



Morgan Lewis

**ADVANCED TOPICS IN
HEDGE FUND PRACTICES
CONFERENCE**

Manager and Investor Perspectives

WEBINAR SERIES

SESSION 4 | Tuesday, May 19

**Private Equity Trends for Hedge Fund Managers: Movement to Closed-End Funds
Credit Funds and the Credit Market**

www.morganlewis.com/2020hedgefundconference

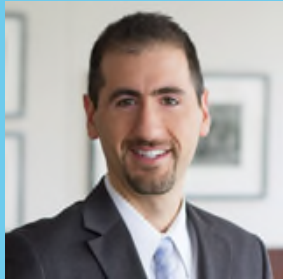
PRIVATE EQUITY TRENDS FOR HEDGE FUND MANAGERS: MOVEMENT TO CLOSED-END FUNDS

SPEAKERS



PETER PHLEGER

+1.415.442.1096
[peter.phleger@
morganlewis.com](mailto:peter.phleger@morganlewis.com)



JOSEPH ZARGARI

+1.212.309.7020
[joseph.zargari@
morganlewis.com](mailto:joseph.zargari@morganlewis.com)

Migration to Private Equity

- In recent years, we have seen increasing activity by hedge fund managers investing in traditional private equity/debt. This trend is a result, in part, of the public markets and investor demand.
- Traditional private equity/debt investing is generally a less liquid strategy and therefore many current hedge fund structures and terms are not well equipped to accommodate such private equity style investment strategies.
- Hedge fund managers are attempting to modify their fund terms (or set up new funds with different terms) to address reduced liquidity of these investments by imposing gates, longer lock-ups, or increase of side pocket capacity.
- Hedge funds, however, have certain advantages over private equity funds: hedge funds have no restrictions on when a PE style investment can be made, can more easily reinvest capital, and can raise or draw in additional capital for its PE investments.

Multiple Fund Offerings

- Compliance with disclosure in existing funds
- Time and attention/exclusivity standards (in offering documents and seed agreements)
- Sharing revenue among the principals
- Expense allocations
- Trade allocations
- Co-investment rights
- Cannibalization risk of flagship product
- Business complexities



Basic Differences Between Hedge and Private Equity

HEDGE FUNDS

- **Liquid assets**
- **Incentive allocation**
- **High water mark**
- **Unrecouped losses**
- **One time capital contribution**

PRIVATE EQUITY FUNDS

- **Illiquid assets**
- **Carried interest**
- **Waterfall**
- **Clawback**
- **Capital calls over time**

Basic Differences Between Hedge and Private Equity

HEDGE FUNDS

- **Open fundraising period**
- **Dilution based on NAV**
- **Fees based on NAV**
- **LP redemptions**
- **2 year lock-up**
- **Evergreen fund**

PRIVATE EQUITY FUNDS

- **Limited fundraising period**
- **Dilution based on cost**
- **Fees based on commitment**
- **Transfer or liquidation**
- **10-13 year lock-up**
- **10 year term**

Alternative Structures for Accessing PE

- Side Pockets
- Hybrid and Crossover Funds
 - Customized mix and match of terms from either side
 - Market acceptance
 - Administrative considerations
- Pledge Funds
 - LP opt-in/opt-out rights
 - Administrative considerations
- Fund of Funds, Co-Investment Funds



Hybrid Funds

- Hybrid Funds – various forms:
 - Traditional hedge funds with side pockets (still common)
 - Private equity–styled fund with a large portion of its portfolio in public securities and a long hold period, with no incentive fee on unrealized appreciation, and limited or no redemption rights (limited rights may include rolling long lock-up periods)
 - Side-by-side fund (Hedge fund for liquids and private equity fund for illiquids)

Cross-Over Hedge Funds

- As hedge fund managers migrate into the private equity world, we are seeing greater interest in the formation of cross-over hedge funds.
- Cross-over hedge funds are funds that combine hedge fund strategies with private-equity investment strategies within a single fund vehicle.
- One main difference between a cross-over hedge fund and a hedge fund with significant side pocket capacity is a bifurcated fee and liquidity structure. In such instances, the fund manager seeks to create a mini-PE fund within the hedge fund with the mini-PE fund subject to traditional PE fund terms: limited offering, limited investment period, capital draw-downs, carried interest waterfall distribution terms, no mark-to-market for valuations, and a finite term. But where a private investment goes public, the cross-over fund does not need to exit the position and the hedge fund portion of the portfolio may (but need not) seek appropriate hedges on the private investments.

