Private Capital
Conference Series

October 1, 2024
New York

PRIVATE CREDIT SUMMIT

A TALE OF TWO PRIVATE CREDIT MARKETS

A Time of Opportunity. A Time of Challenges.

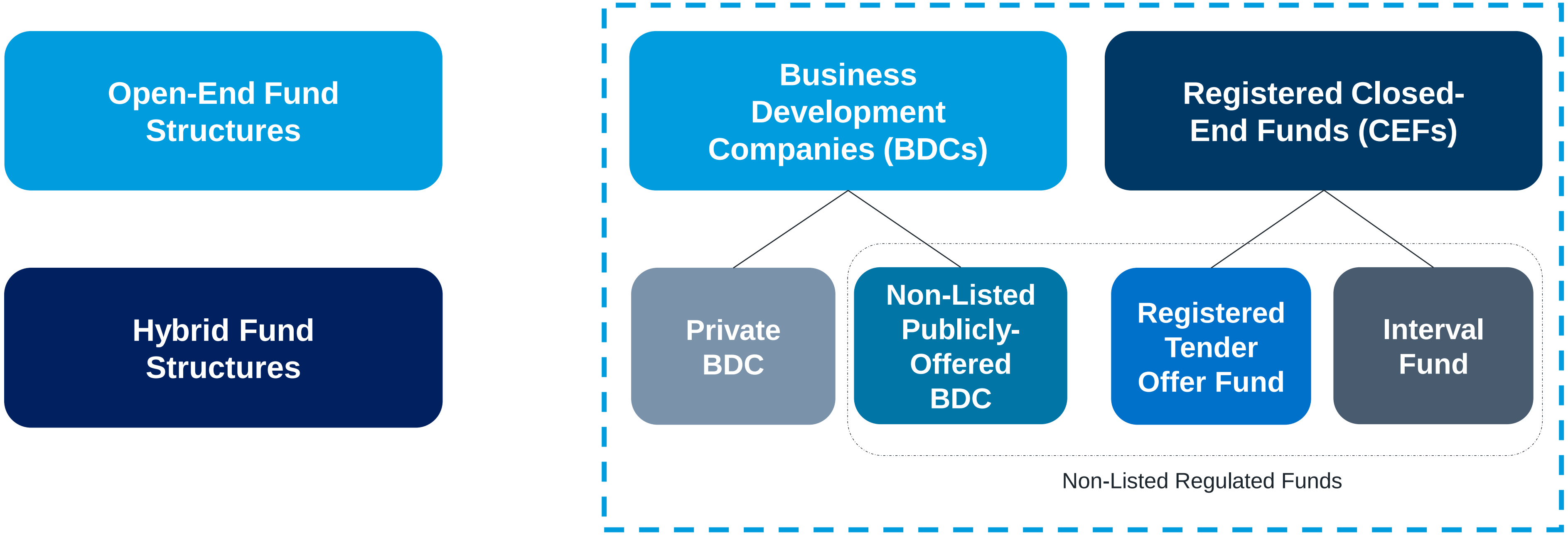
Proskauer

SECTION 01

Types of Evergreen Structures for Direct Lending Strategies

Types of Evergreen Structures for Direct Lending Strategies

Private Fund Options **1940 Act Regulated Fund Options**



Comparison of Evergreen Private Fund Options

Structure	Description	Pros	Cons	Tax Treatment
Open-End Fund Structures	Private open-end fund structure that permits continuous fundraising and provides investors with specified liquidity rights; redeeming investors may be switched to a "liquidation series/run-off series" tied to realizations of underlying credit investments or have gated withdrawals Capital contributions more typical, but can be structured with capital commitment option—fundraising will need to match deal flow Mark-to-market accounting Option to reinvest all income or have current income distributions	• Can charge typical management fees based on NAV and annual performance-based compensation • Performance and management-based fees will capture unrealized appreciation on equity kickers and warrants • No limitation on leverage • No SEC process or public reporting obligations • No 1940 Act restrictions on co-investments with affiliates • Single pool of assets for all investors • Continuously open for new investors	• Liquidity can be challenging absent run-off mechanics and there is operational complexity in potential structure of the run-off • Direct originated credit activities require structuring for tax purposes including either season and sell, use of leveraged blockers or BYOT structures. Treaty-based funds may be difficult to implement with liquidity options. • Heightened focus on valuations • Private fund will be classified as a Hedge Fund for regulatory purposes including Form PF reporting.	Partnership

Comparison of Evergreen Private Fund Options (*Cont'd*)

Structure	Description	Pros	Cons	Tax Treatment
Hybrid Fund Structures	Private fund structure that borrows from both open-end and closed-end fund architecture; typically utilizes a traditional closed-end waterfall structure and may be segmented into "vintages" Capital Commitment structure, where contributions are drawn pro rata based on capital commitments to allow earlier investors to be fully called first Call are made on NAV with book up of capital accounts like an open-end fund Management fees on invested capital or NAV Generally full recycling until exit opportunity, but possible to structure with current income distributions	• Typical management fees and carried interest based on back-end waterfall • Less pressure on valuations as management fees and carry can be determined on invested capital and realizations, respectively • Potentially more appealing to traditional close-end fund investors • Not classified as a Hedge Fund for Regulatory Purposes, including Form PF • No limitation on leverage • No SEC process or public reporting obligations • No 1940 Act restrictions on co-investments with affiliates • New vintages opened periodically, permitting a somewhat continuous offering period	• For investors rolling into subsequent vintages, need to provide a crystallization event on a mark-to-market basis (otherwise long delay to get carry) • Complexity in performance reporting if tracking performance on vintages • Cross-liability risk across vintages that can be mitigated with use of underlying SPVs • Direct originated credit activities require structuring for tax purposes including either season and sell, use of leveraged blockers or BYOT structures. Treaty-based funds may be difficult to implement with liquidity options. • Fundraising is still not as continuous as with an open-end fund structure	Partnership

Comparison of Evergreen Regulated Fund Options

Structure	Description	Pros	Cons	Tax Treatment
Business Development Companies ("BDCs")	1940 Act regulated fund subject to lighter regulation in exchange for investing primarily in U.S.-based private companies	• Can charge incentive fees on realized capital gains regardless of investor qualifications • Up to 2:1 leverage permitted • Can use leverage even if including tax exempt U.S. investors	• Required to file Form 10-Ks and 10-Qs like operating companies • Must generally invest at least 70% of assets in "eligible portfolio companies" • Subject to being deemed "plan assets" for ERISA purposes if "benefit plan investors" ERISA investors exceed the 25% threshold of any class of equity • Restrictions on co-investments with affiliates	If all income is distributed, no corporate tax. No withholding tax on most U.S. source interest income. No UBTI for tax-exempt investors, even if the BDC is levered.
Registered Closed-End Funds ("CEFs")	Investment fund that is registered under the 1940 Act	• Can have 100% ERISA investors without being deemed "plan assets" • More flexible than a BDC with respect to investments	• Required to file annual, semi-annual and other reports with the SEC • Leverage is greatly reduced relative to a BDC or private fund • Restrictions on co-investments with affiliates • No capital gains incentive fees generally	Same as above.

Comparison of Evergreen Regulated Fund Options (Cont'd)

Structure	Description	Pros	Cons
Private BDC	Non-exchange listed version of a BDC that is sold via a traditional private placement to primarily institutional investors	• Free from market price fluctuation • Most offer only limited liquidity prior to a public listing or conversion to a non-listed publicly-offered BDC structure • No state "blue sky" filings other than Form Ds in connection with the private placement of fund interests	• Distribution is limited within the U.S. given the private placement structure • Private BDCs must use a full subscription process
Non-Listed Publicly-Offered BDC	Non-exchange listed version of a BDC that is sold via a public offering to qualified individual investors	• Free from market price fluctuation	• Retail versions often require large distribution networks • Unlike publicly-offered CEFs, non-listed publicly-offered BDCs must registered in each U.S. state under "blue sky" registration requirements • Unlike private BDCs, non-listed publicly-offered BDCs must offer investors periodic liquidity • Liquidity requirements may require a more liquid portfolio • Non-listed publicly-offered BDCs must use a full subscription process

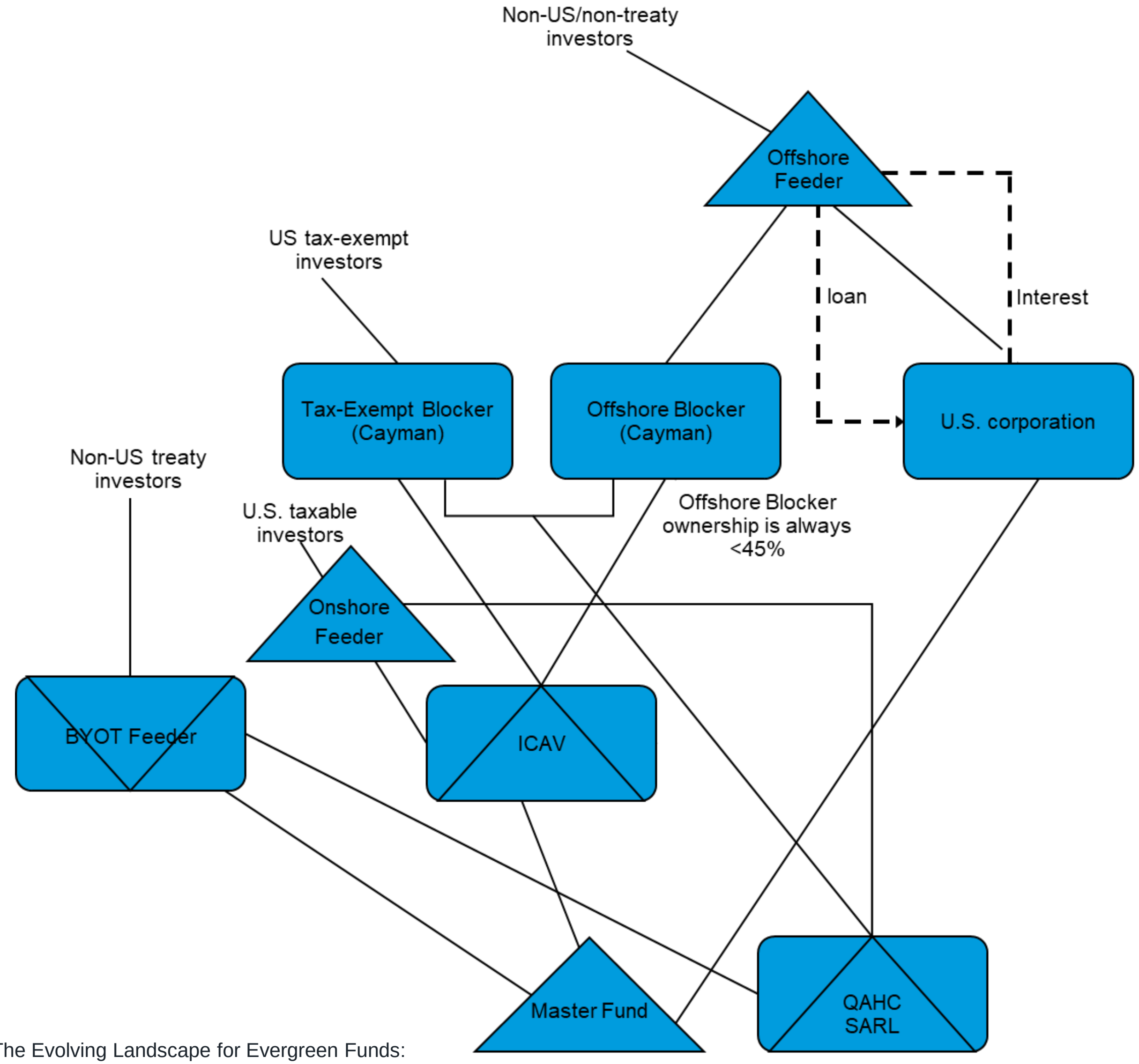
Comparison of Evergreen Regulated Fund Options (Cont'd)

