Out of the shadows

The emergence of direct lending funds has been a major force in the current reshaping of Europe's credit markets. *Legal Business* teamed up with Debevoise & Plimpton to debate the prospects for this new breed of financiers

ALEX NOVARESE

You could make a perfectly credible case that what has swept through Europe's credit markets in the last three years constitutes a key chapter in the biggest shake-up in the region's financial sector since the deregulation of the securities industry of the 1980s.

After all, the UK's 'Big Bang' reforms of 1986 ushered in the era of financial 'supermarkets', strengthening the hand of the foreign banking groups pouring into the City and entrenching the power of a select club of banks as dominant providers of capital for the next 20 years.

Law firms naturally responded by gearing their businesses around elite banks. In contrast, the post-Lehman years ushered in a major challenge to that dominance as banks under regulatory pressure have retrenched, leading many to scale back their lending.

In their place has emerged a new breed of 'shadow bank', a diverse collection of investment funds, direct lenders, and debt arms of hedge funds and buyout houses.

In particular direct lenders such as Ares Management, BlueBay Asset Management and Intermediate Capital Group have become a genuine force in leverage finance. Taken alongside the growth of Europe's bond markets, traditional senior lenders have become less central to City finance lawyers.

Legal Business assessed this shift in its May 2014 cover feature, 'Back in the machine', returning to the theme in the December piece, 'The king is dead', which focused on the migration of deal finance professionals from banks to alternative credit providers.

This month we return to the point in a debate held with Debevoise & Plimpton to discuss the role and prospects of this new breed of credit provider.

We also address the basic question for advisers: should they be trying to cultivate the Hayfins and BlueBays at the expense of traditional banking contacts? For a number of lawyers, the answer to that question appears to be a resounding yes.

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Photographs DANIEL THISTLETHWAITE


Matt Theodorakis, Ares Management: Restructuring groups often don't realise there is an alternative to banks

▶ *Alex Novarese, Legal Business: This is a hot topic in corporate finance circles. Let's start with the obvious question: direct lending funds – have they reached a plateau or is this just the start?*

Klaus Petersen, BlueBay Asset Management: This is just the start. If we look at Ares – sort of the mother of all direct lending – they have been in Europe a couple of years already and started this. Hayfin was next and then it was us coming. Currently, it is just booming in EMEA: the interest on the institutional side has started. If you look two years back, direct lending was a word that nobody would understand in Europe. There is now a constant inflow of new transactions too, so you have a demand side for the product and you have an interested investor base. All the big asset managers these days are starting to do direct lending in Europe too. Kohlberg Kravis Roberts has announced it; everybody who is established is taking this up.

Alex Novarese: Where does the money typically come from?

Klaus Petersen: The first one we had was 60% institutional and 40% everything else, from high-net individuals, family offices… It has shifted: now the majority interest is big institutions who have allocated some bucket to this asset class.

Matthew Theodorakis, Ares Management: Ares' European direct lending team primarily invests out of its current ACE II fund, along with other managed accounts and capital programmes, totalling approximately €7bn of assets under management.

Alex Novarese: Is it primarily refinancing or new money deals?

Matthew Theodorakis: Primarily refinancing and recapitalisations. We do a lot of M&A financing as well, but it seems to be, at least in the alternative lender and credit market, that the banks are competitive in the M&A processes.

Alex Novarese: What has fuelled this market over the last two years?

David Culpan, Sun European Partners: It is a chase for yield. If investors feel they cannot make a suitable return in the high-yield market and mezzanine has died off, they look at alternative investments. People are looking for other pools of capital in which to invest, and unitranche and alternative lending is the growth area.

Mark Fine, Sankaty Advisors: The market for credit products continues to be interesting for investors, reflected by the strong, growing demand we are seeing. It is normally senior secured debt and you are potentially looking at attractive returns.

Alex Novarese: Is it also related to regulatory constraints on banks?

David Culpan: It is probably the regulatory constraints on banks that make it more competitive to move to unitranche if you cannot get mainstream bank lending. However, I am not sure if it is the regulatory pressure on banks that has driven investors to invest in unitranche; it is the chicken and the egg: the opportunity exists in the lending market for unitranche funds and that is probably attracting investors.

Klaus Petersen: Opportunity has arisen in Europe because of the regulatory change. Basel III demands so much risk capital that it is very difficult for banks to justify mid-market deals. If you look across Europe we can see deleveraging, deleveraging, deleveraging, consistently. It's a paradigm shift in the way financing will take place in Europe, driven by the crisis and regulation. You can look to the US in the late 1980s/early 1990s – regulation did the same and forced commercial banks to retreat from this type of business. Then you had the likes of Ares, Cerberus and Apollo getting into this business and providing mid-market financing.

You will see the same in Europe. We can have a very good debate about whether it will be like in the US, where two thirds are provided by non-banks. Will it be significant, about 50%? I think yes. If you look at data today you can see

'If you look across Europe we can see deleveraging, deleveraging, deleveraging, consistently. It's a paradigm shift in the way financing will take place in Europe, driven by the crisis and regulation.' Klaus Petersen, BlueBay

that more than 50% in the UK is in the mid-market direct lending.

Pierre Maugüé, Debevoise & Plimpton: Why do we see more activity for alternative lenders in the refinancing space? Is it because they are reluctant to write commitments in connection with M&A transactions? In the US we see Ares frequently writing commitments to underwrite leveraged buyouts (LBOs). Is that different in Europe?

