the debt instruments). In a convenient world the basic note feeder would look just like a regular feeder except it issues debt alongside the LP interests classically in a vertical strip to the investor that is coming in, however, there has been an evolution where we have multiple tranches.

Of course, there have been various variations of rated note feeders, but the panel noted they are seeing rated note feeders into credit funds most often.

CFOs

Not to be confused with chief financial officers, at its core collateralised fund obligations are the same as rated note feeders, but the underlying risk is not an investment in a single fund but an investment in a diversified pool of funds. One instance where we see CFOs is when we have regulated insurance companies that are keen to get exposure to the asset class and they are looking for a fixed income product, as a result they are willing to lend against the equity risk in those private funds. Once we have leverage against the equity risk, the question is, will there be equity investors that are keen to invest in those product funds on a super level basis. If yes, then you can create a structure where equity investors invest in the SPV, debt providers provide financing to the SPV and then the SPV has ways to write commitments to underlying funds. As a fund manager, you have multiplied the asset under management and that is a great fundraising tool.

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[1] Panelists included Simon Felton (Appleby); John Anderson (Goodwin Procter LLP); Matthew Maguire (Park Square Capital); and Pierre Maugüé (Debevoise & Plimpton LLP).

Is there demand for these products?

As private debt managers, Park Square Capital see a huge amount of interest from investors for rated structures when providing a solution to drive capital efficiency. With CFOs there is less of a use case in private credit land where investors already have access to a very diversified pool of assets.

Where does the interest for these structures come from?

The panel noted that they are seeing interest from three main jurisdictions (i) the US; (ii) Korea; and (iii) across Europe.

The US is an interesting market - insurance clients are looking to get the benefit from a reporting angle or from a capital efficiency angle. Different insurance firms/different subcategories take different views as to whether it is a single tranche or a multi tranche product. The panel noted the most important part is getting the mix of debt to equity in your feeder, this is probably a 90/10 split - 90% in note form and 10% equity being the most optimal.

In Korea there was a huge amount of activity up until a couple of years ago. When the US was making a lot of noise about CFOs, Korean regulatory regimes backed off and are a little more negative on single structure ratings, however, they still remain an important fund-raising tool.

In Europe there is a less obvious use case because of the Solvency II regime, and it requires you to take a look-through view. Having said that, there are a number of insurers that have additional internal models that mean having a rated structure allows them to get a better cost of capital on that non-cash paid element of the portfolio.

The panel did note that all the geographies require different structures and ratings and so it is not a case of one size fits all. It's a complicated process in the sense that when you think about investors you need to know the subset in each geography and find a fitting solution for the anchor investors, but in the opinion of the panel, it is worth it to unlock the additional capital.

How are these structures set-up and what are the costs?

It was discussed by the panel that you need some sort of investment capital beforehand. The process for getting a rating is very methodical and it takes around 6-8 weeks to get a full rating, with an initial rating costing between $100,000 to $150,000 and then an annual monitory fee of 5-10bps, so many

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take the view that a feeder needs to have around $100M to $150M worth of interest before it makes sense to incur these costs.

Panel members have been exploring whether, given the demand for an ‘evergreen’ product, you can figure out the demand first and then when the product is ready, plug that (pre-existing) feeder in and avoid having to wait for a cycle of allocations.

It was noted that the market is aways looking at different types of products and there is a desire to try to focus on providing an investor led solution rather than the other way round, so we will have to see what happens. Either way, there is a lot of time and costs required, and you need to consider these with anchors and insurance companies in tandem with LPs as they all have different requirements.

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EMERGING AND CONTINUING THEMES IN FUND FINANCE[1]

By Tautvydas Medziukevicius

The panel's conversation centred around the growing trend of mega funds and their impact on the finance industry. Speakers discussed the potential benefits of being acquired, as well as the increasing complexity of private equity investments. They also explored the market dynamics of alternative lending in the private credit market and the significance of rating systems in improving liquidity in the debt market. Finally, speakers shared their experience with NAV lending and the challenges of navigating the evolving landscape.

Rise of Mega Funds

Mark Nielsen discussed the benefits of General Atlantic, a private equity firm acquiring Actis, a smaller infrastructure fund manager. From a borrowing perspective, Actis will be able to utilise now a much larger $100 billion platform. Whereas General Atlantic are diversifying and expanding their expertise in a completely different asset class. Actis's investors will have more confidence in investing into a smaller platform which is backed by General Atlantic and helps raise money in the future as well as provide Actis access to General Atlantic's existing base of limited partners. All limited partners on both sides of the acquisition have consented to the deal.

As Actis are investing in sustainable infrastructure, their investment policy aligns with quite a few banks and their strategies in terms of financing. General Atlantic predominantly invest into technology and have a different profile and therefore work with different banks. ESG is a positive differentiator when it comes to financing and banks which have objectives in terms of funding ESG initiatives. Going forward, the plan is for Actis and General Atlantic to agree on a set of banks to work with in the future, particularly as Actis currently going through a change of control process.

Current Climate

There have been significant pressures in the current climate for the infrastructure funds to deploy capital and, therefore, the funds have been having to accelerate fundraising to the extent possible in a difficult environment. As a result, the investment funds are having to raise concentrated facilities

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[1] The panelists included Aimee Sharman (Mayer Brown International LLP); Robert Milner (Carey Olsen); Bhupinder Singh (First Abu Dhabi Bank); Raghav Wadhawan (Standard Chartered Bank); Mark Nielsen (Actis LLP) and Sherri Snelson (White & Case).

where there are one or two anchor limited partners and ensure banks are comfortable with such concentration.