Structure	Description	Pros	Cons
Registered Tender Offer Fund	Non-exchange listed version of a CEF that states an intent to offer liquidity via periodic tender offers	• Free from market price fluctuation • Offerings typically conducted publicly, but can be structured as private placements • Unlike BDCs, publicly-offered registered tender offer funds do not face full "blue sky" registration in each U.S. state • Unlike interval funds, registered tender offer funds can offer less than 5% liquidity per tender offer	• Retail versions often require large distribution networks • Liquidity requirements may require a more liquid portfolio
Interval Fund	Non-exchange listed version of a CEF that adopts a fundamental policy to conduct periodic repurchase offers at predetermined intervals	• Free from market price fluctuation • Offerings typically conducted publicly, but can be structured as private placements • Unlike BDCs, publicly-offered interval funds do not face full "blue sky" registration in each U.S. state • Unlike registered tender offer funds, interval funds may qualify for a ticker symbol and simplified subscription process similar to mutual funds	• Retail versions often require large distribution networks • Liquidity requirements may require a more liquid portfolio • Unlike registered tender offer funds, interval funds must offer at least 5% liquidity for each repurchase offer • Interval funds typically cannot deviate from liquidity requirements without investor approval • Publicly-offered interval funds must determine NAV on a daily basis

SECTION 02

Tax Structures for Evergreen Direct Lending Strategies

Leveraged Irish Open-End Direct Lending Fund



Leveraged Irish Open-End Direct Lending Fund (cont'd)

- As US taxable investors invest in the ICAV or US tax-exempt investors invest in the Tax-Exempt Blocker (which invests in the ICAV), the US corporation would redeem a portion of its interest in the Master Fund, distribute the cash to the Offshore Feeder and the Offshore Feeder would contribute the cash to the Offshore Blocker, the Offshore Blocker would contribute the cash to the ICAV and the ICAV would contribute cash to the Master Fund. The Offshore Blocker will never own more than 45% of the ICAV.
- If a US taxable investor redeems out of the ICAV or a US tax-exempt investor redeems out of the Tax-Exempt Blocker (and the Tax-Exempt Blocker redeems out of the ICAV), and those redemptions are funded by non-US/non-treaty investors in the Offshore Feeder, the Offshore Feeder would invest in the Master Fund through the U.S. corporation so that, at all times, US persons directly or indirectly own 55% or more of the ICAV.
- The US corporation will be subject to corporate level net income tax. Interest paid by the US corporation to the Offshore Feeder should be exempt from US withholding tax. No foreign investor could own 10% or more of the Offshore Feeder.
- Dividends paid by the U.S. corporation will be subject to a 30% withholding tax. We assume that all income allocated to the U.S. corporation less interest expense and corporate tax will be distributed as dividends.
- A QAHC or SARL would make non-US loans.
- The Tax-Exempt Blocker and Offshore Blocker would file US federal income tax returns reporting zero tax on the basis that the income earned by the ICAV is exempt from US federal income tax under the US-Ireland income tax treaty. The Tax-Exempt Blocker and Offshore Blocker may be subject to state taxes and state tax filing obligations.

Leveraged Irish Open-End Direct Lending Fund (cont'd)

- The BYOT Feeder would file a US federal income tax return claiming treaty benefits on behalf of its owners. The BYOT Feeder may be subject to state taxes and state tax filing obligations.
- The QAHC/SARL avoids U.S. federal income tax by relying on the rules under 1.864-5 to the effect that foreign-source income managed by an independent agent is not ECI.
- Manager must qualify as an "independent agent".
- Because the Master Fund would be making loans and wouldn't have qualifying income for "publicly traded partnership" purposes, either the 100 holder safe harbor would have to be met or (i) redemptions could not occur until at least 60 days after an investor notifies the fund in writing of the investor's intent to redeem, (ii) the redemption price could not be established until at least 60 calendar days after receipt of the notification by the fund, and (iii) the redemption could not be more frequently than quarterly.
- To discuss: Liability in the event the ICAV is taxable; tax insurance; whether or not to check open the ICAV; sourcing of redemptions from the Offshore Feeder - distributions from the US corporation give rise to dividends subject to withholding tax; distributions from the Offshore Blocker don't. If redemptions are funded with distributions from the Offshore Blocker (or debt) this could have the effect of deferring the dividends (in which case the last investors would bear the withholding tax).

SECTION 03

Fund Terms and Trends

Fund Terms and Trends: Evergreen Private Debt Funds

- Management Fee Term Range
  - Rates vary widely across strategies and dependent on leverage
  - 0.75% to 1.5% is the common ranges for rates
- Incentive Allocation Rate
  - Generally, rates between 10% and 20% with the mode being 15%
  - Incentive structured as both annual mark-to-market as well as a waterfall structure
- Redemption Mechanics
  - Typically, an initial lock-up of 1-3 years—with the most common being 2-year lock-up
  - Redemption windows vary from quarterly, semi-annually and annually
  - Redemption notice varies between 90 to 180 written notice
  - Most often liquidity is in the form of a run-off sleave
- Hurdle Rates
  - Mostly managers are utilizing fixed hurdle rates of between 5% and 6%
  - Also, there are a few index hurdles—as an example use of LSTA + 1.50%

SECTION 04

Current Status of Registered Fund Industry

Current Status of the BDC Industry*

98

Total Operating BDCs

46 traded BDCs

with aggregate assets of **approximately $154 billion**

52 non-traded or private BDCs

with aggregate assets of **approximately $204 billion**

* Figures reflect available data as of September 20, 2024 and exclude non-public BDCs with assets of less than $500 million.

Key BDC Operating Metrics*

	Traded BDCs	Non-Traded / Private BDCs
Average Total Assets	$3.35BB	$3.92BB
Median Total Assets	$1.81BB	$1.51BB
Average Net Assets	$1.54BB	$2.20BB
Median Net Assets	$839MM	$824MM
Average Debt/Equity Ratio	116.5%	77.2%
Weighted Average Yield	12.7%	11.6%
OPEX as % of NAV	6.5%	3.6%

* Source: Raymond James BDC Weekly Insight (September 20, 2024)

Status of the Interval Fund Sector*

101

Total Interval Funds

with aggregate net assets of approximately $87 billion

63 credit-focused funds

with aggregate net assets of **approximately $54 billion**

22 real estate-focused funds

with aggregate net assets of **approximately $18 billion**

* Figures reflect available data as of July 2024.

Status of the Registered Tender Offer Fund Sector*

115

Total Registered Tender Offer Funds

with aggregate net assets of approximately $66 billion

51 private equity-focused funds

with aggregate net assets of **approximately $35 billion**

31 funds of hedge funds

with aggregate net assets of **approximately $14 billion**

21 credit-focused funds

with aggregate net assets of **approximately $11 billion**

* Figures reflect available data as of July 2024.

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Our Agenda

- Introductions
- Overview of the Market
- The Forces Driving Banks and Credit Funds to Form Joint Ventures
- Current State of Play – Recent JV Announcements
- Picking a Partner - Alignment
- Structural Options
- Control/Ownership
- Termination Rights
- Exclusivity
- Process

Momentum Builds

The New Kings of Wall Street Aren't Banks. Private Funds Fuel Corporate America.

With interest rates at multiyear highs, hedge funds and private equity are taking over lending

BlackRock Says Private Debt Will Double to $3.5 Trillion by 2028

Firm said it expects the asset class to grow at 15% annually
BlackRock see private markets competing directly with public
Bloomberg, Oct 26 2023

Banks Rush to Gain Foothold in $1.5 Trillion Private Credit Market

Wells Fargo and Centerbridge team up on $5bn private credit fund

San Francisco-based bank is latest to push into space dominated by alternative money managers