Matthew Theodorakis: It is about the same. What we bring to the table is ease of execution. On a refinancing, where the motivation is to get something done quickly and have the new lender speak for the entire capital structure, we are very competitive. On an M&A transaction, where it might take a little bit longer, competition is typically greater because it is typically a wider process.

Alex Novarese: How do people around the table feel about the role of banks? There is a lot of talk about them having less clout.

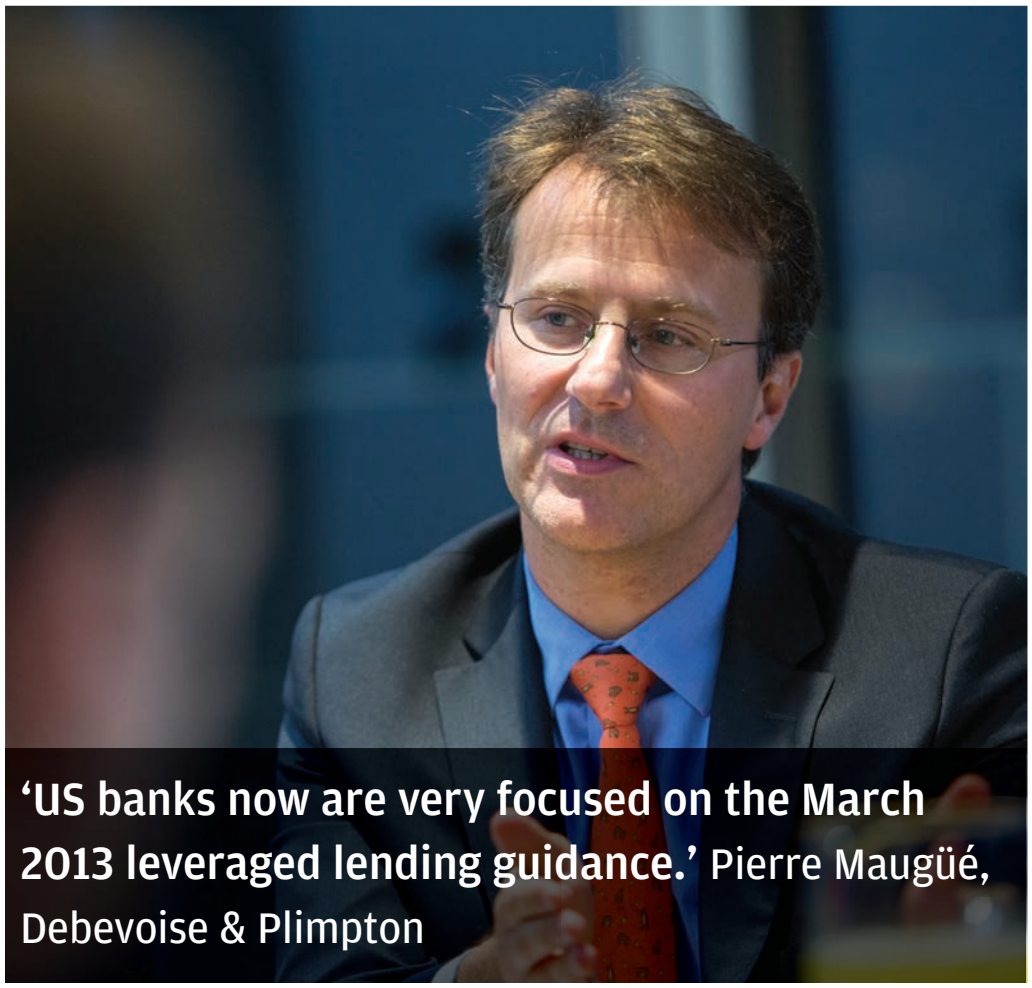
Alan Davies, Debevoise & Plimpton: Immediately after the crisis, club bank financing just became the norm for a while and people were not underwriting at all. Even now we tend to see with sponsor work we do that individual banks are less willing than they were pre-2007 to do these huge underwritings on their own.

Alex Novarese: How do you feel at Debevoise in terms of where you are focusing on the clients? Has it moved away from focusing heavily on banks?

Alan Davies: Some major law firms have focused primarily on the big underwriting banks and now they too are beginning to look elsewhere. Who our clients are from a legal perspective is rapidly changing and the revenue law firms are getting from the big investment banks is going to rapidly reduce if the market continues as it has done over the past couple of years.

Pierre Maugüé: US banks now are very focused on the March 2013 leveraged lending guidance, which is also applicable to their transactions in Europe. A question for the group is whether people feel that US regulated banks have been less active recently?

Alex Novarese: This is the guidance trying to rein in lending?



'US banks now are very focused on the March 2013 leveraged lending guidance.' Pierre Maugüé, Debevoise & Plimpton

Pierre Maugüé: The regulators in the US published guidance that says a regulated bank should not be in the business of originating or distributing loans that carry too much risk. There is a debate as to which transactions will be criticised. What the guidance says is that, in order for a loan to be a passed loan, the borrower must be able to deleverage out of their internally generated cashflow, either 50% of the total debt, or 100% of the secured debt, in each case within five to seven years.

