Legal

On the minds of the Legal Rising Stars

Private Funds CFO's Legal Rising Stars 2023 listees share their thoughts on the trends impacting the private funds space

Q What do you see as the single biggest challenge facing GPs who want to deploy capital over the next few months, from a legal perspective?

Vicky Forrester: A new fund seeking to close and deploy capital quickly likely needs to follow a prior fund that has made distributions to its LPs. Additionally, the manager should be legally nimble, accelerating through the otherwise slow fundraising process. Pushing LPs to close expeditiously and finalize diligence and side letter negotiations is paramount – additionally, having a clear legal perspective on managing conflicts of interest and mitigating concerns around borrowings, particularly for distributions.

Oliver Prakash-Jenkins: With over half the planet's population voting in elections occurring in more than 60 countries, there is that additional layer of political risk in executing deals in the event the balance of power shifts. Given the time required to enact new legislation, the challenge will be anticipating how any changes may impact future management and disposition of investments from a regulatory and tax perspective, rather than the initial investment.

Q What are LPs currently looking for from their GPs? How is the current macroeconomic environment affecting the kind of issues that LPs are focusing on?

VF: Limited partners are focused on high quality managers that they know well. On the legal side, they are focused on in-depth diligence on managers, including their policies, procedures and investment management processes. LPs now expect term changes to be justified with clear explanations. Negotiations take longer and side letters cover more diligence items and legal provisions. Fees and carry, distribution timing and use of leverage are in the spotlight.

OPJ: LPs are placing greater importance on the DPI ratio as a metric to determine whether to re-up with a GP. With bids coming in lower due to acquisition debt being expensive, sponsors are turning to GP-led recapitalizations to generate those distributions, broaden their investor relationships, crystallize carry and retain the ability to create further value and sell to a third party in a lower interest rate environment.

Q How might increasing appetite for democratization within the private funds industry create legal challenges for managers looking to attract capital from new investor types, including retail investors?

VF: The private funds industry has long argued against regulatory interference on the basis that sophisticated investors can 'fend for themselves' – with increased retail capital, the SEC will have new arguments as to why funds require even greater scrutiny. Additionally, increased numbers of investors with smaller investment sizes creates operational complexity that managers either have to outsource or build teams to manage, which increases time and expense.

OPJ: Launching a semi-liquid, evergreen retail product requires significant operational resource and a clear understanding of the structuring options – whether it be a Luxembourg Alternative Investment Fund (AIF), including European Long-Term Investment Funds (ELTIFs) passported under the Alternative Investment Fund Managers Directive (AIFMD) to professional investors across the European Economic Area, or a '40 Act regulated fund distributed to US investors. Critically, sponsors need to develop robust processes that pass muster from a conflicts perspective for seeding the retail product and investing alongside the institutional investor products.

Panel

Vicky Forrester
Partner, Paul, Weiss, Rifkind, Wharton & Garrison

Oliver Prakash-Jenkins
Partner, Latham & Watkins

Q To what extent is pushback against ESG investing regulations in certain US states impacting the way private funds invest and interact with their investors on ESG-related matters?

VF: Managers in the private funds industry handle ESG differently. For example, managers that raise a lot of capital from US state plans with policies against ESG tend to downplay ESG, and therefore may find it challenging to also raise capital from European LPs pushing for more ESG policies and procedures. Ultimately, many managers are able to thread the needle and focus on their fiduciary duty to the fund.

OPJ: While the state-level bills, laws and actions (and the politics and politicians underlying them) have generated a lot of headlines, the reality in the private capital closed-end fund landscape is that sponsors are still able to attract capital from instrumentalities of those conservative-leaning states by reaching agreement on side letter terms or making discrete changes to the LPA that align with the latest developments without undermining the investment strategy.