Basel IV spurs relentless growth of private credit

Peter Lee October 04, 2023

PNC, TCW Partner To Expand Capabilities, Create Private Credit Platform

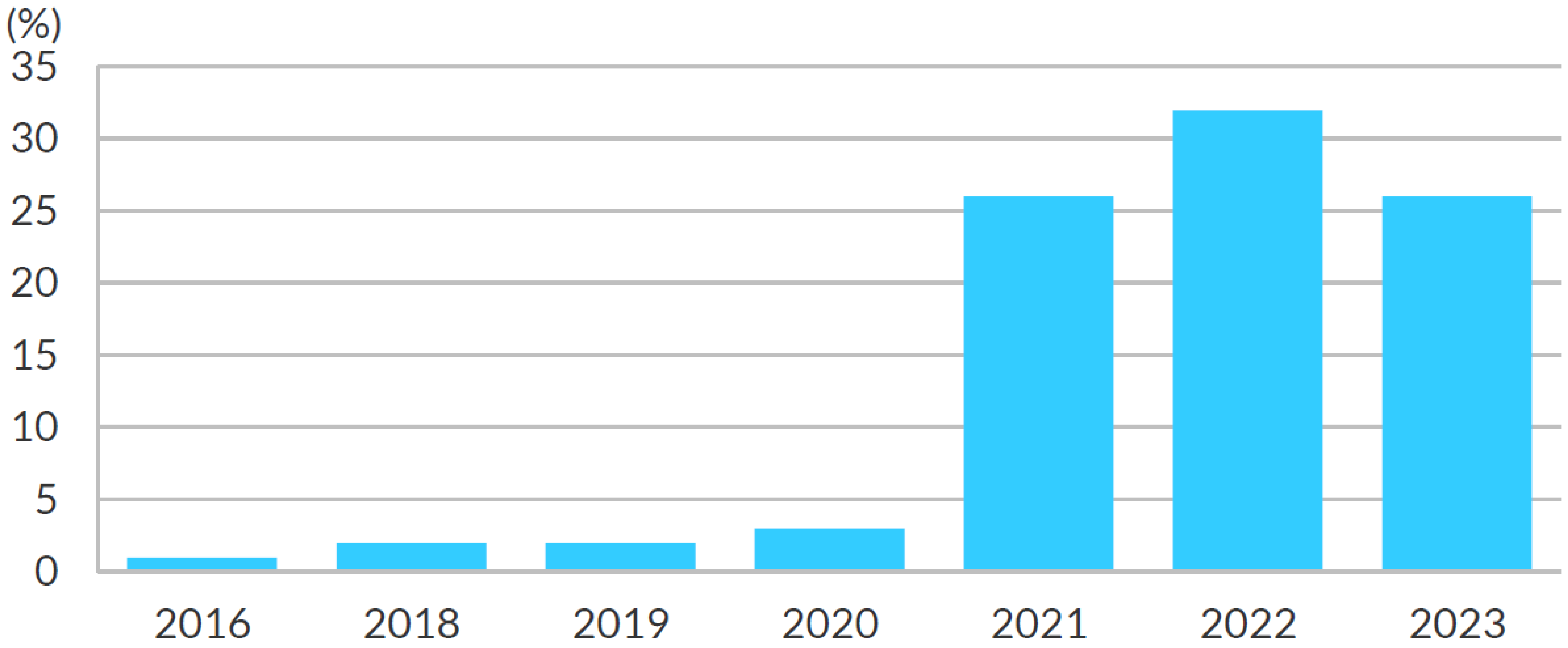
Citi and Apollo Announce $25 Billion Private Credit, Direct Lending Program

Webster Financial and Marathon launch private credit joint venture

Overview of the Market

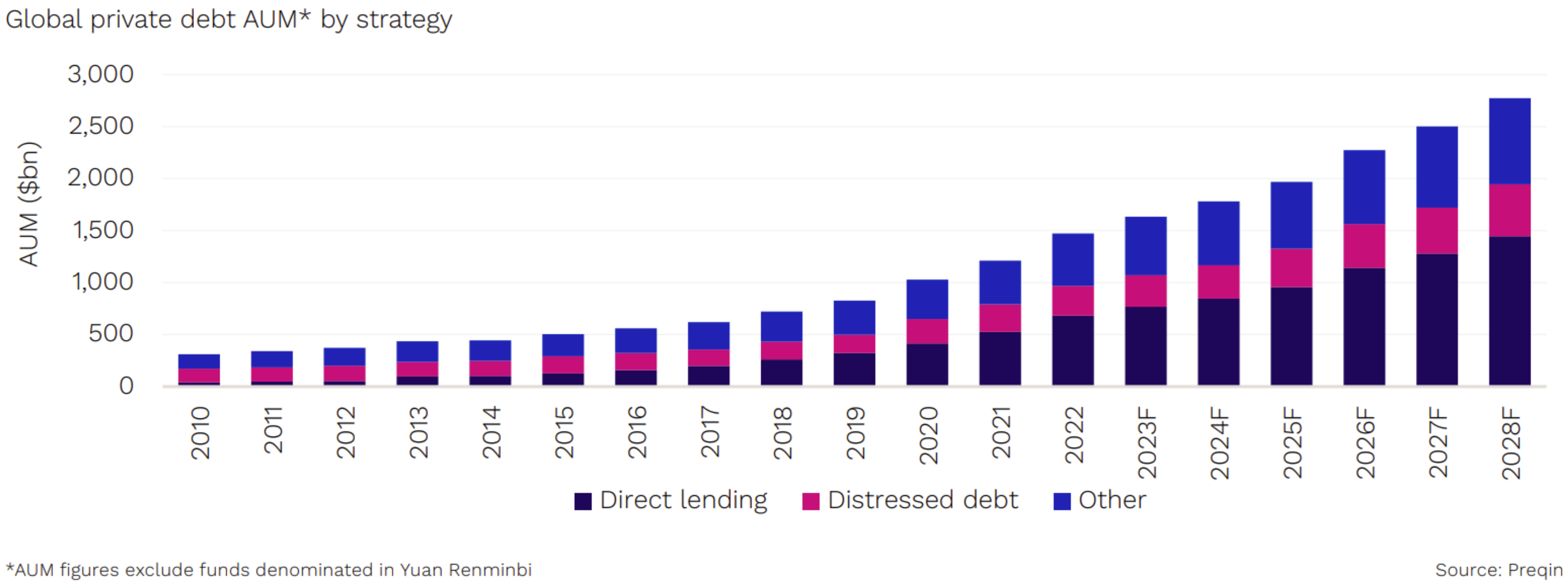
- Size of Private Credit ~ $2 Trillion
- Recap Growth
- Banks Lose Market Share (<50%)
- Power of the Big 10
  - Antares
  - Apollo
  - Ares
  - Blue Owl
  - Blackstone
  - Carlyle
  - Golub
  - HPS
  - KKR
  - Sixth Street