There is no bright-line test but total leverage north of six times of EBITDA raises concerns for borrowers in most industries. Transactions where the financial model does not show the required level of deleveraging may still pass, but that has created a great deal of uncertainty. The US-regulated banks are subject to that the guidance; the European-regulated banks are also subject to the guidance to the extent that they do business in the US. For purely European transactions, a purely European bank may not be subject to this guidance.

Alex Novarese: As I understand it, Debevoise's take is it will constrict bank lending and is a further stimulation to new kinds of funding.

Alan Davies: You have got the sponsors demanding higher leverage and you have got the regulations saying this may be a non-passed loan if you exceed six times the leverage, so there is a huge amount of tension there.

Paul Brusiloff, Debevoise & Plimpton: Matt, should the Fed be looking to make companies deleverage? Are regulators just distorting the market or appropriately moving risk?

Matthew Theodorakis: The latter. They realise there are certain businesses that should not be doing leveraged loans through six, six-and-a-half times. There is more than just focusing on leverage. There are documents there that help you get enforced remedies, or you have a seat at the table if something is wrong. The reason we can get comfortable with the risk-adjusted returns that we have is that we always have covenants, we always have fairly tight ▶

documents and there is a fairly big sponsor pushback out of those terms.

Alex Novarese: What would be the covenants or the terms you would look for to make you feel comfortable?

Matthew Theodorakis: We try to get our full covenants on every deal. You have to have a disciplined approach.

Paul Brusiloff: Mark, maybe you could comment on documentation standards.

Mark Fine: Documentation is getting more sponsor friendly. Post-crash we went through a period where everything tightened up quite dramatically, but we have seen a gradual easing off with that. Certainly on the big LBO deals at the end of 2013 and the beginning of 2014 there were some incredibly sponsor-friendly terms. We are seeing a lot of import from the US market. A lot of the terms from those loans – the 'cov-lite', 'cov-loose' – are certainly being brought into the European market and direct lending as well.

Klaus Petersen: We need to divide the direct lending market into areas. There is the larger size where we definitely see the effect of covenant-lite coming back. If you take the mid-market, there is not any covenant-lite in the mid-market.

The general market view is: 'No, we do not want to have a bond-style covenant loan in the mid-market,' because covenants are one of the key things. We may get a bit higher on leverage than the banks, but we have a full set of covenants to make sure that if something goes wrong, we can act.

We are always being pushed on covenants. For the risk we are taking, we need to have full covenants.

Paul Brusiloff: There was a study on covenant-lite and the conclusion was that covenant-lite performed better than the loans with covenants. What is the group's reaction to this?

Barry Lane, 3i Group: I can give a view from the collateralised loan obligation (CLO) space in Europe. There has been quite a move in terms of how the US has influenced there, so you have had that push whereby initially European 2.0 CLOs were coming out with 10% cov-lite buckets; it has now increased to 30-40%. One of the arguments in favour of larger covenant-lite buckets was that the deals tended to be more in the cross-border transactions, so you get the larger transactions – the £100m-plus EBITDA businesses, as opposed to the small and mid-market deals.

Alex Novarese: You are saying they are more transparent businesses?

Barry Lane: Yes. They are the type of businesses people use every day. As a house view, a covenant is good, but you still need to understand the underlying credit; a covenant is not going to save you if it is a bad credit. We are still seeing a reasonable level of covenant-lite deals, but more at the bigger end. The danger is if you start to see cov-lite structures in the smaller end, but we have not seen that yet.

In the first nine months of the year in the loan market you have seen much more borrower-friendly terms. In September/October you started to see a correction. But the market will always have that cycle point whereby borrower-friendly terms will peak and there will be a correction.

Alex Novarese: Is there any consensus around the table about what sort of deals show real risk? Equity cures? 'Cov-lame' somebody mentioned to me the other day – I don't even know what that is.

Klaus Petersen: There is a deemed cure, something that people always try to push. We definitely would not like that.

But there are certain covenants that do not make sense. Think about a business that depends on air travel. In such a business where you have a disruption in air travel, there is no revenue. The business may be sound, you have an interruption – SARS or an ash cloud for a couple of weeks – and the impact for a short period is massive, which means you may breach the covenants. It does not make sense just to have a covenant breach for a covenant breach.

Alex Novarese: You are saying that some covenants may not work for some businesses, no matter how sound?

Klaus Petersen: Correct. What direct lending can do, because we do not depend on syndication, is that we can caveat that. The banks need to think about syndication.

Alex Novarese: How frothy is the market?

Alan Davies: In the run up to 2007, it seemed from a legal perspective the banks were being less cautious. I would be rung up on the way to work and somebody would say: 'We have decided to drop the covenants generally.' Now it may have got a little bit more active, but people do take time to give consideration to covenants and other legal tools; there is a proper review of the covenants.

David Culpan: The market is frothy in certain deals, whereas pre-2007 you are right: banks were throwing money at every transaction. Now, if you have a very strong credit story with maybe 80% of the revenues on six or seven-year contracts and lenders know it is a very stable business, it is attracting high leverage. If a business has got a 'rap sheet' and had some bumps in the road a couple of years ago, you are not seeing that same frothiness. Are people dropping covenants or are they pushing leverage on good deals? Leverage is going up, but the covenant structure is staying the same. Is that frothy, as it was pre-2007? Maybe not.

