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UPDATE

APAC Fund Finance Symposium 2022 Top Takeaways

Update prepared by Danielle Roman, Hong Kong

The Fund Finance Association hosted its 4th Annual APAC Fund Finance Symposium on 3 November 2022, for the first time in the vibrant city of Singapore. As the first live APAC Symposium in 3 years, there was an incredible sense of energy and excitement as the fund finance community gathered to network, re-connect and discuss the latest trends and challenges facing the industry. This note summarises the top takeaways from the panel discussions.

2022 APAC Investment Fund Market

- There are global macro and geopolitical tensions in APAC, particularly US-China relations and the continued lock-down in China. Together with the war in Ukraine, rising inflation and spike in interest rates, there is a perfect storm of challenges. That said, there is still money to be raised in APAC and demand for liquidity. While GPs are working out where to strategically deploy capital and look past this short term of instability, it is more important now than ever for lenders to be innovative, flexible and relationship-driven to stand by founders and managers in 'bad times' so that they can benefit in the 'good times'.
- In Japan, fund finance has been challenging because of tax, legal and regulatory issues as well as the structures typically used. That said, GPs in Japan are becoming more accustomed to sub-lines and this could be an opportunity for lenders seeking to lend to mid-cap sized funds.
- Managers are seeing more side letter requests from investors, who are actively pre-engaging and pre-negotiating, and requiring comprehensive due diligence on the fund. For single managed asset funds (SMAs) investors are now more at the forefront of deals and are self-managing the structuring of loans, including selecting banks and lawyers.
- In terms of asset classes, private credit has a lot of appeal for investors, as well as digital transformation and energy transition into clean tech; indeed ESG strategies appeal to investors. The Chinese market is trying to develop deep tech and space, while B2B is another potential area of growth. In Japan, strong sectors include real estate, infrastructure and 'retailisation' of private credit (targeting retail investors). Now is an ideal time for start-ups in APAC and to invest in companies with potential. There is currently a lot of focus on private and venture debt investment as well as VCs. Meanwhile, cryptocurrency is not a key target area for most investors.

Show Me the Money!

- Banks expect to be able to provide the adequate level of capital for the expected market requirements for 2023. The overarching view was that the market in 2023 would look much like it has in 2022, however, banks would be more selective of who they deploy their capital to, ensuring the best rewards for the bank's use of capital. Financings which might have been seen as marginal in recent years would be less likely to be approved going forward. This is not about less appetite for the region, rather it is ensuring banks are supporting their clients while managing their book to mitigate risks.
- With rising interest rates, banks wait to see whether GPs will utilise their facilities and will look out for potential LP stress across sector strains (for example, effect of the GBP currency drop on UK pension

funds). During these periods of volatility, uncertainty and complexity, lenders want more transparency with founders and LPs than ever before.

- Lenders in APAC recognise that the need to innovate remains paramount for the industry. The fund finance market in APAC is maturing and NAV facilities and hybrid facilities are starting to be more widely adopted in the region (though are still behind the curve in comparison to the US and European markets). Banks remain dedicated to the APAC market, with mandates to grow in the region. With macro uncertainty and difficulty in exits, lenders recognise that it is important for them to support clients during this time.
- With respect to ESG, banks are willing to support GPs with implementing ESG facilities, but it is important for lenders to understand at the outset what the ESG capabilities of their clients are so they can support GPs in their development and avoid any issues around their abilities to meet KPIs in the future. APAC can learn from the UK and European markets in this regard as many GPs are only just starting to implement their ESG strategies. Banks want to approach this in good faith and avoid being seen implementing ESG arrangements for solely a monetary benefit.

Global Hot Topics in Fund Finance

- The fund finance market has always been resilient, including during times of recession. During such periods, there will always be a recalibration of the market and there will be lenders who can strategically capitalize during market recession. Singapore is well placed to capitalize on these opportunities through its tax benefits and the variety of company structures (including VCCs) available which provide flexibility for participants in the fund financing market.
- The outlook for Hong Kong is certainly improving given the recent relaxation of restrictions and opening up to international travel, however, it is still playing catch-up on other jurisdictions in the APAC region and its future success will be linked to (i) how quickly Hong Kong and China can normalize post-Covid and (ii) the implementation of innovation in the type of facilities, most noticeably NAV facilities, preferred equity and hybrid facilities.
- The Cayman Islands remains the fund domicile of choice for most APAC and US-based investment funds. It is a jurisdiction which investors are very familiar with and can offer structural certainty so that parties can focus on commercial discussions.
- In terms of product innovation, APAC has seen an increase in NAV, hybrid and preferred equity transactions. Meanwhile in the US, the National Association of Insurance Commissioners is due to come out with a ruling on whether funds can use structures to garner more insurance money into the private capital space. Another trend in the US relates to management account structures, whereby insurance investors set up an account managed by a fund sponsor to co-invest alongside a fund.
- While ESG is a global hot topic in fund finance, this is a challenge for some states in the US where traditional energy is very important, such as Texas, which has one of the world's largest pension fund investors. States like Texas may have anti-ESG legislation which may limit its ability to invest into funds which have ESG policies. This is a highly politicised subject.