Mega-Tranche (>$1 billion) Private Credit Deals

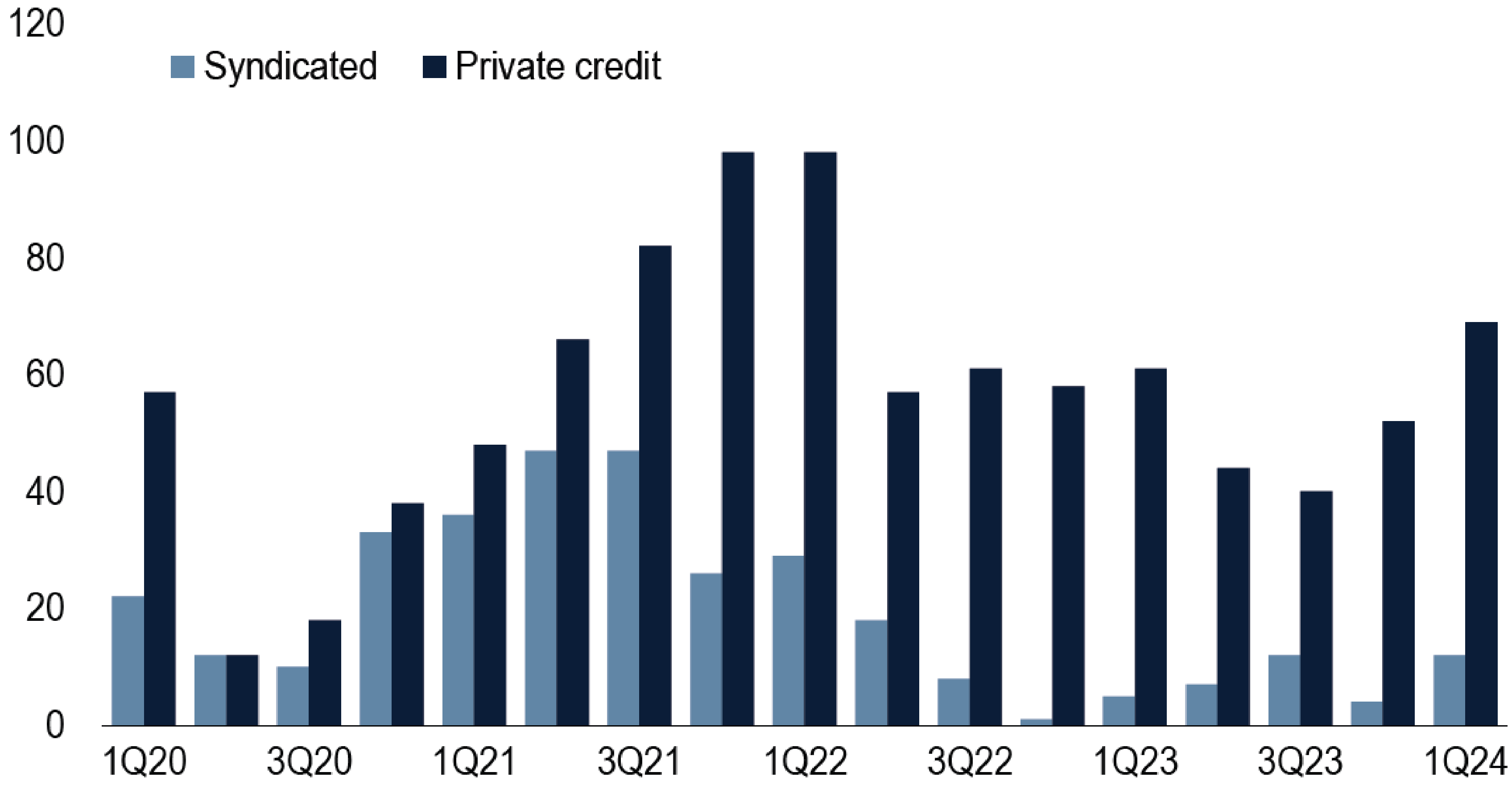


Source: Fitch Ratings

Growth of Direct Lending

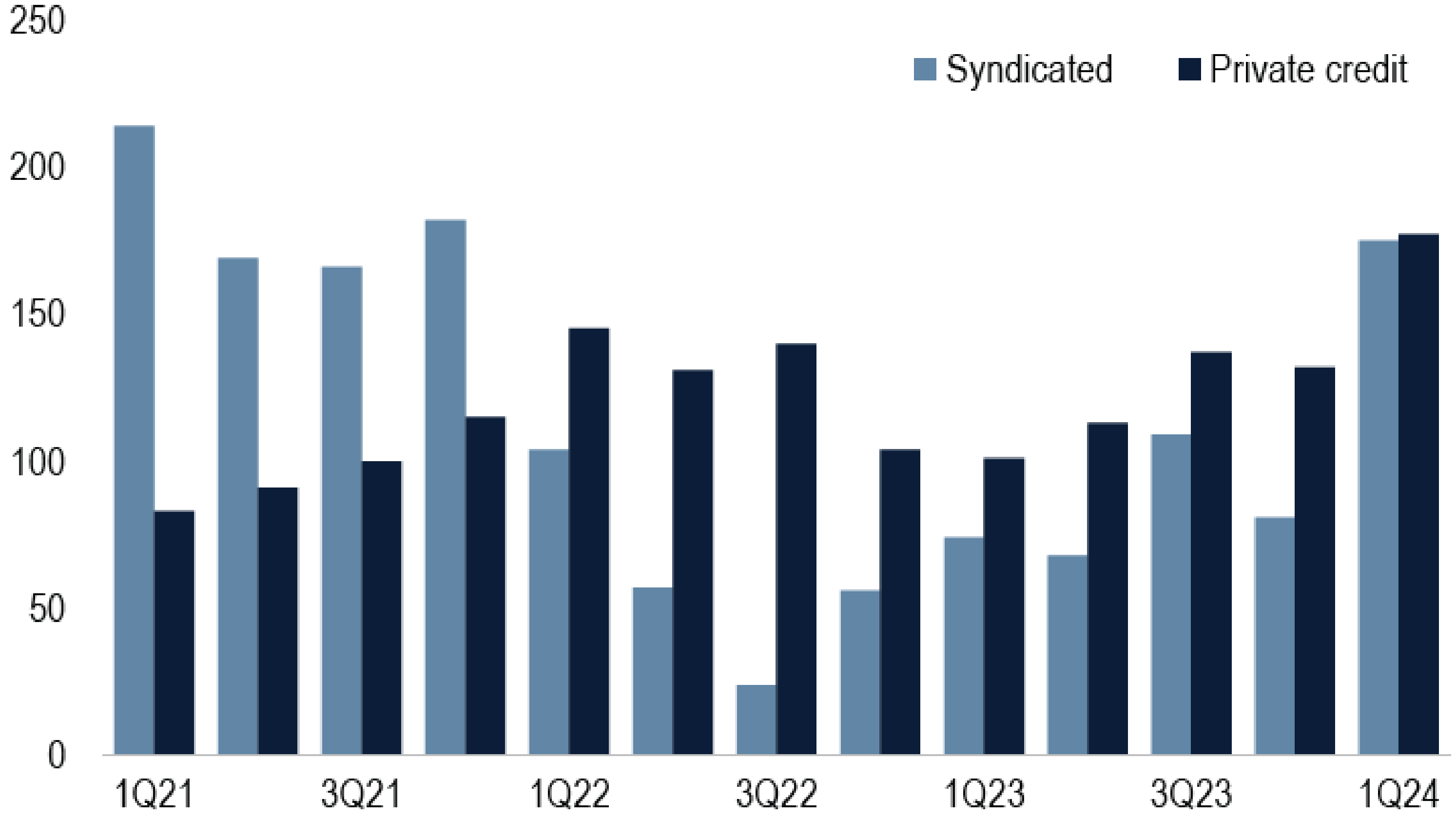


Count of LBOs Financed in BSL vs. Private Credit



Source: PitchBook | LCD • Data through March 31, 2024
Private credit count is based on transactions covered by LCD News

Count of Non-LBOs Financed in BSL vs. Private Credit



Source: PitchBook | LCD • Data through March 31, 2024
Private credit count is based on transactions covered by LCD News

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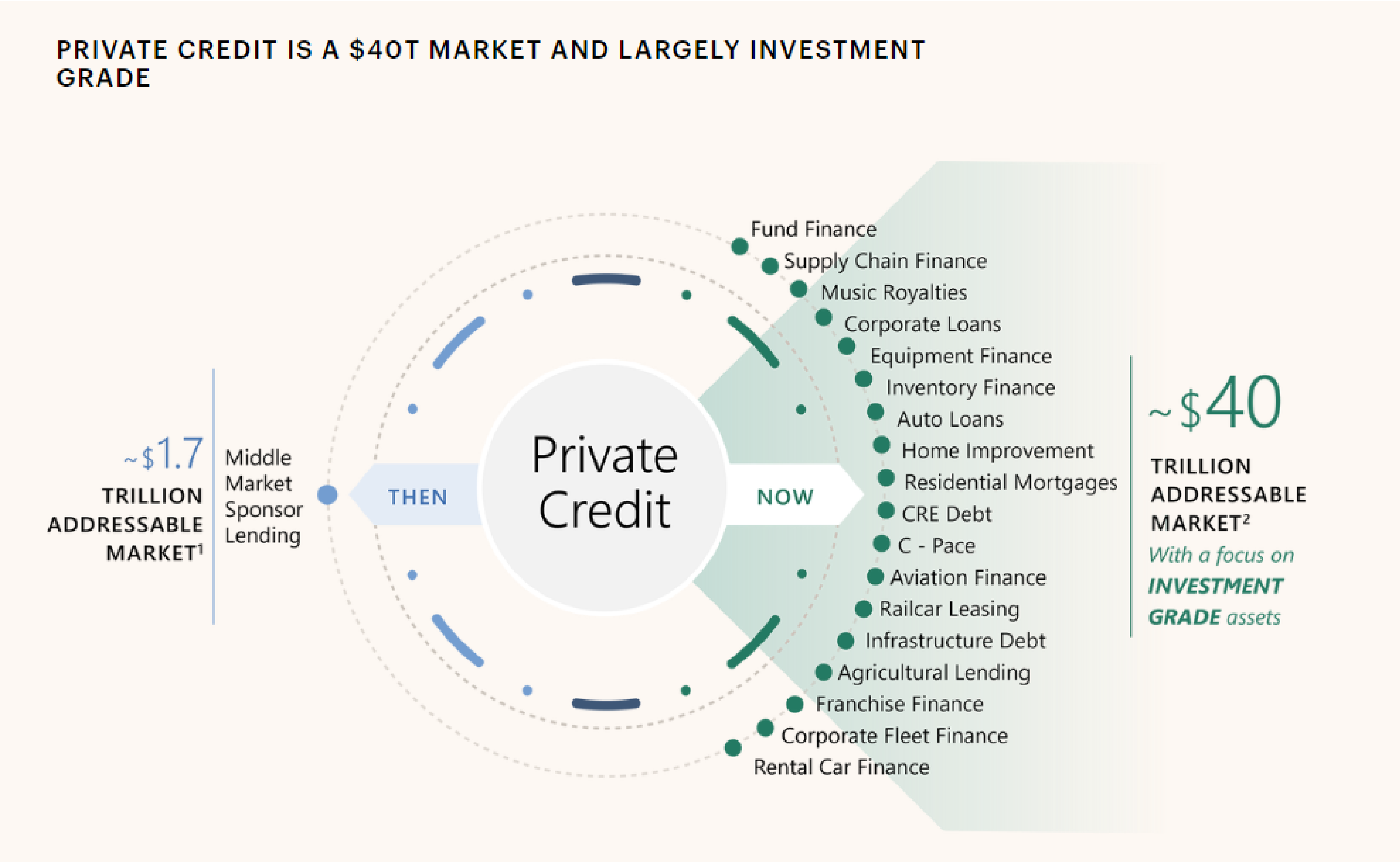
Some Believe We are Only Getting Started……….



Source: Apollo Global Management

The Forces Driving Banks and Credit Funds to Form Joint Ventures

- Increased Competition (Market Share Loss)
- Larger Commitments
- Banks Losing Share to Credit Funds
- Credit Funds Desire to Grow Origination
  - LPs want to invest in a scalable platform
  - Aspirational platforms need “a hook”
- Other Benefits of Joint Ventures
- Regulatory Pressure on Banks

Other Benefits of Joint Ventures

Benefits to Bank Partner	Benefits to Credit Fund (and LPs)
- Retains Issuer relationship: significant fee opportunity	- Delivers differentiated origination pipeline
- Deploys capital within risk parameters	- Accelerates ramp of credit build-out versus organic growth
- Eligible loans exceed typical return hurdles (wider)	- Creates significant scale – doubles (triples) the per deal commitment
- Enhances reputation as a solution-provider	- Attracts investor interest / investment - new narrative
- Bank builds reps in Private Credit as market iterates	- Access to companies / transactions
- Mitigates loss of market share with proven structures already implemented successfully by other banks	- Leverages 100's of bankers without additional cost to GP
- Inside track on providing ancillary services - takeout financing (HY)	- Depending on structure, may enhance investor returns with junior/senior or back leverage
- Bankers and credit infrastructure already exists	- Credibility of (inter) national banking partner

Regulatory Pressure on Banks

- The Leveraged Lending Guidance, introduced jointly by the OCC, FDIC, and the Federal Reserve in 2013 in the wake of the financial crisis, caps leverage for Leveraged Financings at 6.0x and requires that a company show projections which amortize at least 50% of its debt within 5-7 years of closing (both subject to exceptions). *This had the predictable effect of REDUCING the availability of credit, and creating a lane for Private Credit and other Non-Bank Lenders to take market share from Regulated Banks.*

- In October 2017, the U.S. Government Accountability Office determined that the Leveraged Lending Guidance was a “rule” subject to the procedural requirements of the Congressional Review Act, meaning that the Guidance has to be submitted to Congress. The OCC and the Federal Reserve have since indicated that the Guidance is non-binding. *Despite this latitude, most Banks still adhere to the Guidelines broadly, with certain exceptions.*

- ***A joint venture between a Bank and a Credit Fund will not run afoul of the Guidance since (a) any leverage provided by the Bank is to the joint venture and not to a leveraged borrower, and (b) the leverage is collateralized by a diversified pool of assets and not the assets of a single borrower.***

- Other factors that may be considered by Banks in evaluation of the Joint Venture structure include Consolidation or Control issues.

- Banks will seek to avoid Consolidation issues via joint decision making at the JV. The Credit Fund will own the vast majority of the equity (ranges from 50.1%-95%).