Alex Novarese: In this context, how do people feel about the growth of the high-yield market in Europe?

Barry Lane: The bond market has been a one-way bet in the past couple of years. Now you are starting to see a correction. The biggest trend was probably the tired LBO deals that were refinanced into the bond market; some

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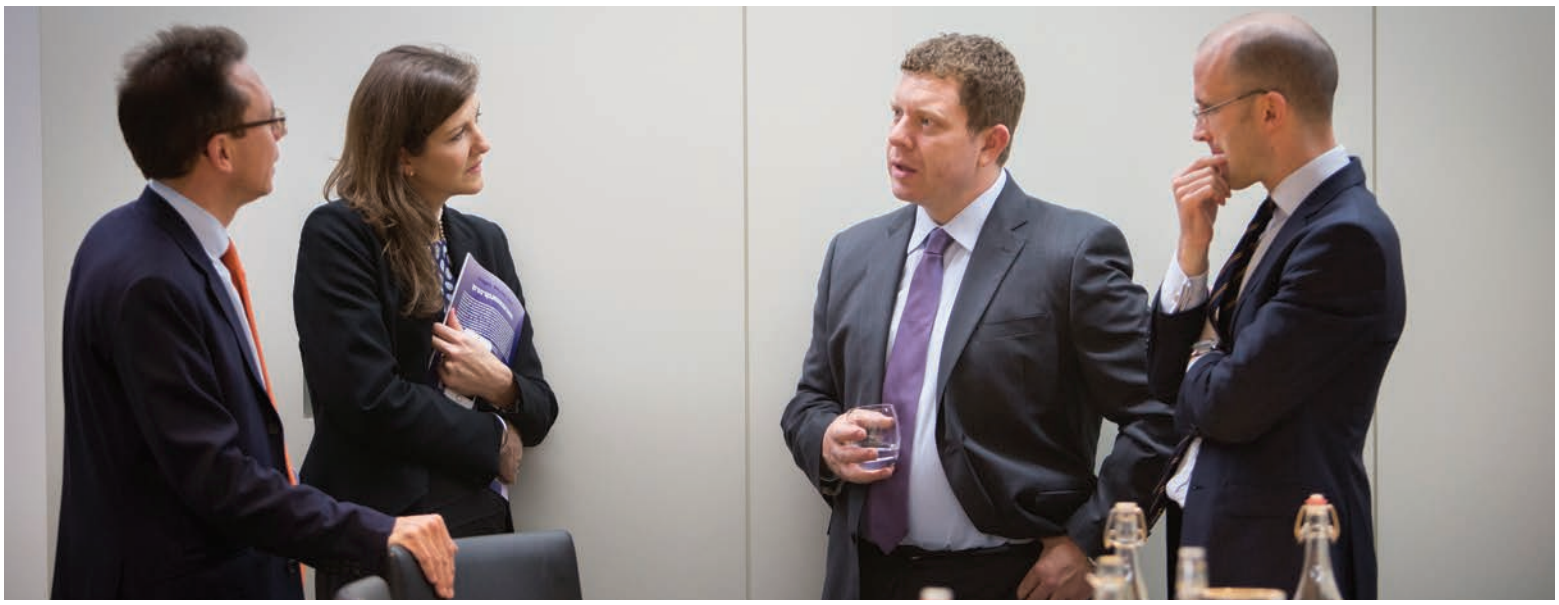


of those transactions have subsequently underperformed. You are getting more sensible pricing in the high-yield bond market now.

Alex Novarese: Do people still see the underlying trend of the high-yield bond market growing in Europe?

Barry Lane: People are still going into high-yield, but it is going to be finding the right transactions. There have been some bad experiences from those examples of the tired LBO deals.

Alex Novarese: Are you talking about multiple refinancings?

Barry Lane: Yes, there will be tertiary buyouts that have gone through a number of sponsors. Now you are seeing the large swings in the bond pricing for those names when they start missing targets. We have seen a lot of that in that last two quarters.

Alan Davies: The other obvious point is that, for the smaller deals, the high-yield bond market is just not available. You cannot generally do a high-yield bond for sub-€100m.

Klaus Petersen: The problem in the European market in this respect is that it is not deep. There is no mid-market in Europe for high-yield.

Matthew Theodorakis: Back to your high-yield question: one area of difference between Ares and our competitors is that we have follow-on capital. That is one reason sponsors enjoy working with us: because they know that we are flexible; they know that we are good not just for this cheque.

Paul Brusiloff: Unitranche is something that the mezzanine community has viewed as competition, at least in a certain space. What does the unitranche community view as the competition?

Matthew Theodorakis: Definitely the banks. The beauty of the unitranche structure from an investor standpoint is that it can often provide better risk-adjusted returns compared to a mezzanine loan. It has a lot of lender protection with a first lien, unlike mezzanine debt. Unitranche loans can also prevent potential intercreditor issues.

Klaus Petersen: I would absolutely agree. Mezzanine has to be in direct lending in Europe, but mezzanine is not competition for us. Unitranche is always just one tranche, but if you have mezzanine, you have at least two, if not three, so it is more complex and mezzanine as a small piece of the structure does not really solve the problem for somebody who needs finance. Unitranche can solve your problem; it can provide all the financing that you need.

Paul Brusiloff: How do you work with the bank to provide value to your borrowers in an environment where the bank may not be able to play in the deals where you can add the most value?

