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# Asia-Pacific Fund Finance Market Update

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**Introduction**

On June 19, 2017, the Fund Finance Association (the "FFA") hosted the inaugural Asia-Pacific Fund Finance Symposium at the Four Seasons Hotel in Hong Kong (the "Conference"). Twenty different market participants sponsored the Conference and 247 people attended, including an impressive turn?out from private equity fund sponsor ("Sponsors") personnel. There were multiple panel sessions, covering topics including private equity fund (each, a "Fund") formation, subscription credit facility transaction structures ("Facilities") and forecasts for future market developments. This article provides a market update of the Asia-Pacific Fund Finance market based on the sentiments expressed at the Conference and our recent practice experiences.

## Fund Formation

I. **Defining The Asia-Pacific Market**. Defining the Asia-Pacific Fund Formation and Fund Finance Markets has certain gray areas at the margins. There is a continuum, one side of which is Asia-based Sponsors raising a Fund from Asia-based investors ("Investors") to make investments ("Investments") in Asia. On the other side, there are United States and European-based Sponsors raising money globally with an Asian Investment component to a global Investment focus. And there is of course a lot in between. Additionally, in certain respects, Australia functions as a sub?market, with certain distinct characteristics. Conference panelists for the most part were not concerned with precise parameters, rather just acknowledging the various Asian touch?points and acknowledging differences where applicable. We follow suit here.

II. **Investor Fundraising**. Ling Yan Teo, Manager – Asian Fund Managers, at Preqin, opened the Conference with a data presentation derived from her firm's extensive research into private capital in the region.[1] While private equity fundraising was somewhat muted the past few years, 2017 is off to a very robust start. Preqin data shows over $36 billion raised to date in 2017 (already surpassing all of 2016) with an Asia-Pacific Investment focus, a full 11% of global capital raised. Average Fund size has been increasing significantly in the region since 2015 as well. Interestingly, buyout and venture capital Funds account for 80% of the Fund formation year to date, with real estate a very distant second. Infrastructure is another asset class experiencing growth in the region, heavily weighted toward China and India. But private debt and secondary Funds, while growing prolifically the last few years on a global basis, are surprisingly underrepresented in the region (perhaps signaling opportunity).

Panelists from the various Sponsors at the Conference anecdotally reported a very robust fundraising environment. Their viewpoints likely contain significant inherent bias – virtually all of the Sponsor panelists were from preeminent, global Sponsors with long track records of successful fundraising and investing. Many of the local advisors give a more muted outlook, noting that fundraising has been and remains challenging for many Sponsors in the region.

III. **Asia-Pacific Fund Structures**. Funds formed by Asia-based Sponsors have traditionally used Cayman Islands vehicles as their preferred entity and that is largely holding true today. Certain Sponsors have introduced Singapore and Hong Kong vehicles, primarily for local Investors. Certain global Sponsors have increasingly been trying Luxembourg. But the Caymans remains the most prominent jurisdiction. The Australian sub-market often uses an Australian Unit Trust, sometimes for larger Funds in parallel with Delaware and Cayman vehicles. While the Australian Unit Trust is somewhat unfamiliar outside of Australia, if documented correctly, it is a perfectly viable vehicle for a Facility according to Australian practitioners. Fund structures are typically co?mingled and closed?end. Separately managed accounts are yet to take hold in Asia the same way they have in the United States.

IV. **Investors**. While Asian-based Investors have increased over time and are expected to increase further, they are still a disproportionately small percentage of the aggregate Investors in Asia-focused Funds. Many Asian Investors have well-developed direct?investing capabilities in the region, thus reducing their need for local Sponsors. Sovereign wealth fund Investors are frequent Investors in Asian Funds, often in a flagship capacity. Having sovereign wealth fund Investors in a lead capacity creates a plethora of challenges for Facility lenders (“Lenders”), from sovereign immunity and aggregate country exposure to concentration excesses and a lack of Investor financial information. These Investors are increasingly investing in Funds via special?purpose vehicles, yet are from time to time less than cooperative with respect to comfort letters and financial statements.

## Fund Finance Market

I. **Historically**. Historically, the Asia-Pacific Fund Finance market was quite bifurcated. There were a relative few large, syndicated United States-style borrowing base transactions, predominantly for the Asia-focused Funds of global Sponsors. And then there was a larger number of smaller, bilateral, bespoke transactions, customized to suit the particular Fund. These transactions were often structured with a coverage?ratio covenant but no individual Investor underwriting, and were often unsecured. This bifurcation existed meaningfully even three years ago (and in certain sub-markets still exists today). But the Asia-Pacific market has grown significantly the past few years and a lot of evolution has occurred.

