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Top 'Take-Aways' from the 10th Annual Global Fund Finance Symposium

The 10th Annual Global Fund Finance Symposium was held at the Fontainebleau in Miami between 12 -14 February 2020. There were over 850 delegates, bringing together bankers, lawyers and sponsors within the fund finance community. We are proud to have been a gold sponsor of this event and wanted to share some of our top take-away points from the high quality panel discussions.

1 Global Private Equity Market Update

- Private capital dry powder has now exceeded $2.4 trillion, which is a record high.
- While the number of funds that closed in 2019 dropped compared to 2018, there was an increase in overall funding. The trends continue to show a consolidation of private capital as it flows towards a smaller number of larger-sized funds.
- Funds with a fund size of $2.5 billion or more now make up approximately 50% of the market.
- There is an increased demand in the market for co-investments.
- The U.S. remains the most attractive market for fund finance and Southeast Asia is seen as the top opportunity for emerging markets.

2 Comparison of trends across North American, European and Asian markets

- Majority of participants considered North America to be the most 'lender friendly' market, followed by Europe then Asia. The US fund finance market comprises approximately 70% capital call facilities, with the rest being NAV and other products.
- In Europe, one of the top trends is the rapid growth of non-bank lenders, among other new entrants challenging the larger established banks. Europe has a greater percentage mix of NAV and alternative products when compared to the US. Given that subscription facilities are now such a mature product, some panellists predicted that the US will follow the same direction as Europe in terms of having more alternative products.
- In terms of calculating a borrowing base, the European model is to offer a single flat advance rate, which can also be used as a selling point. The North American model uses a 90/65 split for rated and other investors. Despite the different approaches, the aggregate result will often get to the same place.
- Asia remains the smaller cousin of the three markets surveyed, and is also the most price sensitive.
- Regional transactions still tend to be bilateral or club deals, and have more bespoke covenants. Deals for global 'name brand' sponsors tend to be syndicated given their size, meaning that covenants need to be bankable in the wider market. There also tends to be more focus on cross-selling to global managers who want a 'one stop shop' for banking services.
- Across all markets, trends to watch in 2020 include:
  - (a) A continued low interest rate environment, making it hard for banks to compete on pricing alone. This should drive product innovation.
  - (b) Non-bank lenders to fill the gaps where banks face lending constraints due to regulation and capital adequacy rules.
  - (c) Increasing number of co-invest deals, and more SMA (separately managed account) financings.

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(d) Following on from the ILPA report debate, investors are generally more educated as to the usefulness of subscription facilities although continue to have a healthy dose of scepticism. This means that transparency in reporting will remain important.

3 Syndication

- There is a strong syndication market, especially for 'mega fund' deals. The number of syndicated deals has increased in 2019 and more lenders are entering space who are typically looking to participate in the lending rather than leading or co-leading deals.
- Syndicate members are becoming more involved in the due diligence phase of the deal.
- Leads and co-leads need to cultivate a syndication invitation list, the members of which will be tailored on a fund by fund basis. There is sometimes a need to 'over invite' potential syndicate members to mitigate possible issues that may arise for some syndicate members during the diligence and documentation phases.
- Leads and co-leads need to manage KYC/AML processes to ensure they are streamlined and efficient for the fund.

4 NAV and hybrid facilities

- Certain funds will require access to leverage during the commitment / investment period as well as to meet funding needs for the fund's investments.
- Hybrids can be complicated to structure and execute, and in fact borrowers can be better off (including in terms of pricing) closing a capital call facility and then refinancing with a NAV facility at a later stage in the fund's life cycle. This may explain why there is still a high ratio of NAV facilities to hybrid facilities in the market.

5 Secondary and GP-led financings

- A relatively new area of focus but fast growing. Historically, secondary transactions were only used to achieve liquidity at end of a fund's life cycle. Now, they are commonly utilized mid-life, in order to recycle the fund's capital investments and allow the manager to focus attention on just the highest performing assets.
- 'Topco' financings involve lending to, or subscribing for preferred equity in, the ultimate sponsor vehicle which receives all of the various net income streams (management fee income, share of realizations, carried interest etc) from the fund. Typically, the lender will take a security interest in those income streams, but there is also a market for unsecured loans.
- Specialist lending teams also offer financing to assist with succession planning and/or for founders and senior executives to liquidate their interest in the business. In addition to leverage, GP financing specialists can also provide add-on services including roadshow support and investor marketing advice.

6 IPO Market

- Private equity and existing listed companies are arguably eroding the IPO market. Marked decrease in U.S. IPOs since 2001. There are currently only an average of 110 IPOs a year in the U.S.
- Drop in IPOs is likely because of private equity and public entities acquiring companies prior to an IPO. The profitability of smaller firms seems to be declining as compared to larger firms.

7 Legal Updates

- There are proposed draft changes to the Luxembourg financial collateral law to harmonize conflict of laws issues. Practically speaking there should be little difference in the approach taken to security perfection in Luxembourg.
- In terms of the collateral package, the approach in Ireland and Luxembourg is to take local law security in addition to primary governing law security. This is not required for Cayman Islands deals.
- There are concerns in Luxembourg that certain investors (eg Italian pension funds and German insurance providers) will be impacted negatively by Brexit. Certain of these entities are not able to invest in non-EU structures but have investments in UK structures.
- ILPA has produced a model form of LPA which, as could perhaps be expected, is very investor friendly. One issue is that the model LPA contains none of the usual subscription line enabling provisions that

lenders have come to expect. The initial reaction is that to the extent the model LPA is taken up, it will probably be used by smaller, emerging sponsors. There is also some speculation that the model LPA will continue to grow with the market and will start to see lender friendly provisions incorporated over time.

Contacts

Alex Last
Partner, Mourant Ozannes
Cayman Islands
+1 345 814 9243
alex.last@mourant.com

Alexandra Woodcock
Partner, Mourant Ozannes
Cayman Islands
+1 345 814 9183
alexandra.woodcock@mourant.com

Catherine Pham
Partner, Mourant Ozannes
Cayman Islands
+1 345 814 9247
catherine.pham@mourant.com

Danielle Roman
Partner, Mourant Ozannes
Hong Kong
+852 3995 5705
danielle.roman@mourant.com

Andrew B Grant
Senior Associate
Cayman Islands
+1 345 814 9194
andrew.b.grant@mourant.com

Finn Howie
Senior Associate
Cayman Islands
+1 345 814 9212
finn.howie@mourant.com