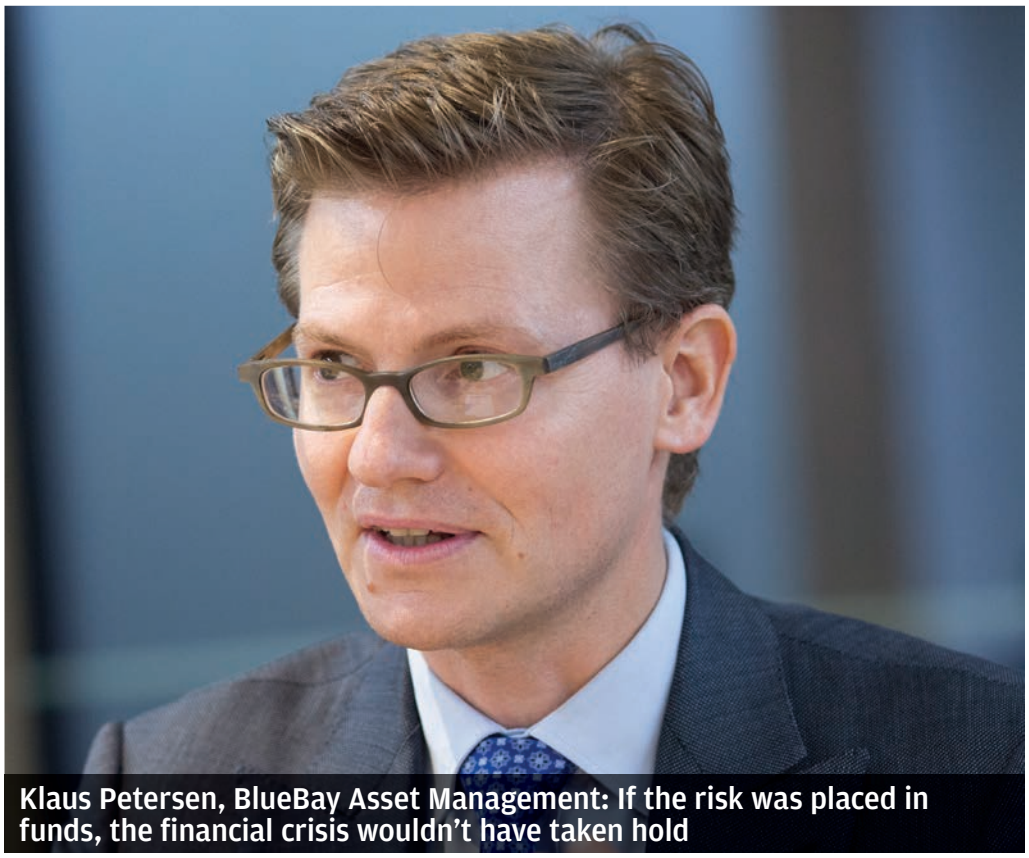
Mark Fine: We work with the banks on numerous unitranche facilities. They will normally come in and take super-senior [revolving credit facilities (RCFs)]; it happens fairly frequently. You are then into creditor negotiations and that normally works pretty well, especially if the borrower just needs general corporate purpose capital throughout the term.

Klaus Petersen: Direct lenders do not want to do banks' business, which is revolving facilities, hedging, cash management. Therefore, it is a very good combination to have a bank in place that does the global and also maybe a senior bid, and then you have a direct lending business or a debt provider that does the majority of the capital structure.

If you think about what happened in 2007, the problem was not that there was too much lending. The problem was that where the risk was sitting: it was systemic. If that risk had been placed with funds, a couple of funds would have gone bust. Yes, that would have been bad, a couple of people would have lost money, but the system would have worked.

Alex Novarese: How do people feel about examples such as BlueBay tying up with Barclays? Is that a trend that will continue?

Klaus Petersen: There is an interest from banks in doing that. We negotiated this deal with Barclays that allowed the two of us to work together and provide the unitranche as an instrument. It gives both of us access to different things. For us it offers access to corporates, which is very difficult. ▶



Klaus Petersen, BlueBay Asset Management: If the risk was placed in funds, the financial crisis wouldn't have taken hold

One thing we have not discussed is that in the US you have corporates using direct lending; in Europe it is an exception. Is it a role model?

We have just been approached by another big European bank and we are very interested.

Alex Novarese: To clarify, with that joint venture you put the unitranche in together but there is super-senior above it?

Klaus Petersen: Yes. The bank can provide super-senior. It depends on the business. Some businesses need an RCF because they have working capital spending throughout the year.

Regarding the structure, very simply, the unitranche is provided for the bank and us together: in rough terms they take a third and we take two thirds of the whole thing, and then there is the option that they could also provide a super-senior RCF in the structure.

David Culpan: Klaus, is that a formal tie-up with Barclays through a joint venture?

Klaus Petersen: No, we have an instrument we negotiated. We have a set of documents that we can use at any time and we are not exclusive. What we can do is if there is a situation that needs a financing, instead of negotiating everything, it is done. You have the documentation, you have the adjustments for consideration, but it works very well.

Alex Novarese: What was the background to the Barclays deal?