The Art of Negotiation

- Relationships are key to ensuring a smooth deal process. If the parties have a good relationship, involve legal teams early and all have a good understanding of the structure of the financing they are working on, deals will be more streamlined as any potential issues can be flushed out early and any necessary difficult conversations can be conducted well in advance of closing.
- Fund documentation is becoming increasingly sophisticated. More vintage documentation may permit a sub-line, but not necessarily the newer FF 2.0 products. GPs should ensure that fund documentation reflects their borrowing strategy throughout the life of the fund and to limit clauses open to interpretation which can increase time and cost.
- Confidentiality of fund information and fund documentation can cause difficulties in agreeing terms of a financing, particularly when dealing with redacted provisions or if side letters prohibit the disclosure of an investor's identity. These situations can be dealt with through additional representations, undertakings or threshold requirements and while not perfect, all participants in the market know that perfection shouldn't stop deals. It's about finding a workable and pragmatic way around such issues.

- On sovereign immunity, it is difficult to negotiate on this – national legislation may permit sovereign immunity to be waived where there is a commercial contract, but this is not always the case. Investor letters can address this, so lenders should provide drafts to the LP in question as soon as possible.
- Documentation cannot entirely stop a fraud, even if you have perfect documentation. Communication by lenders with investors is key, and good managers will realise this is what lenders need. There is a lot of public information available on investors, and lenders can also tap into contacts within its institution to check information. Fraud can be very sophisticated, but simple informal communication with investors can be very important to mitigate risks. With SMAs, the fraud risk is higher as there is only a single investor. Therefore, communication with the investor is even more important. Banks can also shorten the tenor or raise rates to build in any risk into the loan structure.

Beyond the Sub-Line

- NAVs really developed in Europe and US during Covid-19, with funds looking to solidify their liquidity solutions during times of uncertainty. The US is a relatively homogeneous market which makes NAVs easier. In APAC, this is more challenging because of the diversification of jurisdictions.
- When polled on which alternative product is likely to have the most demand, 55% of the audience said NAV, while 33% said GP financing and 3% said preferred equity.
- For NAV, in terms of assets, private credit with a more diversified portfolio is easier for lenders to get comfortable with than private equity. In terms of due diligence, banks will need to rely on the fund's NAV, so it is important that this truly reflects the value of the portfolio. NAVs will not be available for everyone; some banks will only be able to do this on a relationship basis for key clients.
- There is appetite and demand for NAVs with a huge gap and opportunity for banks to grow into this space. It is important for banks to look for expertise within their organisation to understand the underlying assets, and how they may be liquidated in a volatile market.

Private Capital Perspectives

- 2021 was a record year – the Asian market raised US$220bn in 2021 which is a 60% increase on 2020. However tighter liquidity, higher inflation and higher interest rates, combined with global geo-political tensions and supply chain uncertainty means uncertain market conditions going forwards. Sponsors still expecting fundraising to be harder over the next 6 months. However, whilst liquidity in Asia has tightened since 2021, it is still better than US & Europe.
- There has been a lot of volatility in public markets this past year. This has resulted in an increased appetite from LPs in the private capital market. For GPs, there are still valuation gaps (with buyer and seller having different benchmarks) in private equity, leading to a rise in private credit as an alternative asset class which has consistently grown to balance market volatility. There has also been increased activity in the secondary markets.
- Borrowers have been spoiled over the years in low interest rates, and so rising rates will likely have an impact on borrowing appetite. They will be more cautious, though opportunities remain high for borrowers as the current market environment is akin to the 1970s, where the PE market started to develop and came with higher financing costs.

The China investment fund market has been impacted by the zero-Covid policy and more capital has flowed out of China to India. However, China is cheap right now and could pose opportunities should investors buy up now and hope for big rewards when the market returns.

Contacts

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

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