

# 3rd Annual Permanent Capital Summit

2017

Presented by Dechert LLP

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LLP



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# 1 Introduction

Dechert's 3rd Annual Permanent Capital Summit, held on March 8, 2017, brought together fund sponsors and asset managers to consider the impact of a shifting financial and regulatory environment on the formation and investment of permanent capital.

Dechert CEO Henry Nassau opened the event with a thoughtful review of recent trends in the industry. After the 2008-09 financial crisis, the withdrawal of banks from middle-market lending left businesses starved of credit and eager to borrow from yield-hungry investors. As a result, permanent capital burgeoned from a niche play into a key source of capital for mid-market companies. Now a new U.S. administration and growth of direct lending in Europe promise to shake up financial services regulation yet again.

The unprecedented rate of regulatory change and significant growth in the sector makes understanding the regulatory landscape, different vehicles and possible strategies in this space more important than ever.



## 2 Capital Raising for Permanent Capital Vehicles 2017: Innovation in the Face of Change

Two important regulatory developments were among a confluence of factors affecting the efficiency of permanent capital vehicles in their capital-raising efforts over the past year. FINRA's adoption of Rule 15-02 has changed the landscape for commission-based distribution channels by emphasizing lower up-front commissions and more consistent sales structures. At the same time, the rule has created an opportunity for fund sponsors to differentiate themselves on the basis of performance rather than distribution model differences.

Similarly, while uncertainties surrounding implementation of the U.S. Department of Labor's proposal that investment advisors act in their clients' best interests have caused some concern in the sponsor community, panelists suggested that the fiduciary rule could ultimately improve the relationship between Wall Street's registered alternative vehicle sponsors and Main Street investors by codifying the way distributors work with clients and thereby removing challenges to growth in the independent broker-dealer channel.

Panelists were clear that a regulatory landscape that results in increased consistency for distribution models and increased transparency for product offerings will help spawn new products and new avenues for capital raising. Investment managers will be able to focus more on portfolio construction and performance and less on distribution and commission structures. One positive consequence: increasingly substantive discussions by distributors about underlying investment strategies, portfolio composition and portfolio management.

Modernizations such as the increased use of technology to lower the cost of fundraising in the independent broker channel were also widely welcomed. If sponsors and distributors can make use of such sales channel improvements and focus steadfastly on returns, alternative asset managers of retail products should be able to continue to increase their market share in the retail and high net worth channels.





- **Moderator: James Lebovitz**, Partner, Dechert LLP
- **Steve DeAngelis**, Executive Vice President and Head of Distribution, FS Investments
- **Mike Gavisier**, Managing Director, Client and Partner Group, KKR
- **Mitchell Sabshon**, President and CEO, Inland Real Estate Investment Corporation
- **Ken Young**, Partner, Dechert LLP

### 3 Perspectives on Middle-Market Lending

One of the key questions in the middle-market lending space is whether the shift from traditional commercial banks to non-bank lenders can be sustained. After several years of notable growth, middle-market lending has become much more competitive for non-bank institutions.

Non-bank lending remains on the increase across many industries. Despite a competitive climate characterized by excess capital and difficult deal execution, panelists see continued growth for non-bank lenders, particularly given the policy indications emerging from the new U.S. administration. Panelists also see an important

and significant role for banks in the middle market, including by providing working capital lines, hedges, cash management services and other products that non-bank institutions cannot provide. In Europe, middle-market leverage lending by nonbank lenders is also very active, with product availability now largely on par with the U.S. market.

In the current competitive environment, non-bank lenders would do well by prioritizing certain relationships and by being able to offer a variety of debt products, including unitranche, first lien, second lien and unsecured mezz.



- **Moderator: Jay Alicandri**, Partner, Dechert LLP
- **Alex Dashiell**, Managing Director, Ares Management
- **Christopher Flynn**, Co-CEO, THL Credit
- **Steven Wayne**, Portfolio Manager and Managing Director, Oak Hill Advisors, L.P. and President & CEO, OHA Investment Corporation
- **Greg Wiske**, Executive Director and Group Head of Middle Market Corporate Banking, Sumitomo Mitsui Banking Corporation

## 4 Risk Retention: Living in the New Environment

Asset managers have reacted to newly effective risk retention regulations in the U.S. by developing a wide array of structural options for CLO managers. Three bespoke manager structures dominate the post-risk retention market. The adoption of these structures — and their popularity with CLO investors as an opportunity to generate incremental yield on their investments — are clearly positive trends that reduce the uncertainty created by the adoption of the CLO risk retention regulations.

Each of the most common risk retention structures has relative strengths and weaknesses. Capital Manager Vehicles (CMVs) are best suited to asset managers seeking third-party equity to provide risk retention capital; the difficulty with CMVs is that the ultimate asset manager must effectively cede investment control to third-party investors.

Alternatively, asset managers can retain risk through the creation of majority-owned affiliates (MOAs) to manage their CLOs, but this approach can make it more difficult for the MOA, and indirectly the related asset manager, to obtain third-party financing, as few investors are comfortable contributing a majority of the capital without possessing some control over the material economic decisions of the MOA.

Hybrid structures known as Capitalized MOAs (CMOAs) function in a manner similar to CMVs, but CMOAs need not be independent of the ultimate asset manager to satisfy U.S. or EU risk retention requirements. The CLO market has reacted positively to the introduction of the CMOA structure, with trends suggesting that it may soon become the most popular.





- **Moderator: Thomas Friedmann,**  
Partner, Dechert LLP
- **Eileen Patrick,** Head of Strategy,  
PennantPark Investment Advisers
- **Patrick Wolfe,** Vice President,  
Tennenbaum Capital Partners
- **Sean Solis,** Partner, Dechert LLP



## 5 About Dechert's Permanent Capital Practice

Dechert's multidisciplinary permanent capital team is actively engaged in advising asset managers in all aspects of their capital strategies. Our lawyers possess a detailed understanding of the most current trends and developments, the latest regulatory hurdles, up-to-the-minute market terms and an insider's perspective when it comes to regulatory compliance.

We represent the full range of alternative investment platforms and investment management companies, including business development companies (BDCs), closed-end funds, real estate investment trusts (REITs) and other permanent capital vehicles, as well as financial intermediaries serving such firms.



Best Legal Services Firm  
*Creditflux's* Scrolls of  
Excellence CLO Market  
Survey, 2015-2016

Winner of  
"Law Firm of the Year – Americas".  
Finalist for  
"Law Firm of the Year – Europe"  
*Private Debt Investor*, 2016

Best Law Firm Overall  
*Alt Credit Intelligence's*  
European Services Awards, 2015  
*Alt Credit Intelligence's*  
U.S. Services Awards, 2016

As part of a global law firm with offices throughout the United States, Europe, Asia and the Middle East, Dechert's permanent capital practice provides comprehensive services to fund, advisory firm and financial intermediary clients wherever they do business.

We are committed to turning our experience and expertise into value for our clients.

Ranked in Tier 1 (Nationally) for Banking and Finance Law, Corporate Law, Employee Benefits (ERISA) Law, Mergers and Acquisitions Law, Mutual Funds Law, Securities/ Capital Markets Law and Securitization and Structured Finance Law.  
*U.S. News – Best Lawyers, 2016*

Recognized among the top law firms for investment funds globally and for the Asia-Pacific region, China, Ireland, Luxembourg, the Middle East and the United States.  
*Chambers Global, 2016*

Ranked among the most active law firms for private equity deals.  
*The Deal, 2016*