Klaus Petersen: They came to us. They saw that direct lending was taking more market share away from them; that is the UK game in the last 18 months. We negotiated for six months in that deal. There is a full set of fully-fledged documents that allows them to do it. In the background, actually doing [a financing for retailer] Phase Eight, which as everyone knows was the first deal we did, was that mechanism and it was very successful.

Pierre Maugüé: Is this a product that Barclays holds or does it expect to syndicate?

Klaus Petersen: No, they hold it. It is for the mid-market. The bank can normally only hold, say, £20m or £30m, but banks are getting cagey really. Now with one third being theirs and two thirds being ours, they can re-enter the market.

David Culpan: From a borrower's perspective, that approach is a double-edged sword. You are bringing something to the table where you can partner with the bank and potentially put more leverage on and lower the cost of capital, but from a borrower's perspective it also takes competition away because two parties are teaming up.

Klaus Petersen: You have competition. We always compete with other people.

David Culpan: I get that, but if a borrower knows, even if it is not a formal contacted tie-up, if there is a link…

Klaus Petersen: They would always know that we are doing it together because otherwise that is a bit funny in terms of competition. We always compete: the only competition in this particular instrument is the bank: bank financing, because through this structure we can be very aggressive on pricing.

Look at Ares and General Electric (GE), who have a similar structure, which is very effective. It is a more formal tie-up. There is enough competition in the market.

David Culpan: I know we were referencing Barclays when you said you could team up with anyone, but how do you get comfortable with the fact that the bank element of the deal might not get credit sanction whereas you do?

Klaus Petersen: This is why you have to get pre-approval. If I go to the market and say 'here is the Barclays/BlueBay product' and I say I can deliver when I cannot, that product is dead. We both go to credit committee; for us it is very simple, for them it is a bit more formal, but it is the same process in the end.

Mark Fine: How early in the process are you getting that approval?

Klaus Petersen: Very early.

Pierre Maugüé: Would you write commitments on a separate basis?

Klaus Petersen: Together. As Mark said, we would subscribe a commitment for a £70m financing, one third of which would

be provided by them and two thirds by us. Potentially there would be an RCF and that is a commitment together. We would provide a commitment letter together, we would provide a term sheet together… It is all just with two parties, but providing a commitment together.

Alex Novarese: How many deals have been done?

Klaus Petersen: We have done one; we are looking at a couple of others. It is very difficult to get this done. Our leverage would not be as high as we normally do, but with the combination of the two products we can be quite aggressive with pricing.

Alex Novarese: Is it culturally awkward to do a deal in that sense that your institution has a different dynamic to Barclays?

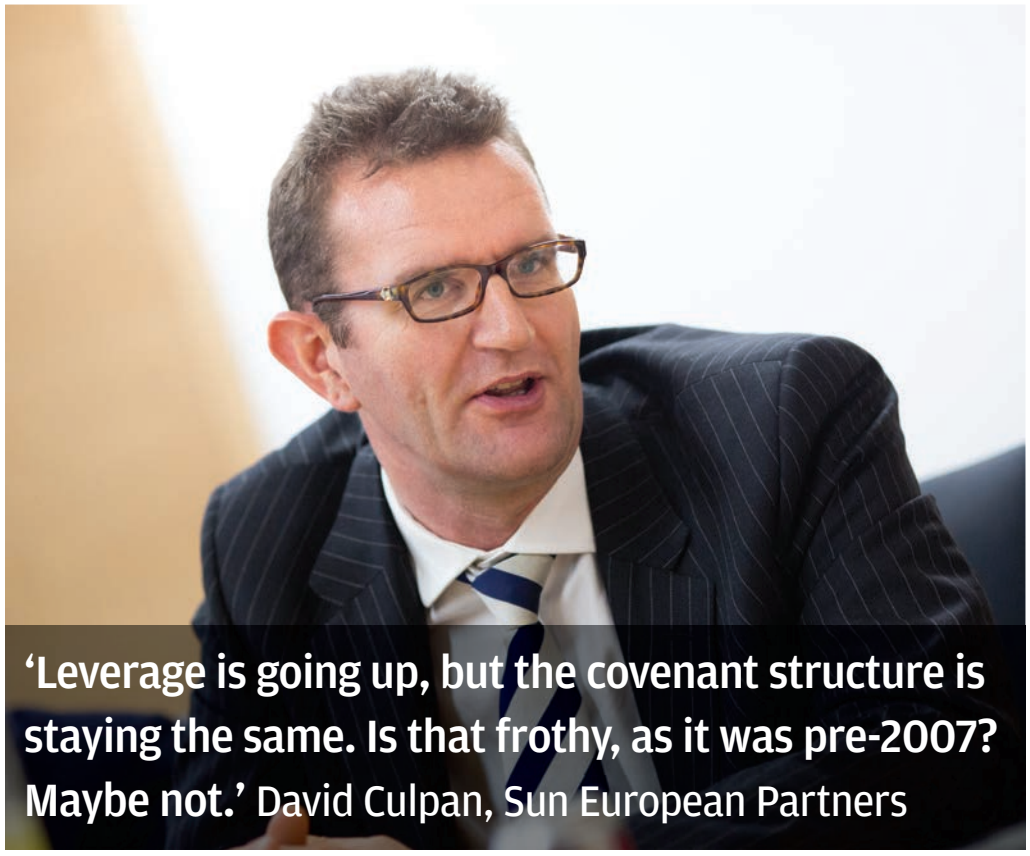
Klaus Petersen: No. The big question is on the credit; the rest, we all know how the processes are working; we have all seen most of the credits in Europe before. The only big difference is that credit decisions are taken for different reasons at a bank compared to a direct lending fund.