- The Volcker Rule prohibits banking entities from engaging in proprietary trading or making certain investments in "covered funds“. The Volcker Rule contains an exception for registered funds (e.g. BDCs), credit funds, and joint ventures that meet certain criteria

Announced JV's: State of Play

Partnerships	Announcement Date	Activity
J.P.Morgan	- Ongoing	- Investment Bank dedicated $10 billion to make balance sheet loans - JPM launched RFP in Oct 23 to institutional investors for JV structure
STIFEL / LORD ABBETT	- Jun-24	- Mostly middle market direct lending
PNC / TCW	- May-24	- $2.5 billion of investable capital in year one - Nippon Life anchor LP (TCW Parent) - Sponsor / Non-sponsor middle market direct lending
LLOYDS BANKING GROUP / OAKTREE	- May-24	- $1 billion of capital raised - European Middle Market
FORTRESS / MUBADALA	- May-24	- Take private by Mubadala
BARCLAYS / AGL	- Apr-24	- Barclays to enter JV with AGL Credit to launch large-cap sponsor Private Credit initiative. - ADIA to anchor initial fund with target equity of $1 billion - $2 billion of investable capital
Goldman Sachs Asset Management	- Feb-24	- JV with GSAM with $110 billion AUM through multiple vehicles (including a BDC active in the direct lending space) - Mubadala $1 billion targeting Asia-Pacific – new JV
BNP PARIBAS / Blackstone	- Feb-24	- Partnership with Blackstone is between BNP's Insurance subsidiary and Private Wealth Division - European Private Credit
citi / LUMINARX	- Jan-24	- Formed Cinergy JV with LuminArx Capital to invest in asset-backed and corporate debt
WELLS FARGO / Centerbridge	- Sept-23	- Partnered with Centerbridge in new JV including anchor orders (ADIA / BCI) targeting minimum $5 billion in investable capital - $5 billion JV announced with middle market focus ($25-100mm)
SOCIETE GENERALE / Brookfield	- Nov-23	- Infrastructure Private Credit (including real estate) focused on global opportunities in Infrastructure Financing - Initial fund will launch with EUR 2.5 billion of seed funding at inception
KeyBank / BEACH POINT CAPITAL MANAGEMENT	- May-22	- Formed JV with Beach Point utilizing senior / junior structure
BMO / OAK HILL CAPITAL PARTNERS / BC PARTNERS	- Pre-22	- JV with Oak Hill to originate direct lending deals - JV with BC Partners
Jefferies / MassMutual	- Pre-22	- Jefferies existing joint venture with Massachusetts Mutual Life Insurance (owns Barings) - Jefferies Credit Partners now manages > $10 billion of AUM - Closed new JV in Jul-23 with ADIA; $1.7 billion of investable capital, targeting $75mm+ EBITDA clients

New Wave of JVs Prove Strategy is Diversifying into Verticals/Geographics

September ’24 - Citi/Apollo announce $25 billion target capital deployment into sub-IG credit

September ’24 - BNP/Apollo announce $5 billion strategy into asset-based IG credit

September ’24 - Blackstone/Partners Group announce model portfolio solution streamlining “retail wealth access” to private equity, credit and real assets.

August ’24 - Stifel/Benefit Street/Diameter announce new strategy into UNITRANCHE and Junior Debt

July ’24 - Raymond James/Eldridge Industries announce private credit initiative targeting sponsor-owned credit

July ’24 - Oak Hill/One IM announce JV to invest into European private credit

Picking a Partner – Alignment

- Key Stakeholders
- Credit Box – Identity Target Investment Criteria
- Dedicated Deal Teams
- Joint Approval
- Investment/Economics

Structural Options

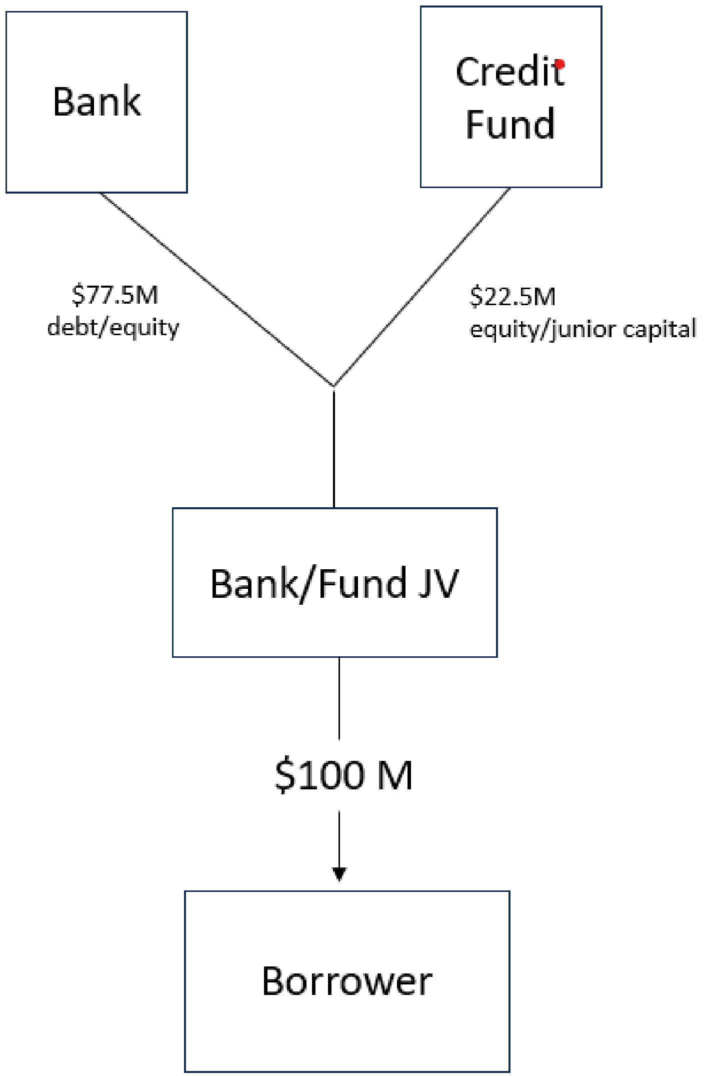
- Loose Affiliations: Intercreditor/AAL Templates

- Sourcing Arrangement
  - Bilateral
  - Programmatic

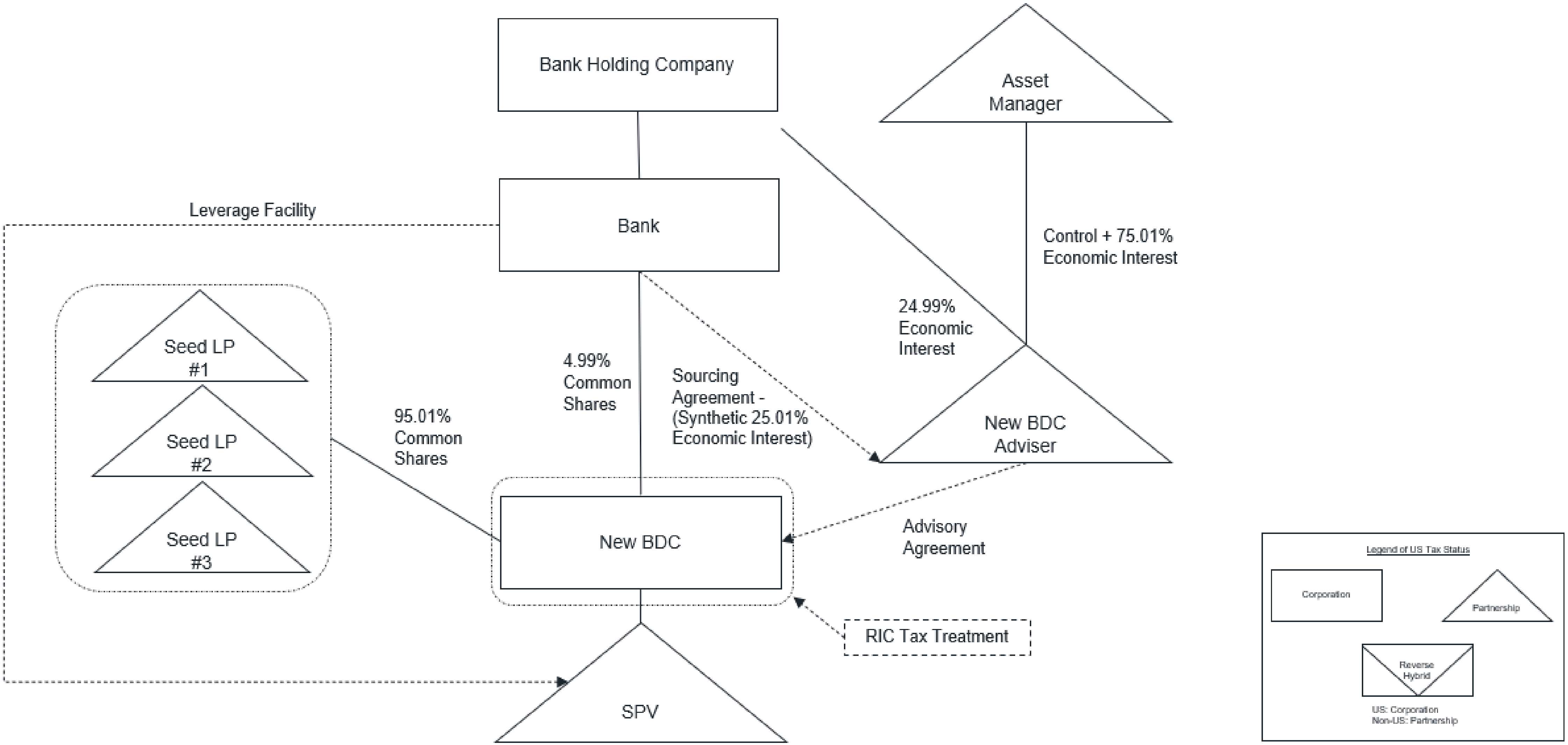
- More Formal Approaches
  - Investor Considerations
  - Structures: Senior/Junior or Pro Rata
  - Back-Leverage to Increase Returns
  - Simple to Complex
    - Capital Commitments
    - Single or Multiple Vehicles
    - Season and Sell Structures

Example $100M Loan Funded using a Senior/Junior Joint Venture

The Bank will typically provide an equity commitment of 2.5-24.99% If the structure is levered, the Bank may offer a leverage facility on favorable terms, with an advance rate of 50-70%, This example assumes a 24.99% equity commitment and a 70% advance rate from a leverage facility. The balance of the capital is provided by the Fund, and may be pari or junior to the Bank's capital. This example assumes a 22.5% equity contribution from the Fund.