NAV facility use is increasing in both Europe and the United States. Interestingly, the US has been slower than Europe in adopting NAV facilities. The slowness in the US market has been probably driven by tax and documentation issues, and perhaps by the need to educate the limited partners. Non-bank lenders, in particular, are getting much more creative and looking at circumstances and designing a product that suits each particular situation.

The panel has also noticed a greater sophistication among the limited partners which have universal fund choices and capacity and ability to evaluate opportunities and fund managers. The sophistication of investors may be one of the driving factors for consolidation of managers. There are not only higher requirements being put on managers but also due diligence requirements from the GPs, more information required and more process required in order to satisfy reporting obligations and keep the limited partners happy.

The panel discussed the potential for further globalisation of the funds market, but remarked that issues related to the success of such globalisation include the nature of the assets being bought, the specific region in which they are being bought, regional concentration of assets and the readiness to enforce against such assets.

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GP FOCUS[1]

By Tautvydas Medziukevicius

The panel discussed the current state of the fund finance market, including changes in GP's liquidity management and the subscription line market. Speakers highlighted the growing demand for innovative solutions in asset financing and the shift from part-time roles to full-time dedicated teams for managing liquidity. They also emphasized the importance of building relationships with lenders to secure favourable terms and navigating the market's increased sophistication.

Current Opportunities and Challenges in the Fund Finance Market

As the fund finance market continues to grow, GPs are establishing teams dedicated to fund finance. Five years ago, fund employees would focus on fund finance part-time, but that is no longer the case. An important role of the fund finance team is now coordinating with the banking community. The fund finance teams within the GPs are becoming more integrated with the whole business to understand how fund finance interacts with the wider objectives of the firm.

As there has been more volatility in the market in the last few years, GPs have placed increasing importance on identifying which participants in the market are a good fit to the sponsor and ensuring that they are finding potential long-term relationships.

Further, the demands and habits of the GPs are changing. Previously investment funds took on borrowing to the maximum extent permitted under the LPA. Now the ask is a lot more sophisticated, as GPs assess what they need in terms of financing more narrowly and thus tailor their requests.

NAV Financing

At a certain point in the life of the fund when the capital starts to get cold and the investment team needs firepower to deploy and take advantage of the market opportunities, NAV financing is being put into funds and even the unlevered strategies. It is a useful tool and there is an increasing demand for NAV facilities from the GP's side.

We see NAV financing being used in respect of different asset classes, including real estate. It is a buoyant market, and segments of it are still in the talking stage.

[1] The panelists were Gianluca Lorenzon (Validus); Jamie Mehmood (Deloitte); Brad Mitchell (Pantheon Ventures UK LLP); Rhita Sami (Hayfin Capital) and Stephen Thomas (Coller Capital).

GP and Bank Relationships

It is becoming more important for the lender to understand the objectives of the GPs in terms of new strategies and new product designs. Banks who innovate to add value are more likely to win deals and relationships, so will benefit by engaging in realistic dialogue with GPs. Early conversation can result in accommodation of lender constraints and accommodation of GP needs.

Subscription Lines

Market events stressed liquidity in 2023 on a macro level and in some cases for individual banks. As a result, there was a tightening of supply. Capital raises slowed, which somewhat suppressed demand, although subscription line facilities remained steadily available, especially for established players. With a market that continues to be predominantly serviced by banks, tenors are shorter, facility sizes smaller, and in a slow fundraising environment, closing times are extended.

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HOT TOPICS AND TRENDS IN FUND FINANCE[1]

By Zainab Al-Qaimi

The panel's discussion revolved around the growing demand for liquidity in the market, and how participants have responded to this in search of a solution. The increasing influence of LPs in private debt investments was also discussed, as well as the rise in non-bank lending.

Key challenge – liquidity

Many of the recent trends in the market are driven by liquidity issues faced by all participants. With LPs suffering negative distributions, they have turned to fund finance for liquidity given that the macro-economic environment has prevented them from utilising typical exit routes, such as IPOs and M&A. As a result, GPs have turned to lenders for creative solutions in an attempt to generate liquidity and there has been a real push towards finding a solution in the form of a fund finance product.

Evergreen funds

The evolution towards open-ended structures allows LPs to reallocate their capital with greater ease – they are able to vote via asset allocation. These structures are designed to allow LPs to invest in a more liquid manner.

Capital pools

In light of the challenging fundraising environment, traditional institutional LPs cannot be relied on to meet the hard caps of funds. As a result, GPs are having conversations with lenders for smaller ticket sizes in the first instance in order to tap into the secondaries market, with a view of fundraising through private capital from high-net-worth individuals. Blackstone saw the largest inflow of private wealth at $8 billion in Q1 2024.

Valid concerns were raised on the panel as to the impact this may have on the borrowing base and therefore facility amounts as lenders have never been in the realm of lending against high-net-worth individuals in the past. However, it was concluded that the industry will cope given that it is a necessary adjustment to plug the gap in fundraising.

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[1] Panelists included Russell Evans (National Australia Bank); Alex Griffiths (MUFG Investor Services); Bronwen Jones (Reed Smith); Antoine Leboulanger (Ardian); Anthony Lombardi (DLA Piper LLP); and Katie McMenamin (Simpson Thatcher & Bartlett).

