The Rise of Non-Bank Lenders in Fund Finance[1]

By Emily Fuller and Kayla Culver

This panel addressed various topics surrounding the increasing trend of non-bank lenders participating in the fund finance space, particularly with respect to net asset value ("***NAV***") secured facilities.

A common theme throughout the panel discussion was how the growth, adaptation and flexibility of fund finance throughout the years has supported the inclusion of non-bank lenders in the fund finance market. Historically, there has been a need for differing liquidity solutions depending on a fund's requirements. For instance, the panel discussed how increasing regulatory pressure, particularly in relation to capital adequacy requirements, means that the fund finance model has to adjust from banks holding large loan sizes on their own books to syndicating them. The panel highlighted how a non-bank lender may have increased capital availability with less regulatory restrictions as compared to a traditional bank. Due to this shift, the market is seeing an increase in bank lenders partnering with non-bank lenders in order to provide financing solutions.

With respect to NAV facilities specifically, the panel examined how a NAV loan, when used correctly, can be a value tool for a borrower, as well as how a lender should strategize with a borrower from the outset to identify the borrower's objective. It was noted that there are multiple uses for NAV facilities, and that the scope of uses continues to expand due to the widening gap of liquidity (i.e., the timeline between raising capital and limited partners ("***LPs***") seeing returns). Due to this widening gap, general partners ("***GPs***") are having to be more inventive for how they manage liquidity, and in turn the market adoption of NAV lines has spurred growth in this type of financing as GPs witness their competitors using this tool.

The panel acknowledged that there has been some negative press coverage of NAV loans, but also likened this to how subscription lines also attracted bad press before the market became educated about their use. Panelists emphasized that NAV lines are not a new product, but the panel also encouraged borrowers to involve their LPs from the beginning on the journey and be transparent about the structuring of their financing. The panel warned that, in a fragile fundraising environment, it is easy to see a financing fall through if LPs are brought into the fold too late in the process. Panelists acknowledged that it is rare for NAV financing to be considered at the fundraising stage, since a catalyst at a later stage of a fund's life typically triggers the need for additional debt. When raised at a later stage of a fund's life, it is likely that entering into a NAV facility would require amendments to a fund's limited partnership agreement ("***LPA***") or LPAC (LP Advisory Committee) consent.

[1] Panelists included Richard Golaszewski, Managing Director at Hunter Point; Karen Goldstein, Partner at Sidley Austin; Dane Graham, Managing Director at 17Capital; Michael Hacker, Partner at AlpInvest Partners; Steven Kahn, Senior Managing Director at Assured Guaranty; and Richard Sehayek, Managing Director at Ares Management.

In order to avoid the need for future LPA amendments or additional consents, the panel considered how LPAs should be drafted to allow for not only "pure subscription financing", but also for a NAV facility at the outset of the agreement.

The influx of insurance companies in the fund finance space is changing the structure of deals. The panel noted the natural synergy between the fund finance and insurance markets, with insurance companies interested in the low-risk nature of fund finance, and bank lenders interested in the capital benefit that partnering with a non-bank lender could bring. The panel discussed how the rating of facilities is crucial for insurance providers, and how the increased participation of insurance companies in the fund finance market will fuel an increase in obtaining ratings for such facilities.

Overall, the need for non-bank lenders to grow in the space aligns with the story of fund finance in general. The panel hopes to see the partnership between non-bank lenders and bank lenders continue and for NAV financing to become just another tool in the belt of GPs to consider when they have a need for financing, including in reflecting on how much capital they may need and how quickly they may need it.

The panel predicted that market participants will continue to work together to ensure liquidity is available, and panelists referred to the increase in collateralized fund obligations as an example of the innovation in the fund finance market.

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