Hedge Fund Co-Investment Vehicles

- Hedge fund managers are offering with much greater frequency co-investment vehicles.
- Co-investment vehicles are:
 - any type of entity (partnership, corporation, business trust) established to invest in a “co-investment opportunity.” The co-invest vehicle can be for one or more investors or one or more co-investments in which the identity of the co-investment is either known or unknown (i.e., blind pools) to the investors.
 - generally managed by the same investment manager of the hedge fund and may invest in parallel with the hedge fund, which investment may be direct into the co-investment opportunity or indirect through blocker entities or other pooled investment vehicles.
- A “Co-investment opportunity” is an opportunity to invest in parallel with or in combination with the hedge fund in a particular investment that is generally either too large, restrictive, or illiquid (or all of the foregoing) for the hedge fund alone.

Hedge Fund Co-Investment Vehicles

- Hedge fund managers are offering co-investment vehicles for the following reasons:
 - Negative perception of “side pockets”
 - Concentration and capacity limitations
 - Opportunities in illiquid investments
 - Showcase expertise and distinguish oneself from “the pack”
 - Creation of goodwill; raise additional capital
 - Dedicated fund for a manager’s “best ideas” or to co-invest alongside the flagship fund

CREDIT FUNDS AND THE CREDIT MARKET

SPEAKERS



KRISTEN CAMPANA

+1.212.309.6030
[kristen.campana@
morganlewis.com](mailto:kristen.campana@morganlewis.com)



JERRY KEHOE

+1.617.341.7840
[gerald.kehoe@
morganlewis.com](mailto:gerald.kehoe@morganlewis.com)



DANIEL LOSK

+1.617.341.7783
[daniel.losk@
morganlewis.com](mailto:daniel.losk@morganlewis.com)



DAN NELSON

+1.617.341.7830
[daniel.nelson@
morganlewis.com](mailto:daniel.nelson@morganlewis.com)



MATT SCHERNECKE

+1.212.309.6135
[matthew.schernecke@
morganlewis.com](mailto:matthew.schernecke@morganlewis.com)

Credit Funds: Defined

A private fund focused on originating and/or purchasing debt and other securities

Typically PE-style fund (closed-end, limited life, no redemptions, etc.)

Some hybrid structures allow limited redemptions/liquidity

Often levered to take advantage of interest rate spreads

Capital typically raised in a combination of parallel comingled funds and SMAs/funds of one (driven by discretion over investments, fees, leverage, etc.)

Context: Growth in Sector Pre-pandemic

- Post-last economic crisis (2008 et seq.), private credit funds stepped in when banks pulled back
- Lots of overlap with PE buyout funds providing equity, and private credit funds providing debt
- Credit funds have a larger volume of transactions and are typically invested at a faster pace than traditional PE



Impact of Pandemic and Ensuing Economic Stress

- Mature debt portfolios under scrutiny – anecdotally, anywhere from 30%-40% of portfolio under water
- Those managers who more recently entered the market are able to raise new capital if they are not burdened by legacy portfolios
- Public fund managers are also pursuing private credit platforms



Manager and Investor Response

Many managers are forming funds focused on liquid credit opportunities and secondary portfolio purchases, and providing customized solutions to distressed and other borrowers.

- Certain existing funds are extending their offering periods and modifying their investment strategies to capture the opportunity.
- Opportunistic funds being formed through various structures, including through traditional commingled fund structures, “annex,” or co-investment funds alongside existing flagship

These products are being launched rapidly and, in some cases, represent a pivot away from a more traditional acquisition fund platform.

The investment opportunities being pursued are driven by multiple factors, including the ability to acquire loans at significant discounts, ratings downgrades, forced selling behavior by certain participants in the market, and borrowers that will require additional capital infusions.