The growing presence of non-bank lenders in the market

Views across the panel were split on this point. At its core, the support for alternative lenders depends on what they are able to do – as there are vast discrepancies in this across different providers. As a part of the syndication process, non-bank lenders who are able to execute revolving credit facilities are viewed more favourably as this allows them to slot into existing structures seamlessly given that many alternative lenders are only able to structure tranche loans. However, it was noted that banks have begun adopting tranche loans to enable them to compete in the market, suggesting that non-bank lenders are here to stay.

On the other hand, it was raised that these structuring limitations ultimately reduce the flexibility of GPs as clients. While the insistence of many non-bank lenders on term loan tranches has proven to be a source of additional capital to the service providers of the sector, it is GPs that will have to absorb these increased costs.

NAV facilities

It was noted that while NAV facilities are a hot topic in the market at the moment, they are not a homogenous product (as bad press makes them out to be) nor are they novel. NAV facilities as a product have existed for some time, particularly in the secondaries and credit space – here LPs are well versed in their use. It is not so much that NAV facilities are a new concept, but rather that there is now a wider pool of LPs that are more focused on this and thus are more willing to ask GPs the difficult questions – painting the picture that they have more power.

The current views held by LPs are not unanimous, and there are varying thoughts on the use of NAV across various asset classes. The key to the broadened adoption of NAV facilities is education – not solely among LPs, but also regulators. Lenders recently received letters from the Prudential Regulation Authority to ask questions. It is important to educate the market on the necessity of NAV and how it can be controlled. Communication is crucial on the nuances of NAV as an option and when they may be best suited.

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LEGAL UPDATE[1]

By Tautvydas Medziukevicius

The "Legal Update" panel discussed latest updates surrounding market trends, regulation, fund terms and the LPA.

Global Trends

The fund finance market continues to grow at a high pace, particularly on NAV and more structured finance fund facilities. Subscription lines have been more commoditized, repetitive and intuitive. It is a proven technology that works for the funds and limited partners. There are more funds involved in the subline space including insurance funds, which means that there are more funded facilities and more term loan type structures that are permeating and persisting through most of the life of the fund creating, in some cases, more ratings requirements.

On the NAV side, it is becoming more interesting from a structural perspective. From a tax and legal perspective, the challenge is that investment funds are not necessarily constructed to accommodate a NAV facility. Legal, accounting and tax teams may have to engage in creative contortions to put facilities in place. With new generations of funds, the fund structures themselves are becoming a bit more accommodating. Preferred terms are being integrated into LPAs and fund structures set up so that there are no longer a multitude of equity HoldCos sitting above each asset that run into the MasterCo. There is now smarter technology to effectively do the same thing as before, compliant with the LPA, without creating unwanted tax implications.

The fundraising environment needs to be taken into context as it has been more challenging over the past couple of years. As a result, the Investor Relations teams are less receptive towards NAV facilities as they would like to change things as little as possible. They just want to focus on rolling over the same limited partners with minimal trouble and therefore NAV facilities may go on the back burner.

Fund Jurisdictions

Luxembourg remains the main fund jurisdiction because of its friendliness to investment funds and known structures and documentation.

[1] The panelists were Loïc Bacquelaine (Travers Smith LLP); Gabriela Patrikova (Linklaters LLP); Jad Nader (Ogier); and Roxana Mirica (Apax).

Luxembourg has been also very successful in last few years in terms of retailisation and establishing UCI part 2 funds. The success should be mostly attributed to the pragmatic regulator. Last year, the legislature in Luxembourg amended the law to bring more flexibility and to structure the part 2 fund as a partnership. By doing so, the legislature answered the questions from alternative investment fund managers whether those types of structures could be dedicated to retail. The possibility of using a partnership for a more traditional structure for alternative investment fund management will help UCI part 2 funds remain attractive.

Fund Documentation: NAV Financing Related Changes

The increase of NAV facilities for any type of fund has been a big topic. It is important to distinguish between different strategies because NAV facilities have been around for a long time for secondaries, credit funds or real estate funds. It is a bit newer in the private equity sector. However, PE documents are usually wired for NAV facilities as they are frequently silent on the type of financing permitted, while including terms that contemplate debt. A standard private equity LPA will typically have limits on borrowing, but those limits only capture borrowing at the fund level, whereas NAV financing will often be set up at a level below the fund.

LPAs do not cover NAV financing and any related disclosure because NAV facilities have not been a focus, and become relevant later in the fund’s life, whereas fund documents are agreed at the beginning of the fundraising stage. Sponsors have taken different approaches to this. Some have taken the view that if the document is silent, it is not prohibited. Other sponsors have involved the investors in the discussions and even if they don't necessarily need consent, they will at least have some sort of consultation with their investor Advisory Committee.

So far, this tension has not led to many changes in the fund documents. This largely to do with the current market and the difficulty to raise financing. Historically, it took many years for funds to recognize the utility of addressing subscription financing in the LPAs, and to overcome their reluctance to ask LPs to make changes to the fund documents. In a time where GPs have less power, it is difficult to introduce significant changes. On the other hand, some investors may be nervous simply because the fund documents are silent on NAV financing, so they do not how, when and why NAV financing is going to be used.

One interesting development over the next month is going to be the release of guidance by Institutional Limited Partner Association (ILPA) on NAV Facilities. Transparency and education are predicted to be big topics in the guidance which will drive the discussion between limited partners and the investment funds on NAV financing.