II. **Today’s Market**. With the growth in recent years, panelists estimated the Asia-Pacific Fund Finance market to now be approximately $30-$50 billion, based on Lender commitments. Virtually every global Sponsor’s Asian Funds utilize a Facility. Structures have “converged to the mean,” a common description during the Conference of the market trend whereby Facility structures are increasingly the same across the United States, Europe and greater Asia. This is driven by two primary factors: First, for a global bank with a centralized Facility product offering, it is very challenging to maintain different structural policies based solely on geography. Second, as Fund sizes have increased, Facilities often now need to be larger and require multiple Lenders to consummate. This tends to lead to Facility structures the lead Lender is confident can be syndicated. As a result, nearly all deals in Asia are now done on a secured basis, and a far greater percentage utilize an "Included Investor/Designated Investor"-style borrowing base. Deals tend to be documented under British or United States law, with some truly local deals being consummated under Hong Kong and Australian law. Hybrid Facilities and NAV-based lending are still in their early stages in Asia, with very few consummated transactions discussed at the Conference. But Sponsors are inquiring. The Asian market may be a little more relationship-based as compared to the price and structural sensitivities that are more prevalent in other markets. Interestingly, there are new Lenders seeking to enter the market, often having to compete on structure and terms. These new entrants can create a balancing act for Sponsors: accepting the execution risk that comes with an unproven Lender with the structural and pricing accommodations that such Lenders may be willing to provide.

III. **Negative Press**. While certainly not limited to the Asia-Pacific region, the recent press articles showcasing the Facility product in a somewhat misleading and inflammatory way were discussed at length at the Conference. While the articles have certainly kept Lenders on the phone answering questions from their seniors and risk colleagues, no panelist reported any actual impact of the press coverage on their daily businesses. There seemed to be a relatively widespread acceptance that sensationalized headlines drive clicks to web links, but as long as Sponsors engage in appropriate disclosure and transparency with Investors as to the intended use of both the Facility and any traditional leverage contemplated in the Fund's business plan, negative press coverage will not be an issue.

IV. **Market Challenges**. Panelists identified several challenges that are more pronounced in the Asia-Pacific market, primarily turning on the greater number of currencies in which Investments need to be consummated. Because Investor capital commitments are almost always in U.S. dollars, currency conversions and foreign exchange exposure is heightened. Sponsors struggle to find hedging strategies that perfectly mitigate currency risk. Additionally, even setting up banking relationships for all the applicable currencies can become an operational burden. On the Lender side, underwriting standards have been increasingly challenged by Investors (particularly sovereigns) negotiating confidentiality provisions in their side?letters that prohibit disclosure of their identity to Lenders. While this certainly creates a credit challenge for Lenders, in certain cases it can cause 'know your customer' compliance problems as well.

## Market Forecasts

I. **Forecasted Growth**. The vast majority of attendees departed the Conference bullish on the near?term growth potential of the Fund Finance markets in the Asia-Pacific. Absent a systematic event, there are simply too many positive trends to think, the market will not continue to expand. According to Preqin data, of the 3,100?plus Funds that are fundraising globally right now, 21% have an Asia focus. That is a far higher percentage of private capital than Asia has historically raised. 95% of Investors have reported they intend to increase or maintain their allocation to the region in the next twelve months. Panelists at the Conference estimate that today only about 50% of Asia-based Funds are utilizing Facilities, suggesting that growth via penetration remains. Finally, local advisors report heightened levels of inquiry and interest, all forecasting continued market expansion.

II. **Chinese Bank Speculation**. Panelists at the Conference contemplated whether a market disruptor might emerge in the near future. One prediction: the Chinese banks. While the Chinese banks have certainly participated in the Facility markets from time to time, they have yet to enter the market at scale. However, if you look at the Asian leveraged?finance market as a potential model, the Chinese banks have meaningfully entered that market, competing effectively on both price and structure. They now command a significant market share of the Asia-Pacific leveraged?finance market.  Their comfort level with local sovereign Investors and historical touch?points with Asia?based Sponsors being what it is, will the Chinese banks take a more relationship-based approach to underwriting Funds and therefore disrupt the market?

## Conclusion

The Asia-Pacific Fund Finance Market appears poised to maintain and continue its recent growth trajectory.  Despite a few real challenges at the margins, we see the region as a potential source of business growth for Lenders and advisors.  We also see opportunity for Sponsors in the region to more optimally manage their Funds' balance sheets with Facilities and appropriate leverage, improving overall performance and returns for their Investors.  We look forward to the 2018 Conference and the further development of the market.

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[1] The slides from Ms. Teo's presentation are available on the FFA's website at www.fundfinanceassociation.com.



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