Recent credit funds typically have broad mandates that contemplate investments in debt and other securities, as well as both increased economic instability and stability, depending on whether the market further declines or recovers.

Investors are also looking to increase their exposure to credit, driven by a belief that the market will rebound in a manner comparable to that after the 2008 financial crisis and the desire to increase their returns in light of significant recent losses.

Certain Key Terms

The terms of these opportunistic funds vary, but many managers are raising and deploying capital on an expedited basis and in an increasingly competitive environment to take advantage of opportunities that may present themselves on a temporary or limited basis.

Typical terms we are seeing in the market include the following:

- Limited fundraising periods (2-12 months)
- Short investment periods (1-3 years)
- Term of funds more limited (5-8 years, subject to extensions)
- Expansive recycling capabilities (e.g., permitting reinvestments at any time for any purpose for which capital can be drawn)
- Management fees typically based on invested capital throughout the fund term, with invested capital sometimes including the amount of the leverage used to make investments

Managers of hedge funds and other open-ended private funds are also forming funds that may differ from their typical structures to address the illiquidity of the underlying investments.

- Given this illiquidity and potential valuation difficulties, these funds may have longer lock-up periods (e.g., from 3-4 years), may side pocket certain assets, and may charge fees based on invested capital (rather than on a mark-to-market basis).

Key Considerations

1.

- Ensure that disclosures are fulsome, including with respect to conflicts of interest

2.

- Consider how investments will be allocated among the various products and whether their allocation policies and disclosures need to be updated

3.

- Consider valuation issues and, if managing a hedge fund or similar structure, whether to include more robust disclosure on the likelihood that investments may be side pocketed or redemptions otherwise suspended

4.

- For sponsors considering rebranding or relaunching an existing investment fund, determine whether any investor or advisory committee consents are required and whether additional disclosure is required – e.g., with respect to existing investments

5.

- Lender licensing issues under state law may be relevant, depending on the structure and investment strategy of the fund

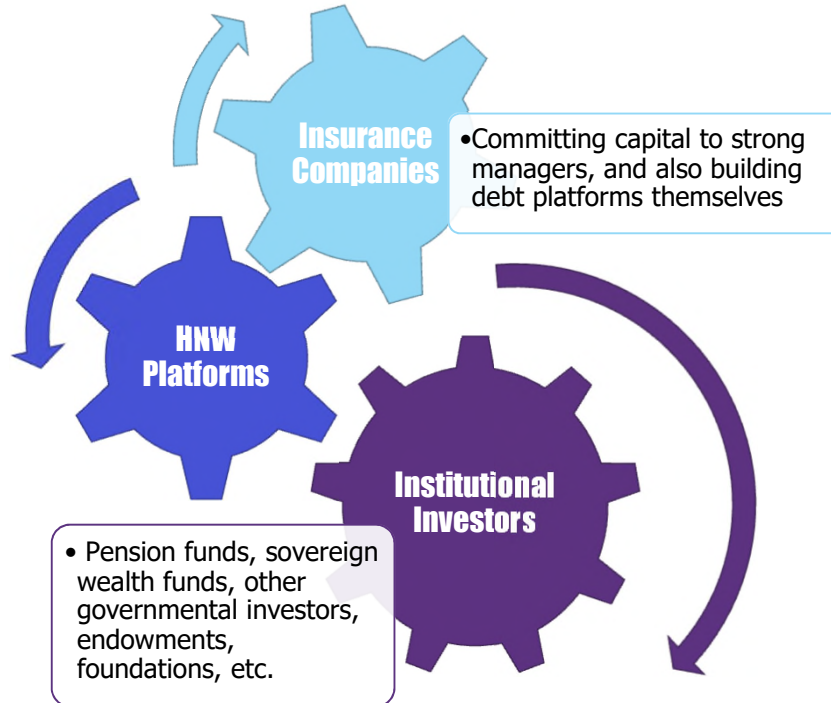
Structuring

- Varies depending on type of investor, where investments will be made, and type of investment (i.e., real estate vs. corporate)
- If a strategy will include loan originations (including modifications of existing loans) and the use of leverage, the sponsor will need to consider the tax implications for tax-exempt and non-US investors in structuring the fund
- A sponsor will need to consider including structural features that will be attractive to, and expected by, these investor groups
- Mitigation strategies may include, *inter alia*, season and sell, treaty structures, blockers (to address ECI and/or UBTI), private BDCs, REITs, etc.