Example Private BDC Joint Venture Structure

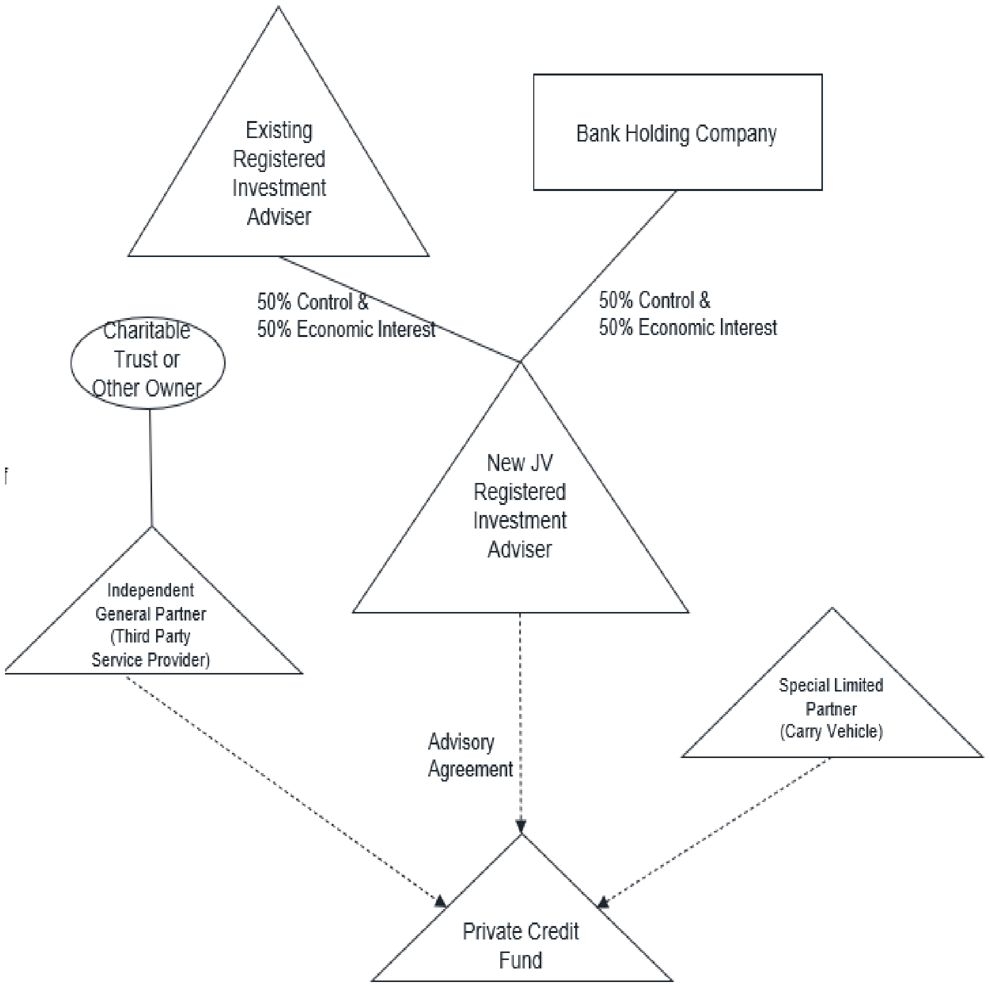


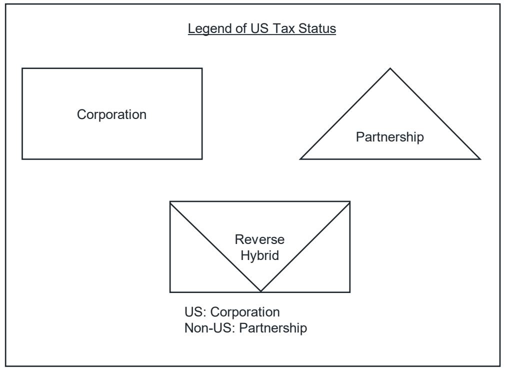
Example New RIA Joint Venture (50/50)

- In a 50/50 split, the Bank Holding Company will control the new JV RIA under the BHCA and the new JV RIA will be a subsidiary of the Bank Holding Company, becoming subject to certain BHCA requirements

- The General Partner will need to be independent of the Bank Holding Company to avoid BHCA control; Carried interest will be received by a Special Limited Partner that is owned by the JV Parties

- If the Bank Holding Company expects to make an investment in the Private Credit Fund, the investment will need to comply with an exception under the Volcker Rule (most likely "Credit Fund" exception)





Control/Ownership

- Avoiding control for BHC Act, Volcker, and the Investment Company Act
  - Ownership limits
  - Providing investment advice
  - GAAP consolidation

- Tie Breaker Matters

- Economics
  - Sourcing Fees
  - Loan Fees
  - Incentive Fees and Carry

Termination Rights

- Change of Control
- Key Personnel
- Regulatory Change
- Failure to Source
- Failure to Fundraise
- Bad Acts
- Mutual Agreement

Exclusivity

- Non-Exclusive
- Non-Exclusive+
- Exclusive for Strategy (i.e. Middle Market Non-Sponsor in N.A.)

Process

- Picking a Favorite Relationship (No Process)

- Dating before Marriage – Free Option

- Beauty Contest – Running a Process with 5-10 Partners
  - Drive better terms
  - Avoid playing favorites
  - Mitigates the late in game opt-out

- Timeline/Regulatory Approvals

Stephen A. Boyko

Stephen A. Boyko
Partner, Proskauer

Stephen A. Boyko is the co-chair of the Corporate Department and a member of The Private Credit Group. His primary focus is in finance transactions, particularly those involving private sources of capital. He represents one of the largest client rosters in the industry, including an array of specialty finance companies, private debt funds, business development companies (BDCs), CLOs, sovereign wealth funds, insurance companies, hedge funds, private equity investors and issuers in connection with leveraged buyouts, growth capital investments, acquisition financings, going-private transactions, management buyouts, as well as other finance-related transactions, including innovative, first-in-kind transactions across the U.S. and in the UK.

Recognized by Chambers USA, clients note that Steve has an “amazing ability to deconstruct an argument in a heartbeat and walk through negotiation issues point by point” with one client praising “we know we are being protected and we’re getting what’s fair.” Steve has had extensive experience in intercreditor and interlender issues, secured creditor and bankruptcy rights, debt restructurings, and private equity investments. In the past 20 years, he has closed finance transactions with an aggregate value of approximately $75 billion.

Jennifer E. Crystal

Jennifer E. Crystal
Partner, Proskauer

Jen Crystal is a partner in the firm's Corporate Department and a member of its Private Funds Group.

Her practice focuses on representing private fund sponsors across asset classes, including credit, venture, and private equity. She advises on a wide range of matters, including fund formation and fundraising, firm operations, internal structuring and regulatory compliance.

Prior to joining Proskauer, Jen was a Partner and General Counsel at technology focused venture capital firm WndrCo, and previously was the lead lawyer for PineBridge Investments' U.S. Alternatives platform.

Mark B. Cohen

Mark B. Cohen
Managing Principal,
Bradley Credit Partners

Mark B. Cohen founded Bradley Credit Partners in 2023 to advise Financial Institutions on forming Private Credit Joint Ventures -- structuring, modeling and documentation of JV's. Running RFP processes to identify suitors amongst Banks, Insurance Companies, and Credit Funds -- establishing best "partner fit" and negotiating competitive economic terms.

Previously ran Capital Solutions, Restructuring, and Portfolio teams at UBS, Deutsche Bank and RBC for combined 25+ years. Built new product areas to originate Private Credit-structuring and investing in Opportunistic Credit including Sponsor-owned and Corporate Issuers, and Commercial Real Estate. Originated closed over $90 billion of Leveraged Opportunistic Credit.

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Credit Secondaries: Recent Trends and Structural Challenges

October 2024

Proskauer

PRIVATE CREDIT SUMMIT

Table of Contents

SECTION 01

Credit Secondaries

Credit Secondaries – Background

- The private credit market totaled nearly $2 trillion globally in 2023, roughly ten times larger than the total in 2009
- While the market for private credit continues to grow, we have seen shifting market valuations, high interest rates and other market conditions create a challenging exit environment
- These pressures have created a need in the market for liquidity solutions for private credit investors

Data source: McKinsey & Company, The Next Era of Private Credit (2024)

Credit Secondaries – Background

- The buying and selling of pre-existing investor commitments, or investors' indirect interests in credit assets, to private credit and other alternative investment
- No public market
- Credit secondaries is a broad umbrella term within the market, which may include the following transaction types:
  - Traditional LP portfolio sales of private credit fund interests, pursuant to which Buyer assumed all unfunded obligations ("LP Portfolio Transactions").
  - GP-led transactions
    - Strip sales of loan portfolios and similar sponsor-led liquidity transactions
    - Traditional GP-led transactions that involve LP optionality (e.g., roll/reinvest options) still nascent in the credit space
  - Structured capital and hybrid solutions
    - Preferred equity
    - Other structured solutions

Credit Secondaries – Background

- Given that secondary market volumes typically run on a lag, it is believed that we are still in the early stages of expansion as private credit AUM has continued to reach new heights in recent years.
- Private credit sponsors may seek to provide a structured solution so they can avoid an outright sale of the assets.
  - These structures can include preferred equity or other “hybrid” structured capital solutions.
  - These structures can provide considerably more flexibility (and potential upside) for would-be-sellers since they result in potential for upfront cash but not a true sale.

Data sources: (1) Second (is) Best, Atalaya Capital Management LP & Proskauer Rose LLP (Q3 2023); (2) Lazard, Secondary Market Report 2023

Credit Secondaries – 2024 State of the Market

- Although the private credit boom has been a more recent phenomenon, we are already seeing downstream secondary market growth.
  - From 2012 to 2022, it is estimated that credit secondary volume grew to ~$17 billion, representing 30x growth for the decade. However, we believe that the "real" credit secondary market is considerably larger than reported.
- LP portfolio transactions in the credit space to date have primarily involved closed-end senior debt funds given less volatility in pricing, but other credit strategies (e.g., mezzanine, opportunistic, distressed) have increased in prevalence as more sophisticated credit secondaries buyers have entered the market.

Data sources: (1) Second (is) Best, Atalaya Capital Management LP & Proskauer Rose LLP (Q3 2023); (2) Lazard, Secondary Market Report 2023

Credit Secondaries – 2024 State of the Market

- Potential increase in GP-led transaction volume as quality of deal flow improves; large increase in supply of deals from lower and mid market GPs, including credit.
- Although secondary transactions generally remained heavily weighted towards buyout, dollar volumes continued to grow in credit and it is expected that this segment will see substantial growth as the market matures.
  - Buyer appetite for private credit transactions has remained strong, although activity historically limited by a lack of supply.
  - Supply has started to increase gradually driven by $1.5T of unrealized assets in private credit funds.