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Fund Documentation: Subline Related Changes

The development of the subline market has led to higher caps compared to a few years ago and there have been smaller changes to make sure that the LPA works. Almost all LPAs will include an agreement by the LPs to fund capital calls without defence or counterclaim. The investors now accept this and no longer challenge it, although sovereign investors or international organisations (like the U.N.) have internal procedures and policies that may restrict their ability to agree to waive rights. However, an agreement to fund, while reserving rights against the GP and other LPs may often be accomplished, even if the LP has to get approval from senior management in their organisation.

AIFMD 2

Credit fund managers will be the most impacted by the new changes because of the new loan originating rules. AIFMD 2 will differentiate between funds which originate loans and loan originating funds. New rules will be on concentration limits, risk retention requirements, leverage limits and requirements to put in place policies to monitor and manage the credits and the assets of the funds.

Investment funds which do not originate loans to third parties may be within the scope of AIFMD 2 if they provide loans to entities within their capital structure. Many investment managers do so for internal structuring purposes. We will need to see how the directive is implemented in the member states to confirm this and how this will affect the shareholder exemption. Because of this a lot of the documents for the internal structure may need to be redrafted.

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LENDER LANDSCAPE[1]

By Alexander Short

The "Lender Landscape" panel covered questions relating to lender-side fund financing issues of today.

- **What new lender strategies have been adopted?** Slow fundraising has led to a more concentrated day one borrowing base recently. Borrowers want earlier liquidity, so are approaching lenders earlier (so lenders are seeing more continuation vehicles). Similarly, they are seeing a lot more demand for more structured products. For example, ESG is moving from being driven by lenders to being driven by borrowers (along with a bit of tightening of terms).

- **What new competition is there and how are banks responding?** Set policies and procedures are quite rigid, and banks are often reluctant to change lanes. While they will consider HNWIs, these need more consideration and work, with different adaptations. It is a misconception that non-bank capital deployment is limited to term loans and many non-bank lenders can provide RCFs, and deal with all currencies etc. (depending on who the investors behind the non-bank lender are). Benefits of using non-bank lenders is that they don't compete for ancillary business and could free up more capital for bank lenders when partnering on a facility.

- **What products are borrowers looking for?** Borrowers are looking for flexibility, and so there's an increasing element of products being combined together – non-bank and bank lenders are moving towards cross-selling each other's traditional products. This could lead to tensions. While there's appetite and space for everyone, going forward lenders need to be flexible about what they're offering. However, non-bank lenders still have ongoing requirements, and still have standard levels of involvement at all stages. Sublines will remain the largest stake of the fund finance products being offered. Ultimately, it comes down to liquidity need, so second lien security packages or more concentrated borrowing bases are products that some borrowers will request.

- **Latest market updates?** Discussions on Basel 3.1, predominantly ratings focused. Some GPs are keen to consider ratings, but many are adopting a "wait and see" approach. There were initially concerns about public disclosure of LP lists for example, but this has not been an issue to date. Borrowers and lenders are focused on the reference rates and looking for them to go down.

- **Predictions for the next three to five years?** Funds will get larger and larger, requiring more syndication. Use of ratings will become commonplace, albeit slowly. Rates will stay high for a while

[1] Panelists included Findlay Hyde (abrdn); Charlotte Jones (ING); Leigh O'Brien (Mizuho EMEA); Victoria Stewart (Partners Group); Paul Tannenbaum (Proskauer); and Steven Tremblay (Assured Guaranty).

so change will be slow. With regulation like CRD VI on the horizon there's lots for lenders to consider in the next few years. Funds anticipate more financing at all stages of the lifecycle of the fund. There should also be more space for insurers, both to provide their products and to lend.

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MARKET UPDATE[1]

By Alexander Short

The "Market Update" panel covered questions relating to the current state of the market.

- **What is current state of the market?** For larger managers, fundraising is slower but still robust. A slower exit environment is influencing borrowers' desire to keep their subline in place for longer, but lenders are offering shorter tenors, often 364 days, or a single two year maturity, leading to requests for (committed or uncommitted) annual extensions. The panel is carefully watching Basel 3.1, remarking on increased interest in rating facilities. Generally, managers are optimistic about market outlook, unlike last year. Pricing has widened 20-60bps, and on NAV 40-45% on LTV is now more typical, as there is less risk appetite. There is also an influx of new players – alternative providers and banks opening new desks, plus regional banks in the US returning to the market in numbers.

- **Reactions to interest rates and inflation?** For a while there was less liquidity, but borrowers aren't changing their strategies – they need their sublines. This has led to pricing increases, but borrowers have accepted this. Given fundraising is slower (up to 24 months) the banks have seen facilities been put in place initially, but then not reaching full size until a year or two later, often with additional banks. There was also the view that there were generally more concentrated investor bases, with some investors being accepted who wouldn't have previously been (e.g. UHNW individuals). This goes hand in hand with an update in SMA financing.

- **Fallout from regional banking crisis – has the market recovered?** The view from the panel was that SVB moved over to HSBC with minimal disruption, and business is back to normal generally, other than pricing which has shot up 25-50bps.

- **Challenges for 2024?** The roll-out of additional regulations that constrain liquidity at banks is the biggest challenge. Fundraising will continue however, so the gap between supply and demand will cause pricing to increase. On the positive side, though managers will hold assets for longer, alignment between GP and LPs is getting closer about need for NAV financing, e.g. having appropriate optionality in LPAs is more common. The development of non-bank demand to meet constraints due to banking regulations will be a big focus.