Alex Novarese: That is quite a big difference potentially.

Klaus Petersen: Yes, but that is the only difference once you have jumped through that hoop and both credit committees have said yes, the rest is just process.

Alex Novarese: With direct lending, how established is the legal documentation? Is it adapting standard clauses?

Paul Brusiloff: In the US there is a lot of variation. The US does not really have the equivalent of the [London Market Association (LMA)] form; the Loan Syndications and Trading Association has some standard provisions that they have tried to promulgate. Those, by and large, have only made their way into the direct lending market via those deals in which the direct lenders are there with a bank.



'Leverage is going up, but the covenant structure is staying the same. Is that frothy, as it was pre-2007? Maybe not.' David Culpan, Sun European Partners

Klaus Petersen: In Europe differences are mainly driven by regulatory factors. However, in the main mid-market where sponsors want to get, it depends on the sponsor really. Because they are representing, more or less, the borrower, they will try to get the LMAs done and the reason there actually is driven by being able to have a document that is tested. Investors like us would like it too because you know there is a standard that everybody respects.

If you go to GE or our co-operation with Barclays, I absolutely agree that it is a standard set of documents. We would not change that.

Alex Novarese: As these are fairly standard documents, are there many opportunities for the legal adviser to add something?

Klaus Petersen: Definitely. There are a couple of things that are very driven by commercial terms: the baskets, the covenants, what defines a significant business, etc. However, there is a huge part where we need the lawyers, which is about security; ask anyone at the table and they will know what security is, but without the lawyers we would not know how to enforce it. The other things we depend on the lawyers for is making sure that the document really works. We always underestimate that bit; we just assume they work, but if you go to the courts they need to work.

It was interesting in 2007 when things went to court that these things came up. On a commercial side they are helpful because they see everything. We see our part, so through lawyers we get to see a bigger and wider area and we can then have the argument with the sponsor about what is standard. It is a bit of a game, but it is a massive service that we get.

Alan Davies: The key non-commercial terms are generally based on the LMA. You see the standard terms come out on every deal, but the lawyers always get very involved with the intercreditor agreement and there has been ▶

'We try to get our full covenants on every deal. You have to have a disciplined approach.'
Matthew Theodorakis, Ares Management


Alan Davies, Debevoise & Plimpton: Until recently law firms haven't focused enough on direct lenders

some move towards standardising it. The LMA has now come up with a super-senior intercreditor, for example. The intercreditor discussion – which the business people generally find extremely tedious and try to avoid at all costs – is where lawyers have a field day because the stuff is incredibly complicated and if you get it wrong the subordinated creditors can be completely cut out.

The great thing from a borrower perspective when dealing with the likes of Ares, BlueBay and Barclays is that they do not have to worry so much about all that because that is a relationship that those lenders sort out between themselves. This is very helpful because nothing frustrates borrowers more than banks fighting with each other about intercreditor terms. It often holds up deals.

Mark Fine: I agree. When I was previously acting for sponsors I would always try to get intercreditor principles agreed upfront because inevitably it is the last document to get agreed. The lawyers can provide decent input on the commercial side as well. If you are working with a law firm that has credits coming across their desk every day, they are going to be able to tell you things about where the market is as well.

Alex Novarese: The credit market has been through so many changes over the past few years. Is the LMA keeping up?

Mark Fine: The LMA intercreditor is a good starting point. The intercreditor has come on leaps and bounds in the last year or so. There was not one before 2011 and it now deals with junior creditors' rights to a greater extent. I am not sure it goes as far as some of the junior creditors' precedents that are cited in the market and there is probably still a little bit of senior bias. However, they are very useful tools and they are developing all the time.

Alex Novarese: Are there any particular areas that people around the table would like to see the LMA take on?

Alan Davies: There is a risk that people will just rely on the LMA documents and not think about it, particularly for young lawyers. For example, the financial covenants for a retail business are very cyclical when all the cash comes in at Christmas. Your standard set of covenants needs a lot of adjustment. There is a risk to the LMA of becoming almost too market-dominant in Europe.

Alex Novarese: What is the feeling about how geared up law firms are to direct lenders?

Alan Davies: Law firms have been so focused on banking relationships and getting on the bank panels, that until the last two or three years, this area has not been focused on as much as it should have.

Matthew Theodorakis: When I meet restructuring groups within law firms, they have said: 'I had no idea what you guys were doing.' They had these entrenched relationships with banks and they did not realise that there is an alternate lender space.

Pierre Maugüé: This is a new opportunity. Traditionally you have the banks and the law firms with relationships with banks, and you have the law firms who have relationships with sponsors of funds. Now direct lenders are funds that act like banks. Are the law firms that traditionally represent banks going to represent them or will it be the law firms that represented funds that occupy that space? We are trying to develop that business.

Klaus Petersen: It is also a young business. We should not forget that two years ago direct lending was something that nobody would know what you are talking about. It is early days and there is a long way to go, but it will be interesting.