Data sources: (1) Second (is) Best, Atalaya Capital Management LP & Proskauer Rose LLP (Q3 2023); (2) Lazard, Secondary Market Report 2023

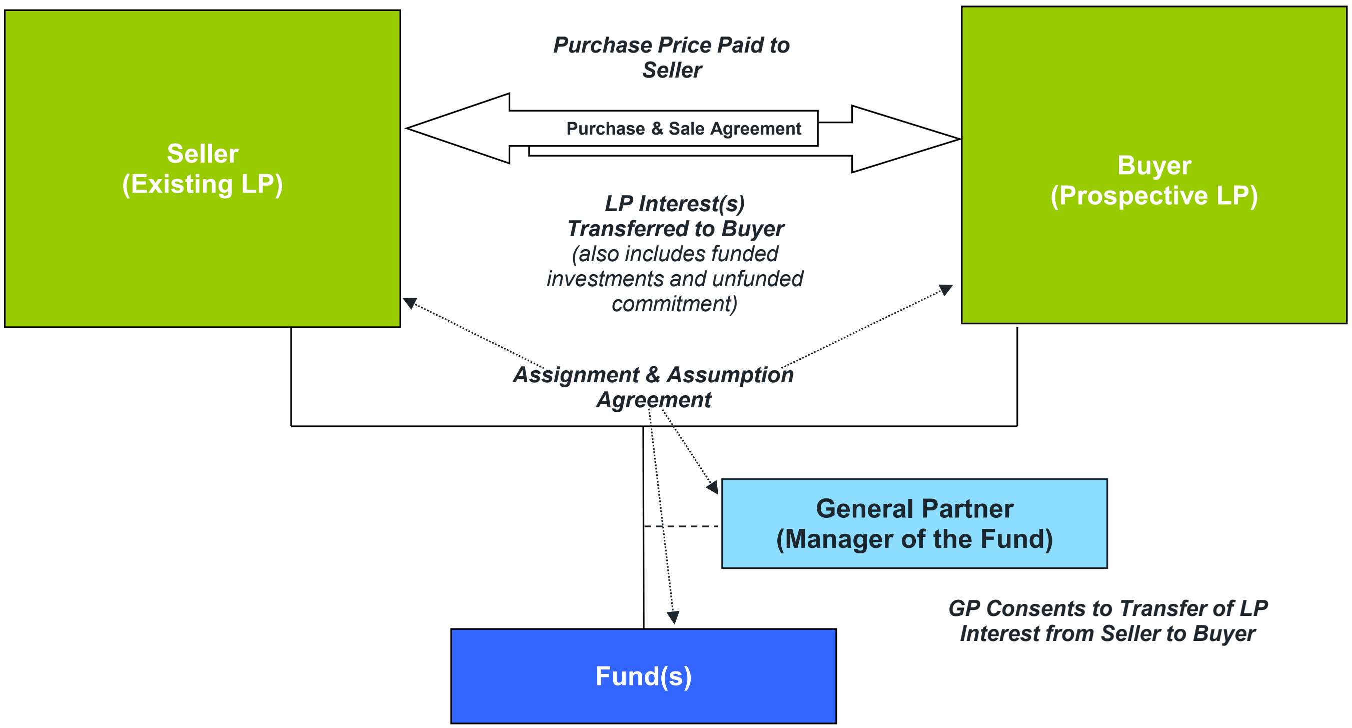
Why do Credit Secondary Transactions Occur?

- Seller's motivation
  - Will differ in LP-led vs. GP-led scenario
  - Need for liquidity and/or exit from "tail end" positions
  - Overallocation to private equity or particular subsector (decrease in value of rest of investment portfolio), portfolio rebalancing
    - Particularly relevant in light of declines in public markets going into 2023 and the prior year
  - Regulatory restraints
- Buyer's motivation
  - Pricing discounts
  - Portfolio diversification
  - Access to desirable fund managers and/or portfolio companies
  - Often less risk than a primary investment (existing portfolio that can be diligenced)

SECTION 02

LP Portfolio Transactions

LP-Portfolio Transactions: Typical Structure



LP Portfolio Transactions: Timeline, Process and Documentation

- Marketing – Seller engages a broker to market portfolio and solicit interest.
- Bid process – interested bidders sign NDA and access limited diligence, bids are submitted
- Letter of Intent
- Legal and Tax Due Diligence
- Purchase and Sale Agreement
- Transfer Documents
- Closing(s)

Legal Due Diligence

- Review of partnership agreement(s) for fund(s) in portfolio
  - Rights of first refusal (ROFR)
  - Investment Company Act issues (i.e., buying into 3(c)(1) funds)
  - Transfer requirements
    - Notice
    - GP consent
    - Opinion
      - If required, determine whether it can be waived by the GP
  - PSA disclosure points (e.g., litigation, opt-outs, AIVs, blockers, fund structure)
  - Other Buyer-specific concerns
- Side letters

Economic Due Diligence

- Waivers or deferral of carry or management fee income
  - GPs typically have the ability to waive carry allocations and catch up out of future profits from investments held for more than three years
    - Less relevant for credit funds, as investments tend to generate ordinary income (rather than capital gains)
  - Some GPs fund GP commitment via deemed contributions / waiver of management fees
  - Concern in either case is shifting of pre-Cut Off carry or fees to the post-Cut Off period
  - Can be address as an “excluded obligation” in the PSA

Certain Tax Considerations

- Tax sensitivity around eligible transferees
  - Credit fund structures may have heightened sensitivity over transferees in particular feeders or funds
    - BYOT funds: Typically, only investors that qualify for the benefits of a tax treaty with the United States will be permitted to invest
    - Treaty funds: Typically rely on, among other things, an ownership test that ensures continued qualification for treaty purposes
  - Flow-through transferees may be problematic for sponsors in certain structures
- Blocker corporations
  - Consider whether the portfolio fund and/or any AIVs are corporations or blockers for US tax purposes
    - Blockers can be associated with an inherent tax liability based on built-in gain that may not be factored into NAV (e.g., blocked investment in a flow-through equity investment in a mezz debt fund)
  - Blocker analysis for credit secondaries is more nuanced
    - May be essential to bringing down tax leakage to acceptable levels for non-US investors (e.g., in a direct lending fund)

Certain Tax Considerations (cont'd)

- ECI & FIRPTA Withholding
  - US sellers: Can deliver an IRS Form W-9
  - Non-US Sellers: Subject to withholding on 10% of the "amount realized" (for ECI) and 15% of the "amount realized" (for FIRPTA)
    - Buyers should obtain a certificate from the seller or the GP to avoid being responsible for withholding on the transfer
    - Credit funds that originate loans, depending on how structured, may not be able to provide fund-level certificates
- Publicly traded partnership restrictions
  - Too many transfers of partnership interests within a single calendar year can increase the risk that the portfolio fund is taxed as a corporation
  - Most GPs will require transfers to fall within a safe harbor

Purchase and Sale Agreement

- Purchase Price and Adjustments
  – Cash vs. deferred
  – Adjustments for deemed distributions?
  – Are liquidated interests transferred?
  – Currency conversion issues
- Excluded Obligations
  – LP giveback
  – Waived/deferred management fees and carried interest
  – Withholding taxes and seller’s pre-closing taxes
  – Portfolio agreement scheduling and liabilities
- Reps and Warranties
  – Survival

Purchase and Sale Agreement (cont'd)

- Pre-closing covenants
  - GP-led transactions
- Closing conditions
  - First closing threshold
- Indemnification
  - De minimis threshold
  - Cap and carve-outs
- Post-closing matters
  - Confidentiality
  - Tax refunds

SECTION 03

GP-Led Liquidity Solutions

GP-Led Liquidity Options: At a Glance

SPONSOR OBJECTIVES

- Term Extension
- Additional Primary or Follow-On Capital
- Enhance Distributions to Paid-In Capital
- Re-set Sponsor Economics

SOLUTIONS

QUICK / SIMPLE

- Term Extension
- Tender Offer
- Amend for Enhanced Recycling
- Preferred Equity
- NAV Facility
- Strip Sale
- Single-Asset Continuation Fund
- Multi-Asset Continuation Fund

LONGER / COMPLEX

LP INVESTOR OBJECTIVES

- Liquidity
- De-Risk Portfolio
- Retain Equity Ownership

Stakeholders

Sponsors

- Extended duration to optimize value of high performing assets
- Additional capital to support existing portfolio/investments
- Crystallize carry for GP
- Reset incentive economics
- Sometimes seen as a solution to tail end assets

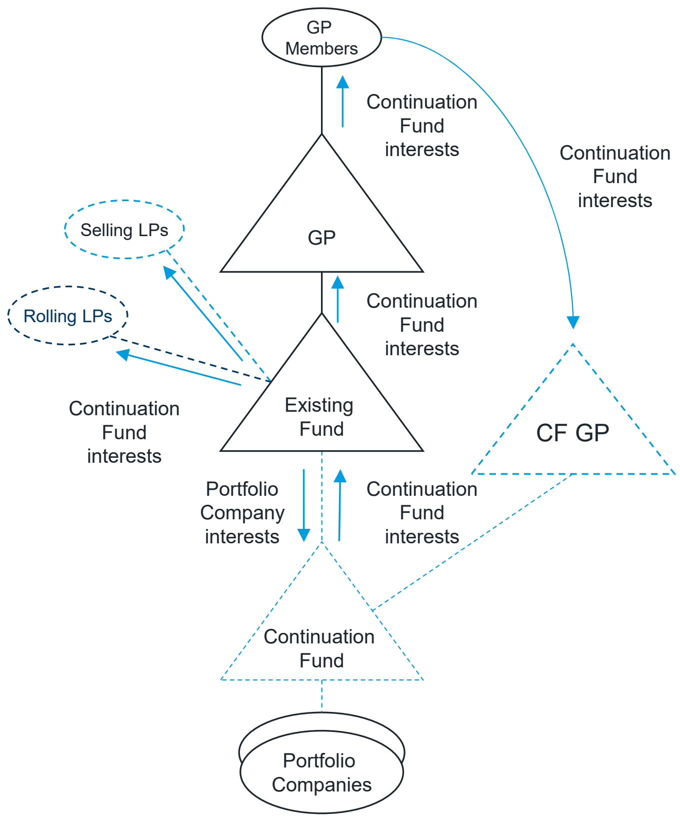
Existing LPs

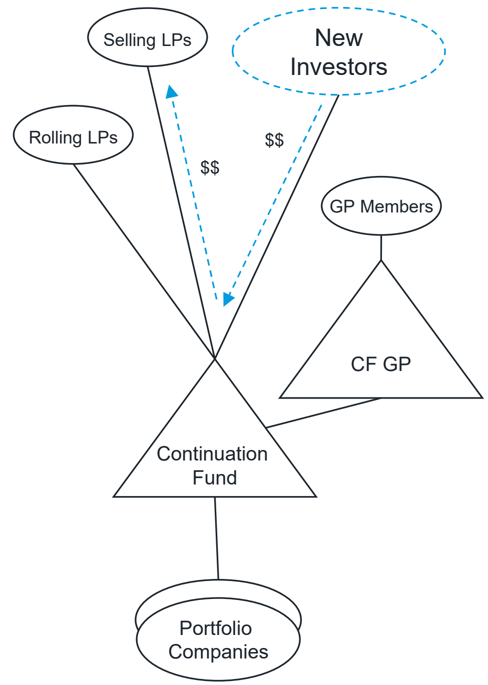
- Current liquidity vs. future upside (what is being left on the table?)
- Ability to assess opportunity: roll or sell? Status quo offered? Forced sale for all LPs?
- Conflicts of interest (what is GP receiving)?
- Internal allocation/portfolio management
- Proposed structure and economics