[1] Panelists included Mark Alexander-Dann (ANZ); Mike Durnin (Ares Management); Vanessa Lawlor (Maples Group); Keenan McBride (Morgan Stanley); Emily Rose (HSBC); and Saniyé Tipirdamaz (Mourant).

NAV 1.0[1]

By Alethea Barretto

The "NAV 1.0" panel dealt with the primary question of "what does NAV mean to you?"

- **What does NAV mean to you?** Everyone has a different view as every lender has a different underwriting policy and there is no 'market standard'. Generally, a NAV facility is a downwards looking financing where lenders have recourse to the value of the underlying assets of the fund. How this type of financing is structured and why it is used depends on the GP/LP conversations and the asset class of the fund, amongst other things.

- **Is there a difference between GP/LP attitudes with respect to leverage at the outset?** It depends on the strategy and what was intended by the LPA at the outset of the fund's life. Funds may not be able to predict their future leverage needs at initial closing, with such needs only becoming apparent as the fund matures. Amendments to the LPA in order to permit the incurrence of additional debt at a later stage in the fund's life is when LPs are likely to start questioning the use of the debt and the benefit to them.

- **How has the NAV product changed over the years**? NAV is not a new product and many lenders have been providing types of portfolio financing, which now would be categorized as NAV, for years. The main change has been in the collateral package. Historically, some bank lenders may have provided unsecured NAV lines in the past (or taken security over bank accounts where distributions are paid into only), but now will want a comprehensive collateral package.

- **What is the collateral package generally like now**? The panel agreed there is no standard NAV collateral package in the market and the nature of collateral offered up will depend on the asset class of the fund. Generally, lenders want to be as close to the asset as possible. Security is generally taken over the SPV that holds the portfolio of assets, along with security over any account into which distributions are paid into. Collateral can be trickier where the fund only holds minority stakes in portfolio assets. Security can be taken over these minority stakes with a view to any creditor being able to sell them on the secondary market in the event of enforcement, but lenders should be aware that there are instances where the secondary market may be closed.

- **Who are the key lenders in the space**? There are two key actors: financial institutions and alternative lenders and which of these lends is largely dependent on the size of the fund. Large

[1] Panelists included Sarah Ambulante (Loyens & Loeff); Zoe Hallam (Walkers); Stanley Likver (Ares Management); and Mohith Sondhi (OakNorth).

funds will have access to traditional lenders but options for mid-tier firms are greatly reduced, with alternative lenders more likely to lend. Insurance companies are also coming into this space. It also depends on the asset class, for example, real estate funds find it difficult to get funding as real estate is an illiquid asset class.

- **Enforcement** – Since the COVID19 pandemic, there has been an increased focus on enforcement and exit strategies with upfront enforcement memos becoming common. Enforcement is particularly crucial to lenders and creditors are looking for multiple exit strategies, how they can exit and the ease with which they can exit. They want to understand how to take control of the vehicles or replace the GP if needed.

- **What does the future of NAV look like**? While NAV is by no means a new product, there is an education piece that needs to take place in the market. The panelists were of the view that NAV financing has increased in the past year and will continue to become more commonplace in the next 12-24 months. Hybrids, mentioned throughout the conference, also came up and the panel and audience are interested to see how these will be deployed/developed in practice. The reality is that it is often more expensive to put a hybrid in place then it is to put a separate subscription-line and NAV line in place. The hope is that education of the use of NAV financing continues at the LP level and becomes a commonplace tool in the fund finance market, much in the same way as subscription lines have evolved following industry education and uptake.

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NAV 2.0[1]

By Alethea Barretto

The "NAV 2.0" panel discussed a more advanced and sophisticated NAV product deemed to be "NAV 2.0".

- **What is NAV 2.0?** It's a more sophisticated version of the NAV product. The distinguishing features are (i) a specificity of terms and approaches for individual asset classes, for example and (ii) multi-disciplinary nature of more sophisticated products. The panel explained this as there being waves of NAVs, with NAV 2.0 being a product with more intermediation, larger fund sizes, larger executions and broadening participation. There seems to be a real convergence of term sheets on NAV facilities and a strange standardization is being observed in the market.

- **Structure –** Typically a NAV facility is a covenant-lite structure. From the sponsor's perspective, this is the focus of the financing and typically it's an aggregator with pref. The unsecured/cov-lite nature of NAVs makes it easy and quick to execute as every asset is not checked.

- **Ratings –** The panel mentioned the securitisation rules for private debt. Ratings agencies are now developing ratings for equity NAV financings. Banks are looking at capital usage internally so the ratings would help with tranching and back levering.

- **Valuation –** When underwriting, underwriters look at the underlying covenant package so the V in LTV is crucial. As there are more trades, everyone will become more comfortable so 20 LTV trades could become more attractive. Separately, independent valuations have a role to play in NAV financings.

- **Borrower's view of the NAV model vs Credit fund ABL model –** NAV is a more flexible type of financing but it is still not directly secured by the underlying assets so borrowers appreciate this position. Reporting on ABL is very time consuming so the lack of a need to do this in NAVs is another benefit. With base rates approaching 4.5%, asset level debt is expensive so NAVs become an attractive option for borrowers looking to take advantage of strategic debt.

- **Trends in syndication –** Sponsors might want to know who the lenders are. This can be tricky and sensitive due to the information transfer that would need to take place for this. On the flip side,

[1] Panelists included Susannah Amini (Kirkland & Ellis); Richard Fletcher (Macfarlanes); Andrew Husdan (Clifford Chance); Fantine Jeannon (LGT Private Debt); Steven Mansy (Macquarie Group); and Simon Thwaites (Barclays).

sponsors also want protection at the asset level and as NAVs are priced more expensively than capital call facilities, there is greater expectation for a more sophisticated product.

