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UPDATE

APAC Fund Finance Symposium 2024 - Top Takeaways

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The Fund Finance Association hosted its 6th Annual Asia-Pacific Fund Finance Symposium on 14 November 2024. Mourant was proud to be a gold sponsor for this landmark event.

The theme of this year's symposium was 'Innovation and Our Future'. The theme reflected the fund finance community's commitment to driving change and creating innovative solutions for its clients and our businesses, ahead of challenges in the industry.

These top takeaways summarise the panel discussions as experts reflected on 2024 and their hopes for what lies ahead.

Keynote speaker Barney Swan, polar explorer and founder of ClimateForce, is pioneering a venture to restore the world's oldest rainforest. Barney emphasised that environmental, social and governance (ESG) management is not merely about ticking boxes; it involves understanding how practical actions by the 'man on the ground' can help with meaningful reporting. He also highlighted how technology such as spatial mapping can provide valuable data to understand the costs and benefits of diversification to create more sustainable and resilient systems. There is a big opportunity for the APAC community to step up in being a leader in supporting sustainability and a green economy.

Attendees were also enthralled by keynote speaker Sophia the Robot, created by Hanson Robotics, the world's most famous humanoid robot. She emphasised the importance of humans and AI collaborating to create a future where technology enhances our lives rather than diminishes them. Sophia also highlighted the importance of responsible development and deployment of AI, and the need for robust compliance with legal frameworks and industry standards, including how data is collected and shared. Sophia also impressed the audience with her sense of humour and her ability to interpret emotions though facial expressions.

Preqin market update

The long-term forecast for AUM growth through to 2029 paints an optimistic picture despite recent market challenges, with private equity expected to remain the largest and fastest-growing segment. The APAC challenge has been the change in sentiment towards China-focused funds, which are at a decade low. However, recent policy stimulus in China and a shift towards APAC regional funds are anticipated to drive positive growth in the region. Japan and India are identified as particularly attractive markets, with Japan ranking high in private equity and real estate, and India leading in developing markets.

Investor sentiment and fundraising trends reveal that private debt has become a favoured asset class due to benefits it has gained from increased interest rates. While private equity continues to perform well, venture capital and real estate have faced challenges due to high interest rates.

Preqin also noted the rise of secondary strategies in private equity and the importance of fund finance to support liquidity in the industry. The main challenges to returns in the next 12 months are the exit environment and interest rates, particularly for real estate, which is also impacted by asset valuations.

Back to the future - Subscription finance in APAC

A challenging fundraising environment regionally and higher interest rates has resulted in lower demand for new sub-lines. However, there remains significant activity in refinancing existing fund finance facilities, with requests to increase borrowing bases or convert into hybrids or NAVs, driven by the need to tap into new liquidity. Additionally, there has been a noticeable trend of refinancing facilities from the US to Asia to leverage better pricing and opportunities in the region. Utilisation of facilities vary, with borrowers asking for more creativity and flexibility in moving between committed and uncommitted facilities to minimise costs.

The consolidation in the market among fund managers has been a key trend, and the management of credit exposure and the challenges posed by the concentration of larger managers is crucial for lenders. The role of high-net-worth investors in the borrowing base and the need for banks to adapt their risk assessment and monitoring frameworks to accommodate this new investor type are also important considerations. Technology and generative AI will become important so that lenders can calibrate their exposure to certain investors.

The Navtian: Alternative space exploration 2.0 in APAC fund finance

The evolving landscape of fund financing in the APAC region highlights the increasing complexity and innovation in financial products. There is a significant shift towards hybrid and NAV financing, driven by the challenging exit environment and the need for more flexible liquidity management solutions. The US market has seen more product development with insurance companies embracing fund finance as an asset class, as they seek for stable returns.

Regulatory developments, including the guidance issued by Institutional Limited Partners Association (ILPA) on NAV financing, has encouraged conversations between managers and investors, addressing apprehensions with NAV lines. While there is a rise in alternative lenders for NAVs in the APAC region, there are operational challenges such as multiple currencies and jurisdictions. There has been a noticeable convergence of NAVs and securitisation in the US and European markets, driven by the need for capital efficiency. However, NAVs can be broad and varied, making comparisons challenging without specific definitions.

While capital call facilities have seen a focus on ESG, it is less prevalent in the APAC region than in the US and Europe. For this to gain more traction, banks need capital relief for providing ESG facilities.

Guardians of the (APAC) legacy - Japan, SE Asia, India or Australia; and fund domiciles

Over the past decade, there has been a significant shift in the focus of funds within the APAC region. China, which previously dominated with 60 per cent of APAC-specific funds, has seen a decline to 12 per cent, while countries like India, Japan, and South Korea have experienced substantial growth in their share of funds. This shift is attributed to various factors, including economic conditions, regulatory changes, and investor demands. In India, legislation and regulatory arbitrages have driven the creation of India-dedicated streams within regional funds, catering to the increasing demand from local and international investors. Similarly, Japan has seen a rise in private equity activities, with the yen's low value contributing to this trend.

The Cayman Islands continues to be the fund domicile of choice in the APAC region, particularly with international investors. The use of new fund structures like Singapore's Variable Capital Companies (VCCs) and India's Gift City reflect a broader trend of regionalisation and diversification within the fund management industry, with fund managers increasingly looking to leverage local opportunities and navigate geopolitical uncertainties.

Blue pill or red pill - Secondary or NAV?

