KEYNOTE INTERVIEW

A new era for fund finance

The industry is on the cusp of significant innovation, ranging from capital relief structures to securitisation, say SMBC's Sammy Asoli, Stuart McIntosh and William Wallace

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Q How has subscription finance supply and demand evolved, particularly given the weaker fundraising environment and disruption in the lender community?

Sammy Asoli: The use of subscription finance has become standard in the market, providing liquidity to sponsors and supporting LPs with their cashflow management. Despite the recent weak fundraising environment, demand remained strong for subscription lines; additionally, the market supply was disrupted by the regional banking crisis in the US, which took a significant part of the lender community out of the mix.

This disruption was short-lived, however, as affected businesses have found new homes. As a result, more competition has crept back into the market.

Stuart McIntosh: Despite some obvious ripple effects, the impact of the regional bank issues was naturally not felt as acutely in Europe. Anecdotally, some European lenders did get close to their internal limits, but the handbrake wasn't applied in quite the same way.

In terms of demand, while fundraising has been slower over the past 18 months, a lot of managers have continued to require financing for segregated accounts, meaning banks that are able to support single-investor vehicles have seen a steady flow of deployment opportunities. I would add that we are now beginning to see the green shoots of fundraising return, with managers starting to upsize facilities as a result.

Finally, while the penetration of subscription finance has historically been lower in Europe than it has been in the US, that has fundamentally changed over the past five years. It is rare now for a fund to begin investing without having a subscription finance facility in place.

Q Has the proliferation of non-bank entrants coming into the fund finance market put a strain on access to talent?

William Wallace: Without a doubt. We are seeing an almost insatiable demand for talent. As a large global team, we are lucky to have strong inbound interest and so are able to be selective, but it can be challenging to find the right person for each position. Part of that is because non-banks are leaning so heavily into the fund finance space and hiring the talent that they need to help them grow; these organisations are naturally leaner than banks, so they need to find qualified individuals who have a lot of strings to their bow. Talent is definitely at a premium right now.

Sammy Asoli: While there are certainly benefits to being an expert in fund finance, given our focus on being a broad solutions provider across structured debt and equity, we like to look for talent in unconventional places where skills can prove transferable.

Stuart McIntosh: Historically, fund finance has not been viewed as a well-defined career path in the same way that, for example, leveraged finance has. I think that has now changed. As a result, we are having a lot of success recruiting internally from other areas within the bank, again with transferable skills that enhance our team. We are also receiving significant inbound interest, which we believe is a result of our sponsor-driven strategy.

Q How have lender/borrower relationships been affected by the legacy of the banking crisis?

SA: Banks are much more sensitive around balance sheet deployment today, particularly as many are evolving their return models. There is a real emphasis on understanding how fund finance fits within the broader institutional strategy, which means teams like ours are working closely with our sponsor coverage, financing and investment banking businesses.

William Wallace: Fund finance has become a quasi-relationship-driven product where we want to work with managers that have multiple touchpoints across the bank. It is not just a question of structuring a facility, but also of considering how that could help drive wider business or give us access to more capital markets initiatives, for example. As a result, GPs are more cognisant regarding the banks they work with because they understand those expectations around building long-term relationships.

Q What demand are you seeing for NAV finance, and what is driving it?

SA: The NAV product has been around for a long time and is only receiving additional attention today because, in the absence of traditional liquidity events, facilities have occasionally been used for the purpose of synthetic distributions. This has created some controversy in the space.

The reality is the range of use cases for NAV finance is far more sophisticated and comprehensive: NAV finance can be used to provide liquidity for semi-liquid funds where subscription facilities are not necessarily appropriate, for example. It can also be used to support acquisition activity to help build value in a portfolio. There are many situations where NAV finance continues to be used in an accretive manner.

> *"The range of use cases for NAV finance is sophisticated and comprehensive"*
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> **SAMMY ASOLI**

Q How is the supply side evolving, with both banks and non-bank lenders hungry for deals?

SA: We are certainly seeing a lot of non-bank lenders coming into the space, and there are many opportunities with differing risk profiles that fit the varying parameters these lending institutions may have.

WW: I do think we are seeing a blurring of the lines, though, when it comes to traditional perceptions that banks are always more conservative and non-bank lenders are more open to risk. Some of these non-bank lenders have pockets of higher-yielding products alongside lower-yielding products. On the lower-yielding side, they are able to come in with structural covenants and terms that top the bank market. They are also competing with us on capital deployment. It isn't only banks that can take down entire transactions and syndicate them out – many non-bank lenders can now do that as well.

Having said that, banks that are able to provide NAV finance as part of a broad fund finance product suite – one that also includes subscription finance, hybrid loans, margin lending and other products – are able to provide a one-stop shop that offers clients cradle-to-grave financing, from the beginning of the life of a fund to the end. That is a clear competitive advantage.

"In Europe… it is rare now for a fund to begin investing without having a subscription finance facility in place"

STUART MCINTOSH

Q Are you seeing sustainability-linked facilities gaining traction?

SM: I definitely think that is the case in Europe. We are seeing a fair amount of sustainability-linked and use-of-proceeds (green) loans getting done. This demonstrates alignment between GPs, LPs and lenders in terms of their collective sustainability goals.

Particularly in Europe, we've seen specific ESG mandates from certain investors and the rise of both voluntary and mandatory regulatory ESG disclosure requirements. Lenders are, however, increasingly conscious of greenwashing risks, so it is critical to ensure KPIs are carefully evaluated and sufficiently challenging, while also not unnecessarily constraining a fund's investment process.

Q What do you see as the key trends likely to shape the fund finance space in the coming years?

SA: I have long felt the need to elevate fund finance outside traditional balance sheet lending and bank syndications by introducing products and core components of the capital markets. We are now really starting to see that take off. Not only are non-bank lenders coming into the market and private credit managers setting up dedicated fund finance vehicles, but we are also starting to see an increasing appreciation for capital relief structures that help lenders manage their own balance sheet risk.

In addition, we are starting to see a lot more interest from the institutional investor community as they enter into facilities either directly as a lender of record or participating via a variety of unique structures. We at SMBC have a core competency in Asia and are therefore focused on how we can serve the Asian institutional investor base.

Lastly, I would say that securitisation is just around the corner. We already see securitisation from a NAV perspective, but we are now in active conversations regarding the securitising subscription risk.

WW: Another interesting development is the role of ratings agencies, all of which have now set up subscription finance and NAV finance ratings methodologies. That is helping lending institutions with capital relief. It is also helping the non-bank lenders enter transactions alongside banks.

Additionally, we are seeing growing demand for term loan tranches combined with traditional revolving tranches. This not only benefits distribution from the bank perspective, but also enhances structures in a way that benefits lenders and borrowers at the same time.

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WILLIAM WALLACE

SM: I would finish by returning to the green shoots that we are beginning to see around fundraising. While certainly positive, this is something to watch this year as it relates to subscription finance lending capacity. It remains to be seen whether the non-bank lender supply that has entered the space will be sufficient to fill potential capacity gaps. We have reached a point of relative stability over the last 12 months, but that could change as fundraising picks up. ■

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