- **Future predictions –** The NAV 2.0 product exists and has a foothold in the market but there is a need for education. There is an upwards pressure on the LTV level and more innovation in private financing so one can definitely expect movement in this space. One speaker did express concern that the rush of lenders in a space with no sector specialists might be a risk of sorts, but the advice is to borrow carefully and to get regulators comfortable with this product. With 3 trillion USD in PE assets, it will be interesting to see how much of this is filtered to LPs so that it affects NAVs and the overall outlook for the future is extremely positive.

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NAV LENDING TO CREDIT FUNDS[1]

By Alexander Short

The "NAV Lending to Credit Funds" panel covered questions relating to the net asset value financing market.

- **What are the different approaches to lending to private debt funds?** There are three main differences: (1) a much more homogenous portfolio; (2); a lot more granularity for the underlying eligibility of assets; and (3) the structure is going to be a securitization type structure with different tranches. Private equity strategies are more opportunistic (end of life for example). Credit funds on the other hand expand the size of the fund and enhance returns, and are more all-encompassing in terms of security over all assets.

- **Pros and cons?** Yield is higher, and the advance rate is higher, so funds can maximize leverage. Cost – they are cheap for lenders, so they can lend more at a higher rate of return. Tenor – 5yrs or longer means certainty of capital. Hedging – multicurrency facilities so naturally hedge the debt creating IRR benefits. One main con is that if assets diverge from expectations, there are issues around edge-cases which might require lots of analysis regarding concertation limits for example, which requires resources. On the whole it is an intense facility requiring lots of reporting on the assets. Lots of documents must be provided and reviewed, and reporting needs to be done on time and constantly updated. Finally, an approval based approach means lenders can reject assets with wide discretion, which can be difficult for borrowers.

- **What different strategies are we seeing?** The general view was that the lender process was still very non-standardized and bespoke. There are a lot more non-bank lenders moving into the market and transaction sizes are increasing. The assumption is mark to market and fully recourse, but borrowers/lenders are sensitive to marking methodologies that are unilateral. A lot of the product development for funds of this type has been to find the right balance for delivering valuing methodologies that is linked to underlying credit principle. Many ideas are being borrowed from other markets, e.g. securitizations. Finally, lenders are seeing a growth in lending to funds where security is just limited to rights to distributions to assets rather than a locked box structure, so ultimately less secured. This may be made up for by diversification requirements and modest LTVs. It is crucial to have a good trusting relationship between borrower and lenders in this market.

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[1] Panelists included Emma Russell (Haynes Boone); Jons Lehmann (Fried Frank); Pierre-Henry Quantin (Corinthia); Thomas Speller (KBRA); Marco Unti (Deutsche Bank); and Ramesh Yesodharan (Sumitomo Mitsui Trust Bank).

- **Performance of fund – how does structure impact?** Under the typical fund five year tenor, ramping up is an issue – a borrower needs a good diversification score for large lenders so it can't have much leverage day one, meaning there's a need to have a subline or hybrid for this ramping period (and there's a similar issue at the tail end). Once capital is deployed, borrower is obligated to make lots of repayments to lenders ahead of itself.

- **Regulations impact?** Given these products are effectively securitizations, they always need to be analysed for securitization regulations (including risk retentions). The lender analysis of capital treatment is essential as it impacts pricing to a huge degree, as well as impacting which investors can invest in funds that have securitizations. When considering AIFMD II, concentration/leverage limitations on funds need to be borne in mind. This means all parties need substantial operating teams, credit monitoring and examining aggregated exposures.

Conclusions? From the borrower perspective, it is an attractive product, but the key is to knowing who to partner with. Some of the biggest challenges include the ability to deploy capital given funding rates remain high. The sector has modest defaults, trending very low in private credit, and elevated interest rates still hasn't caused too much difficulty. If interest rates stay high then more disciplined and larger manager will start to outperform.

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PREQIN UPDATE[1]

By Zainab Al-Qaimi

The "Preqin Update" discussed the state of the market across various asset classes using data to analyse past performance and predict future trends.

Current challenges in the market

Investors are focused on the interest rate environment and inflation. The key question on everyone's mind is when will rates fall – but these are set to remain higher as central banks have indicated that they need to see more data before making any cuts. It is predicted that higher inflation is also here to stay, playing a key role in the correlation between various asset classes.

Trends in asset allocation

Alternative assets – why are clients gravitating towards this?

From GPs and LPs to sovereign wealth funds and family offices, there have been underlying regime changes to traditional portfolios. The key driver here is the correlation between public markets, equities and bonds. This correlation has increased over the last 25 years.

A shift in the market

A wide variety of assets constitute alternatives – these range from endowments, foundations, insurance and pension funds. In the past five years, there has been a huge growth in allocation towards these kinds of assets. As of 2023, allocations to alternatives make up nearly 20% of weighted average portfolios. Within this, endowments are the biggest allocators at 46%.

Looking ahead

Figures suggest that more than 50% of investors plan to commit more capital to private debt – it is predicted that this asset class will see the most benefit in the next 12 months. Positive sentiment has also been expressed towards private equity and infrastructure in particular. Following on from recent performances, it is no surprise that venture capital and hedge funds do not have positive projections for the upcoming year given the significant growth in down rounds over the last two years.