Secondary markets provide liquidity solutions by developing a market for continuation funds, which allow fund sponsors to avoid forced exits in unfavourable environments. This approach involves selling assets to a new buyer vehicle, creating a taxable event and potentially changing the investor base. On the other hand, NAV financing offers a less drastic solution by using the underlying investments as collateral to secure additional capital and allows the fund's investments to grow over time. This capital can be used for various purposes, such as making follow-on investments or facilitating cash distributions to investors without the need for an actual exit. Both continuation funds and NAV financings add to the tools of a fund by providing additional liquidity options.

Secondary activities are common and aim to provide pre-tax returns to investors who have been invested for a long time. NAV financing, however, focuses on creating liquidity without an exit, often through financial engineering. This is becoming increasingly popular in APAC as it allows portfolios to recover without crystallising extreme losses.

From an operational perspective, NAV facilities in APAC are difficult to execute given challenges with asset valuations and asset concentration risk which requires asset diversity criteria to be included in the facility agreement. In addition, taking and enforcing security under a NAV facility in APAC may not be as straightforward as it is in other jurisdictions where the security is located in one country and the governing law of the security documents is the same. Given the challenges in a NAV facility transaction, it is not surprising that the costs of implementing a NAV facility (which is more customised than a standardised subscription facility) and the implementation time, are factors which managers are also taking into consideration when seeking liquidity.

May the force be with you - Legal insights in APAC fund finance

Undertaking due diligence is essential to understanding the fund structure and to help mitigate risks of fraud. However, there is a growing trend of strong sponsors, borrowers and investors pushing the boundaries and resisting the disclosure of information, and providing redacted, incomplete or only template documents. Strong relationships and clear communication will help parties to better understand the importance of due diligence on the fund and its investors. Where the security package includes collateral account security with a third-party account bank, lenders should seek to request electronic access to the secured account to monitor and manage the secured account and check cash flow. Lenders also want investors to fund capital calls without defence, counterclaim or set-off. Whilst due diligence and protective lender provisions can help to mitigate the risk of fraud, it is not possible to completely exclude the risk of fraud (or being provided with fraudulent documentation).

The landscape of fund finance is evolving and at different stages in APAC, the US and Europe. In the APAC region, capital call security and account security form the standard security package. However, London is seeing deals without any security documentation. Instead, the lender is provided with a range of powers and rights under a power of attorney - it may be a while before APAC lenders get comfortable with taking the same approach.

A brave new world: Charting the course for securitisation and ratings in APAC fund finance

There has not yet been any securitisation of fund finance facilities in the Asia market. The feasibility of this in the APAC region will depend on whether there is enough deal volume and pressure on banks to optimise their capital requirements, and whether banking regulation across APAC will allow for synthetic securitisation. For cash flow securitisation, there is a question on how many deals need to be put into the structure to make it feasible (with a higher number of deals making it easier to obtain a better rating). Rating agencies can rate securitisation of fund finance facilities, though because of concerns on confidentiality, most borrowers prefer private rather than public ratings. It can also be challenging for rating agencies to assess family office and high-net-worth-individual investors. Other challenges in APAC include the lack of diversity in loan portfolios and the variation of currencies of facilities and FX, because of the many jurisdictions in the APAC region. The fund finance market in APAC is also not yet as deep as the US and Europe.

For lenders, securitisation can help to free up their balance sheet, help with liquidity and overcome regulatory restrictions. For sponsors, it can also be helpful, because it creates more liquidity for their subscription line lenders. There is also an opportunity for sponsors to invest into subscription lines as a means for diversifying their portfolio. Insurance companies and non-bank lenders are also likely to be keen to participate and support in the development of securitisation of fund finance in the APAC region.

GP industry panel

The current fundraising environment presents significant challenges for private equity firms, particularly in the APAC region. Fundraising has been described as 'brutal' by some general partners, with a difficult environment driven by a lack of exits and an aging portfolio of companies. While large managers have been able to tap into retail and insurance channels, making fundraising slightly easier for them, the average sponsor faces tougher conditions. The macroeconomic situation, especially in China, adds to the complexity, with growth tapering and local regulatory restrictions posing additional hurdles. That said, there is no sense of 'giving up' on the China market particularly as it is producing a growing number of entrepreneurs who are helping to drive innovation in and outside of China. Despite these challenges, there are opportunities, particularly in private credit. India and Japan are still attractive markets where major private equity firms are still seeing strong opportunities. India paints a positive picture with a strong capital markets landscape and a consistent stream of liquidity coming into the Indian equity markets which has also helped to propel foreign direct investment into India.

In this context, the focus on delivering DPI (Distributions to Paid-In Capital) has become paramount for private equity firms. Institutional investors are increasingly demanding actual capital returns rather than just paper valuations. This shift has led firms to prioritise liquidity, with strategies tailored to ensure consistent returns and capital back to investors. As firms navigate these complexities, the emphasis on quality investments and strategic exits remains crucial to maintaining investor trust and securing future capital.

Appetite for fund finance facilities remains, with subscription lines and NAVs both being an important part of the toolkit. In choosing a lender, pricing is important, but the relationship is paramount – as are opportunities to deepen the relationship through innovative solutions, access custody, cash management, interest rate risk management, LBO financing and margin financing. It is a holistic relationship.

While the APAC fund finance market is less developed than the US and Europe, it benefits from all the education learned from elsewhere, so it will continue to develop at a more rapid rate.

Plant a tree

'The biggest threat to the world is the belief that someone else will save it.' Robert Swan (Father of Barney Swan).

In his session, Barney Swan spoke about The Tropical Regen Project, a reforestation effort to preserve the world's oldest rainforest in Queensland, Australia. Find out more about how you can plant a tree with ClimateForce (either individually or with their corporate programme).

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