Buyers

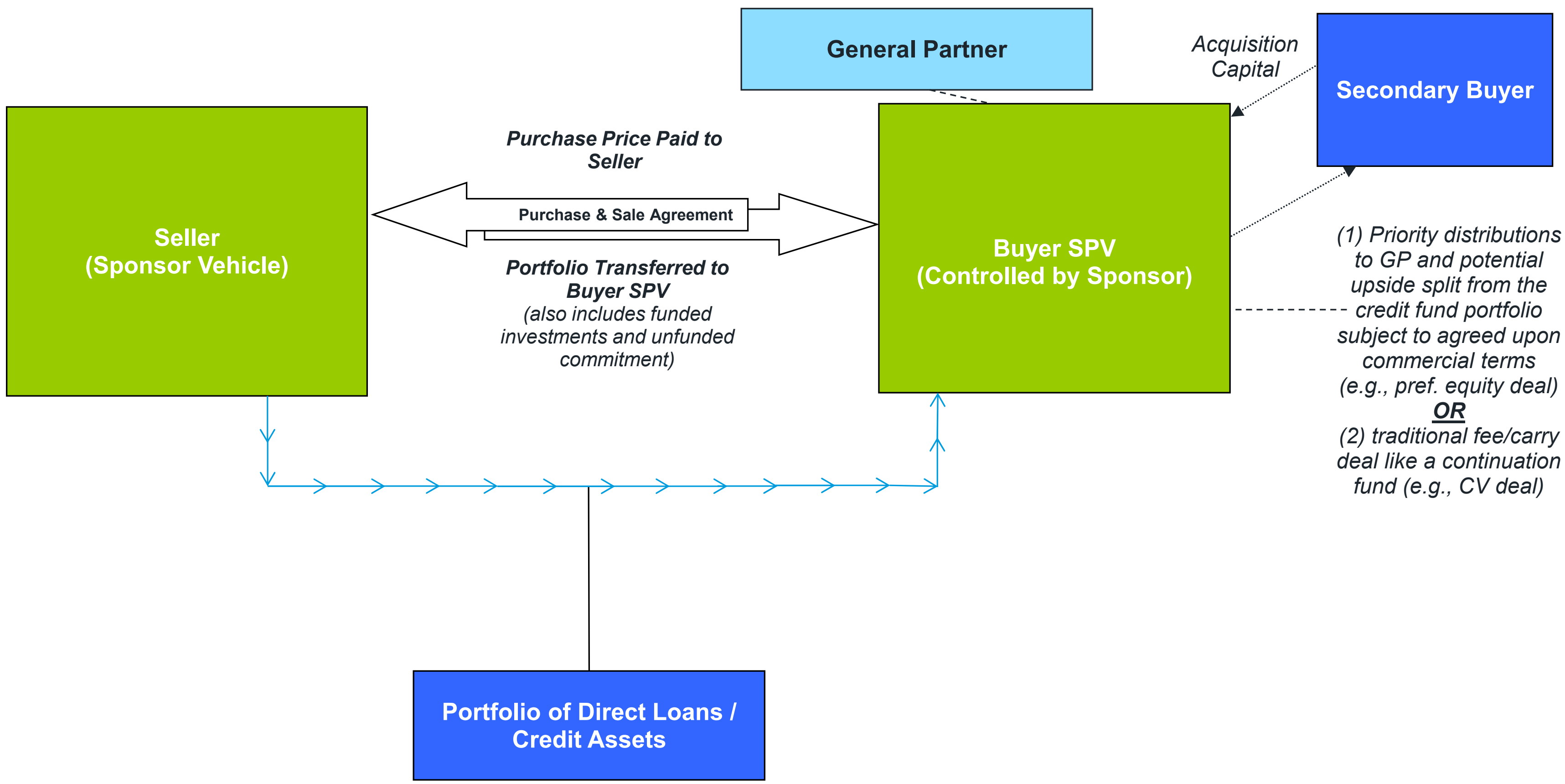
- Access to a mature portfolio with unrealized upside
- Maximize return potential from IRR and multiple perspective
- Create GP/LP alignment
- If LPs are provided an option, will there be a critical mass of selling LPs?
- How will GP manage conflicts and existing LP base?
- How much due diligence is possible?
- Unfunded commitment requirements for follow-ons and fees and expenses

Sample "Traditional" Continuation Fund Structure





Sample Structured Capital and Hybrid Solutions – GP-Led Deal



GP-Led Liquidity Options – Commercial Objectives

OPTION	ADVANTAGES	OTHER CONSIDERATIONS
Continuation Fund	▶ Optional for LPs to sell, roll with new capital, and/or roll with status quo; 100% forced sale structures ▶ Crystalizes unrealized carried interest in existing fund ▶ Ability to reset economics on existing assets and re-incentivize current management team ▶ May provide additional capital for follow-on investments ▶ Longer period to maximize value in continuation fund ▶ Potentially increase AUM through buyout of co-investors and/or portfolio company management	▶ Typically LPAC/LP consent required as sponsor controls purchasing vehicle (affiliate transaction) ▶ Complex transactions comprising portfolio M&A plus seed portfolio fundraising ▶ Broad flexibility in structuring ▶ Often structured as a tax-free exchange for the GP and rollover LPs
Strip Sale	▶ Provides liquidity to LPs and de-risks existing fund portfolio ▶ Can accelerate repayment of preferred return and improve DPI ▶ All LPs participate/benefit equally ▶ Sponsor may receive additional carried interest in purchasing vehicle	▶ Typically LPAC/LP consent required as sponsor controls purchasing vehicle (affiliate transaction) ▶ Sponsor incentivized from new cost entry point ▶ Portfolio as a whole is de-risked

GP-Led Liquidity Options – Commercial Objectives (cont'd)

OPTION	ADVANTAGES	OTHER CONSIDERATIONS
LP Tender Offer	► Pure liquidity option for existing LPs ► Often improved pricing to existing LPs over typical secondaries market given enhanced diligence, scale, etc. ► Potential staple for sponsor ► Comparatively simple to execute	► Sale proceeds paid directly to selling LPs so will not generate carried interest ► Generally, no re-set of carried interest or other economic incentives to sponsor ► Transaction risk and no assurance of investor participation
Preferred Equity Financing	► Can fulfill urgent fund or portfolio-level funding needs without standard debt covenants ► Flexible use of proceeds (LP liquidity, expenses, follow-on capital, etc.) ► If utilized as liquidity solution, can improve DPI and accelerate repayment of fund's preferred return ► All LPs participate/benefit equally	► Some reduction of equity upside ► Cash sweep in favor of preferred equity results in a deferral of future distributions to the fund/LPs ► Typically, no new incentivization of current management team ► May be an attractive alternative to secured debt

Indicative Timeline: Continuation Fund

Typically 3-6 months (for buy side)

Buy side due diligence

- Review of any relevant publicly available information or any teaser presentations
- Selling fund analysis and key metrics
- Change of control analysis: portfolio company equity & credit agreements, material litigation, regulatory issues, employee compensation matters, co-investor rights, commercial contracts, etc.
- Investor tax / ERISA considerations

Consider if desirable

- If so, start process early
- Agree allocation of cost and scope of coverage
- Consider exclusions and who bears liabilities not covered by RWI

Key documentation:

- Term Sheet
- Rep & Warranty Outline
- Transaction Agreement
- New Fund LPA
- New Investor Side Letters
- RWI Policy
- Confidential Information Memorandum

Closing

- Closing occurs once conditions have been satisfied (including regulatory consents and Approvals)
- New Investor Capital Calls
- Payment of Purchase Price

NDA → **Due Diligence** → **Auction Process (if relevant** → **Representation & Warranty Insurance** → **Approvals** → **Negotiate and Sign Documents** → **Election Process** → **Closing**

Process run by secondaries advisor

Investors to consider:

- Appropriate pricing, including impact of any fairness opinion process
- Syndication process
- Process, number of rounds involved
- Acquisition finance

Determine/confirm required LPAC and/or investor approvals, as well as any governmental or third-party approvals

Existing LPs decide whether to sell or roll

Key Risks

CONSIDERATION	COMMENTS
Fiduciary duties and conflicts of interest	► Potential for intense scrutiny after-the-fact by aggrieved LPs and regulators ► Status quo option provided to existing LPs? ► Equal access to diligence in the dataroom? ► Fairness or valuation opinion provided to existing LPs? ► Improvement in GP economics?
LPAC/LP consent	► LPAC consent will typically be required given sponsor conflicts ► LP consents/amendments may also be required ► Socialization for consents should commence early in the process to avoid “dead” deals
Tax Structuring	► Consider whether blockers are being purchased or inserted ► Consider potential withholding taxes and how they will be addressed ► Consider tax characteristics of existing assets (such as U.S. lending trade or business risk)
Regulatory Considerations	► Anti-trust, CFIUS, FCC ► SEC rules and reporting requirements ► SEC best practices

Potential Credit Specific Considerations

- Assignability of Loans
  - Applicability of assignability restrictions
  - Required consents
  - Disqualified Institutions
  - Participations vs. Assignments
- Purchase Price Adjustment Considerations
  - Interest and amortization payments and accruals
  - Voluntary and mandatory prepayments
  - New revolving or delayed draw issuances
- Regulatory
  - Licensing/approvals required for CV

Potential Credit Specific Considerations

- Structure of transaction – contribution/redemption v. sale
- ECI or "trade or business" considerations
  - Dealer activity if originating with intent to sell?
  - "Taint" of originated loans being contributed into buyer SPV structure
  - Structure to maximize secondary purchase of "old and cold" loans
    - Representations as to "old and cold" status of loans (including recent modifications)
  - Distressed loans – buying with the intent to workout?
  - Foreclosures and flow-through equity

Diligence Considerations for Credit Assets

- Managing risk around withholding and leakage
  - Customary tax gross up
  - Qualification for portfolio interest
  - Registered form
  - Debt-for-tax status of loans
  - Historic withholding, if any
  - If loans are not assigned, assurances that change in circumstances or lender of record does not interpose leakage for buyer SPV
- Non-US considerations if any loans relate to non-US borrowers or guarantors

Diligence Considerations for Credit Assets

- Deal Term Diligence
  - Financial covenants
  - “Sacred rights” and minority lender protections
  - Liability management transaction protections

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PRIVATE CREDIT SUMMIT