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[1] The speaker was Paul Sinthunont (Preqin).

Looking back – 2023

Fundraising

Last year was a muted year in terms of the fundraising activity in comparison to previous years (2021 and 2022). 2023 presented a tough year, and no recovery is expected until 2026. Q1 data in 2024 indicates that this year will see a similar performance unless there are significant macro-shocks. From an asset class perspective, only private equity managed to outperform last year on the fundraising front, other asset classes suffered significant falls – some even double digit.

Deals

This landscape proved similar to that of fundraising, as there has been a fall in the number of deals since the peak of 2021. However – while deal count has reduced, there has been an increase in aggregate value at the tail end of 2023, which could signal a turning point for the market when it comes to transactions.

Impact on LPs

The slowdown in fundraising and deals has resulted in fewer distributions being received by LPs – either slowing down or completely pausing. This is hurting the pacing models of LPs, and in the long run this could result in lower commitments being made.

AUM

Looking at both dry powder and unrealised value, it is projected that the market will reach the £25.5 trillion mark. Generally, over the past decade the growth of AUM year-on-year has sat around 16%. While this level of growth is no longer expected, it is still projected to stay in the double-digit range at 10% – with private debt, infrastructure and private equity being key in driving this. From an aggregate perspective, the only asset class expected to outperform in the next six years is private debt.

Asset class updates

Private equity – while M&A deals have been falling (including sponsor backed ones), the European markets have shown positive signs as a rebound in global exits spark hope for recovery – with the LP-led secondaries market being of growing interest among clients. Generally speaking, the market seems to be awaiting direction from central banks as interest rates will play a key role. Funds-wise, despite more fundraising, fewer have been able to close.

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Real estate – deal count has seen 8 consecutive quarters of decline, with contraction expected to continue. A lot of structural changes within the economy (e.g. the rise in working from home) have impacted this sector in particular. However, real estate debt has seen steady capital deployment despite deal decline. There has been a surge in dry powder across the different strategies in response to the slower deals market, with GPs waiting on the right time to invest.

Private debt – direct lending remains the most popular strategy here. Europe in particular has experienced a huge push towards private lending, while the US has remained more diverse; taking advantage of opportunities in both direct and mezzanine lending. In Europe, direct lending has taken the dominant share of AUM, with experienced managers capturing the majority of this.

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SECONDARIES[1]

By Kirsty Harshaw

The "Secondaries" panel discussed the growing volume of secondaries with regards to both, the traditional LP-led secondaries, and the more recent growth in GP-led secondaries.

What is the deal volume in the secondaries market and how has this developed? The panellists discussed that in a period when fundraising and the exit environment is falling, secondaries (both LP-led and GP-led) have taken advantage of this and are experiencing a significant time of growth. LP-led secondaries are thriving to free up liquidity and GPs are seeking to hold onto their assets. GP-led secondaries are growing, particularly in the single asset space and we can expect to see more this year.

What's the key driver behind the growth of the secondaries market? Secondaries offer LPs a chance of liquidity, and whilst some sponsors are offering open ended funds to deal with the continued lack of liquidity the panel highlighted that more innovative methods are also being used through secondaries. From a GP perspective given the current market (i.e. IPO and M&A markets slowing), GPs are keen to hold onto their investments and secondaries enable this. Secondaries are not just being used as an option for when assets are performing badly but for when assets are performing well as GPs are seeking opportunities to expand their investments.

What's the general structure of transactions? The panel noted that typically the secondary fund establishes an SPV for the purpose of obtaining the financing and holding the portfolio investments, and essentially everything is transferred into this SPV.

How do you get over cash flow issues and are there capital calls left? Cash flow is slower, but it is picking up and the panellists noted that whilst some portfolios do have high levels of commitments which are unfunded, this is not always the case. On that basis, even though distributions are slow, they are still outstripping the unfunded position. In some situations, you can take additional security (by way of cash or guarantee etc. to cover lender's exposure).

[1] Panelists included Thomas Rapp (Wells Fargo); Cassie Fisher (Lloyds Bank); Stuart Ingledew (Investec); Dave Moloney (ICG); and Kieran Welsh (Partners Group).

The panellists also remarked on the fact that capital overhang in the secondary market is in a very good position, currently sitting at 1-1.5 times, compared to the primary buy-out space which sits at 3-3.5 times. It is worth noting that as a lender this means there are high quality opportunities available, and you must be competitive. Transactions require you to understand what the buyer is trying to achieve, and the emerging theme is that transactions are of high quality.

Are there non-bank lenders in the secondaries space? Portfolios with less mature vintages will have a high proportion of uncalled capital, and may not be a natural fit for a bank lender. Non-bank lenders can provide a higher loan-to-value and be more flexible, which allows, for instance, distributions to be re-invested into the portfolio.

What's the outlook on GP-led secondaries? Traditionally secondaries were offered when investors didn't get distributions and fundraising was slow, however, motivations for GP-led transactions have evolved over the last few years and given the difficult exit environment GPs are forming continuation vehicles which allows the GP to continue to hold the asset. The panellists noted that we have moved from the '*zombie fund'* and we are seeing more GPs and blue-chip GPs taking on single asset continuation vehicles. The panellists highlighted that single asset continuation vehicles now make up around 50% of GP-led vehicles and there is still a lot of growth potential.

What's the verdict? The panel remarked that secondaries are increasing as a result of the relative value that you can extract in comparison to a primary buy-out, with the M&A environment picking up this year it should be a good year for secondary investments.