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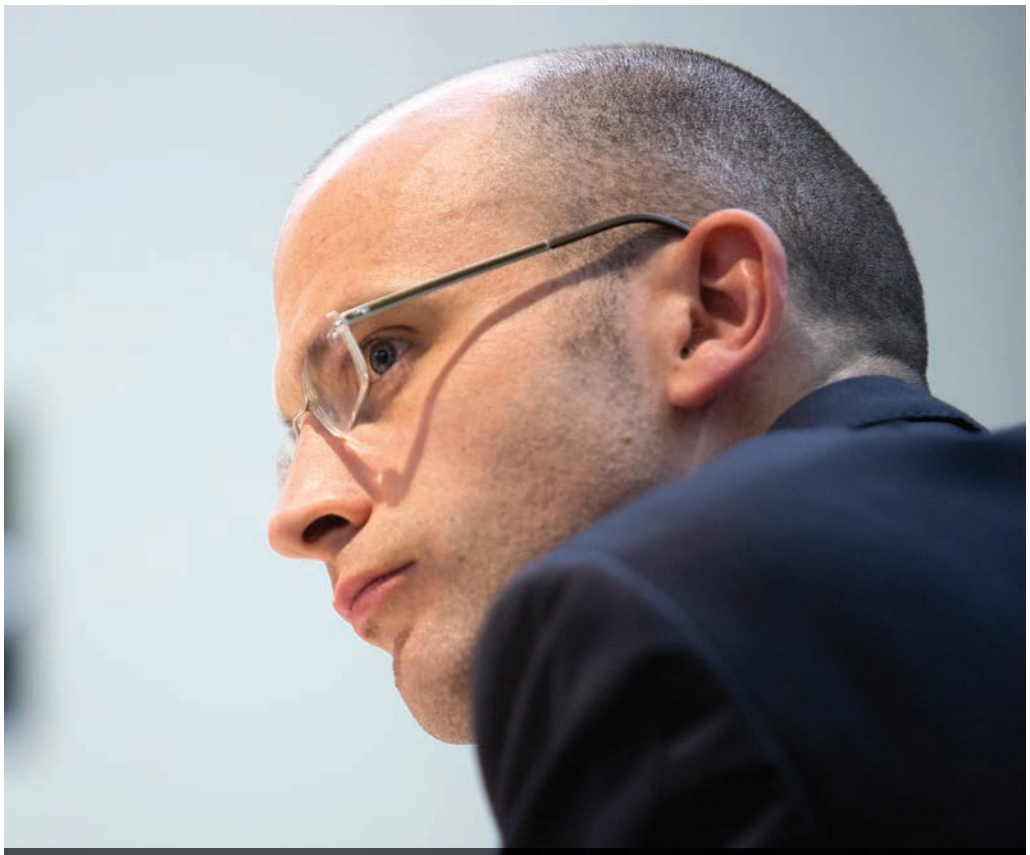
Mark Fine, Sankaty Advisors



'The bond market has been a one-way bet in the past couple of years. Now you are starting to see a correction.' Barry Lane, 3i Group

THE PANELLISTS

- **Paul Brusiloff** Partner, Debevoise & Plimpton
- **David Culpan** Vice president and head of European capital markets, Sun European Partners
- **Alan Davies** Partner, Debevoise & Plimpton
- **Gareth Davies** Head of client services, Augentius Fund Administration
- **Mark Fine** Legal counsel, Sankaty Advisors
- **Caroline Hill** Contributing editor, *Legal Business*
- **Barry Lane** Director of business development, 3i Group
- **Pierre Maugüé** Partner, Debevoise & Plimpton
- **Alex Novarese** Editor-in-chief, *Legal Business*
- **Klaus Petersen** Managing director, BlueBay Asset Management
- **Steve Sabatier** General counsel and chief operating officer, Chenavari Investment Managers
- **Matthew Theodorakis** Managing director, Ares Management
- **Miguel Toney** Director, MezzVest

Caroline Hill, Legal Business: What are people's thoughts in terms of regulatory action? I saw Mark Carney talking about a framework. Is that a threat or an opportunity?

Klaus Petersen: He announced that the next thing he will regulate is debt funds. The one thing you cannot ignore is that the bigger we get, the more the question is whether or not it needs to be regulated. It could be a threat; regulation does not normally get the thing right the first time.

We need some regulation, [because] Europe is unregulated in this respect. There are ten to 12 different jurisdictions with different regulations with respect to direct lending. Are we a bank or not? I think we are not a bank because we do not have deposits; we do not face the individual.

Alan Davies: There are very good reasons that banks should be more regulated than funds. Until the ring-fencing is in place, we need to take account of the fact that banks are taking deposits from members of the public – it is as simple as that.

Alex Novarese: I am going to ask for a few last thoughts on how far the market can potentially go, particularly the credit funds.

David Culpan: For me, the more funds that come in bring more liquidity and it brings more competition but also capability to structure larger deals. From a borrower's perspective this has to be a good thing.

Klaus Petersen: I would completely support that. The need to get more financing and liquidity in the market is massive, and I definitely think competition is important. If you think about the European market and the different countries, we have just seen the beginning of banks shifting away from SME financing, so they need to do some part of it. Germany, to give one example, is hugely overbanked and the lowest pricing that you can get in the mid-market is in Germany. That will change because it is no longer making money for the banks and regulation is kicking in, so we need something else. We are at the very beginning of that development.

Alex Novarese: That feels like a good place to stop. Thank you everybody for attending. **LB**

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