Fund Finance Market Review: What's Ahead in 2022

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Having gathered our collective breath after a furiously busy 2021 across the US, Europe and Asia (the usual frenetic December deal closing only exacerbated by LIBOR remediation), all signs point to a strong 2022.

Here we share some observations on the year just gone, as well as what in particular we expect in 2022.

Fundraising

The fundraising market had a stellar 2021, which fueled both transactional volume and, just as importantly, product innovation.

Global M&A last year reportedly exceeded $5 trillion (boosted by a significantly increased number of PE exits) after a difficult prior period. Preqin reported fundraising at an all-time high, with over $1 trillion raised across the private funds market. That's not to mention over $3 trillion of investor dry powder awaiting deployment.

Furthering a trend, fewer funds were raised last year than in previous years, meaning that fund size has continued to trend upward—something we have seen echoed in the fund finance arena as sponsors have increasingly demanded larger fund lines and bigger commitments from their relationship banks.

The strength of the fundraising and investment market has fueled confidence in managers. Last year saw several high-profile fund manager mergers and acquisitions (as well as public listings) that have propelled demand for liquidity solutions at the management company level.

The Evolution of Fund Finance

We predict that this year's buzzword will be "Fund Finance 2.0." Perhaps more than in any other year for some time, innovation in the fund finance market really sparked in 2021.

It was exciting to be part of the adoption of preferred equity, NAV and hybrid-based lending by an increasing number of providers, coupled with sponsor-driven appetite for inventive liquidity solutions. This trend has maintained in early 2022, and we think it will continue for the foreseeable future.

We also expect an increase in the number and complexity of GP company and management lines of credit, as well as SMA financing, after a robust 2021 (in the case of SMAs, with an uptick in sponsors seeking umbrella or platform arrangements across their SMA portfolios).

Moreover, 2021 was an interesting year for the subscription line market. Alternative lenders have started to flex their muscles, with direct lending from investors and JV arrangements with sponsors providing alternative liquidity solutions. This year we worked with multiple new lenders in the subscription line market—both new bank players and increased appetite from insurance companies and institutional investors (as well as the development of new lending platforms to support those institutions).

From the sponsor side, managers continue to seek longer facility tenors, pricing continues to trend towards pre-pandemic levels, and, as noted above, the demand for larger facilities continues to grow. This bullishness from strong sponsors has also been evident in term sheet processes, with many GPs striving to achieve increased flexibility around covenants, permitted payments and other structural considerations.

Hot Topics

LIBOR transition kept lawyers, bankers and sponsors busy for much of last year in the "year of the amendment," and the passing of the December 31 2021, LIBOR cessation date for the first batch of currencies will doubtless have come as a relief to many.

The fun is not yet over, of course: USD LIBOR is scheduled to cease in 2023, but the FCA has prohibited its use for new deals in the UK market from January 1, 2022, while, in North America, ARRC and bank regulators have made similar recommendations to US participants. While we've seen an increased convergence on RFR market terms in the US and London, divergences remain with the European and Asian markets, where we expect market participants to look to their counsel to guide them through as 2022 continues, particularly with the increasing number of facilities syndicated across the globe.

2021 was witness to a real shift in market attitude towards ESG facilities. The first half of the year saw developing market consensus reflected by the LSTA, LMA and APLMA, in particular with the publishing of updated Green Loan Principles in February, Social Loan Principles in April and Sustainability Linked Loan Principles in May.

Investor pressure has seen increased demand for ESG-linked fund formation and a meaningful ESG component to be added to new fund-level facilities. We've seen a rapid increase in the number of ESG-linked products over the course of 2021, and we expect to see even more in 2022.

Conclusion

Fund finance continues to be an innovative and exciting space to practice and the depth and experience of Mayer Brown's fund finance team across the US, Europe and Asia means that we are uniquely positioned to offer our clients a global perspective on market developments and trends, both within core products and also at the cutting edge of innovation.

We are privileged to work with so many great clients and partners and look forward to strengthening those relationships and building new ones in 2022.