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SECURITISATION, RISK TRANSFER, RATINGS[1]

By Kirsty Harshaw

The panel discussed current problems facing the loan market and how securitisation can provide a solution.

The panel opened the session by highlighting that we are still seeing a huge number of loan financings and few securitisations, however, this might not be sustainable anymore, or the best option, for the following reasons:

1. the debt quantum - the value of capital call facilities is somewhere around $700B and $900B and NAV facilities are valued around $100B – that's a huge debt quantum for the loan markets to absorb;

2. the regulatory landscape is changing – new reforms mean that funds and banks will have to report and itemise a lot more. Investors are also asking for more transparency and scrutiny - they too want to know how valuations are done; and

3. the role of Basel IV – the Basel Committee is looking at tightening up the models that banks are using to calculate their capital requirements and address concerns that the current models are too varied and not comparable.

Where does securitisation come into play – can it help?

The panel noted that there are different issues in Europe compared to the US. For US banks, particularly larger banks, from a regulatory view, they are under a standardised approach, and it is a fairly capital-intensive product. Whereas, for European banks it is an IRV (interest rate value) approach, so there is no real risk-weight problem.

Consequently, when it comes to significant risk transfers (SRTs) to address those issues – there are two different markets, (i) US banks are using SRT securitisation to manage risk-weight; and (ii) European banks are using it to create new risk limit.

[1] Panelists included Navdeep Benning (Ashurst LLP); Dr. Eric Denton (Allen & Overy Shearman); Greg Fayvilevich (Fitch Ratings); Fabrice Guesde (Asia Pacific); Andrey Nikolaev (S&P Global Ratings); and James Parsons (PAG).

Either way, what we have seen so far is that SRT securitisation is helping banks to maintain volumes or increase volumes in subscription line lending. The panel observed there were around 12 billion dollars' worth of subscription line portfolios subject to SRT transactions in 2023 and they expect that number will increase this year.

By reducing their debt load and risk (through securitisation), banks can use their capital more efficiently.

Has securitisation made life easier and can it be used throughout the fund's life cycle?

It's undisputed that you need to offer solutions through the funds' life cycle. The panel discussed this in great depth, ultimately highlighting that securitisation should be seen as part of a tool kit. As fundraising becomes more difficult, you need to have leverage and provide investors with liquidity - that's where collateralised fund obligations come into play.

What role do ratings play in securitisations?

The panel considered this across three levels noting that ratings are used on underlying instruments at the first level, by banks and sometimes insurance companies at the next level to grow appetite and on the third level to consider the broader purpose of ratings (i.e., to increase transparency).

It is no longer a small market, and as you syndicate much more increased transparency provided by the ratings becomes so critical across the board.

Who pays for the rating?

This is one of the heavily debated questions, but the panel noted it comes down to the situation at hand. If one bank needs a rating (e.g. for regulatory purposes), then they should pay for it - if it's needed for pricing and distribution, then it is a different story. There are cases where it may be needed on both sides, and you can (of course) split it – therefore it is quite bespoke and dealt with on a case-by-case basis.

Concluding thoughts

Whilst these are continually evolving areas, a couple of points that are clear is that it is all heavily affected by regulations and whilst the market is maturing and SRTs are becoming a robust product there is still little uptake. **So, what could banks do better?** (i) standardise what information is needed and provide standard term deliverables; (ii) provide a consistent approach with NAV financing; and (iii) regarding fundraising process, consider bridge facilities to warehoused private funds. Watch this space.

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SURVIVING AND THRIVING IN THE PRIVATE CAPITAL WORLD OF THE FUTURE[1]

By Alethea Barretto

The "Surviving and thriving in the private capital world of the future" panel was about the individual career journeys of the panelists and their predictions/ tips for succeeding in the private capital world of the future.

- **Individual career journeys** – This was the NextGen panel and we heard from each panelist on their career journeys and the importance of taking calculated risks, particularly in the start-up space.

- **Entrepreneurship** – This was a key theme on the panel and the panelists' individual career journeys were proof of the need for entrepreneurs to do things well and for the first time. In the start up world in particular, this involved discovering a product-market fit, a pathway to bridge the two and then using networks to get deals.

- **AI** – AI is now a very big part of the future, and this applies to private capital too. Underwriters are trying out AI to produce credit memos, demonstrating how AI might be an everyday part of the world of credit. The panel stressed though that AI won't necessarily replace jobs, as the output of AI will still need to be reviewed and amended as appropriate by a person with the relevant experience and qualifications. OpenAI and the use of generative AI will also be a key area to watch as one would expect it to broaden the pool of data available to/from all parties in a private credit deal.

- **Future private market trends** – The panelists discussed how hard the industry is working to increase the involvement of private credit into personal portfolios, such as pensions, which could be very significant for the future. There is an observed blurring between the private and the public sectors, with investors investing across both.

- **Challenges we face currently** – We are living in a capital constrained environment but the consensus was that banks should not operate in silos so the industry can navigate these times together. Fundraising is a challenge but there is still potential to tap into private wealth, and the market participants must continue to use their expertise to maintain the market find solutions. One example a panelist referred to is how the Muslim middle-class in Britain alone is predicted to grow exponentially, opening up a new market for shariah-compliant finance products.

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[1] Panelists included Joel Buckett (Deutsche Bank); Ibrahim Khan (Cur8 Capital); Mohamed Khan (Goldman Sachs); Martin Mahler (Vizlib & Astrato Analytics); and Billal Muhammad (Citi).