Investors

Who are the investors we are seeing in this market?



Pre-COVID-19 Credit Market Observations

- Sponsors dominated the market
- Acquisition financing robust
- Leveraged lending is pervasive and non-bank lenders predominate



Post-COVID-19 Credit Market Observations

- Workouts and existing credits
- Market opportunity for investors not averse to risk
- Restructuring and bankruptcy as a means to achieve value
- Origination deals have slowed significantly



Leveraged Loans and High-Yield Bonds

- Carry significant credit risk, and defaults and losses increase during a recession.
- Investors and borrowers focused on risk, especially when lending to companies leveraged more than average.
- Sponsors tend to hold back uncalled capital and, in times of economic downturns, may use such uncalled capital to buy back debt at deep discounts.

See Kotowski, Chris, et al., *A Deep Dive Into Credit Markets; Why We Think All is Not Lost*, Oppenheimer, 2020.

Status of Leveraged Lending

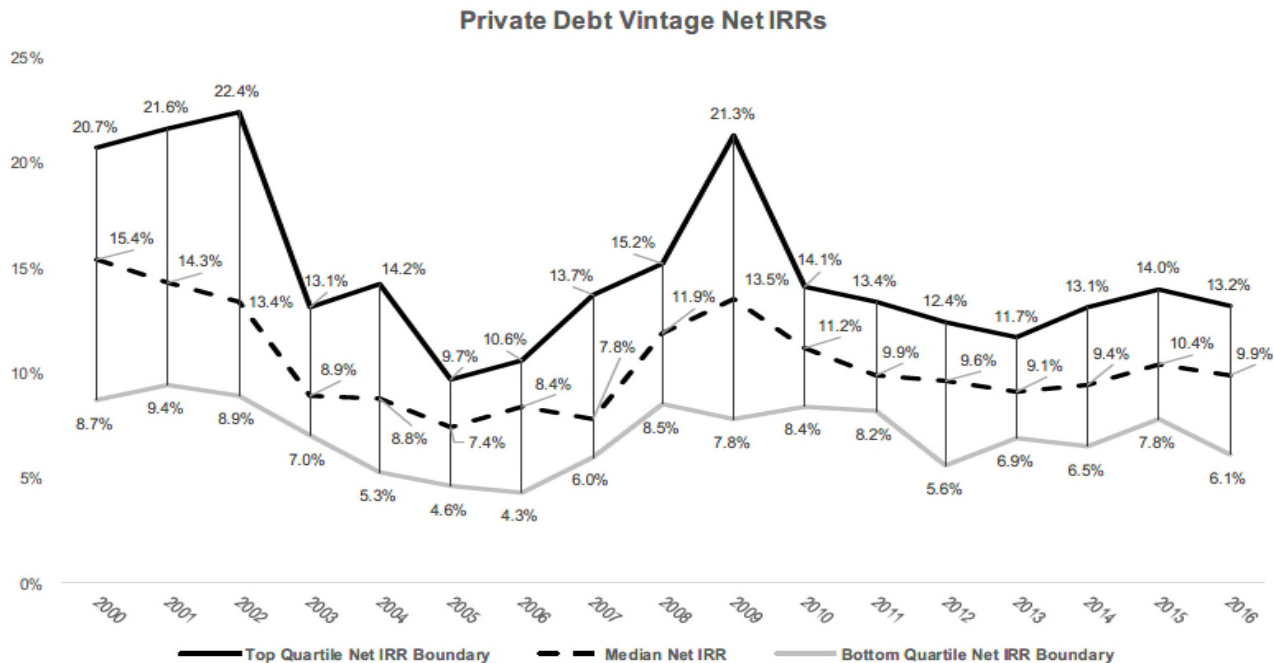
- Recent data supports the notion that leveraged lending took a hit in March.
- Early signs show that trading of such debt is coming back online and this suggests lending activity may come back soon, at higher pricing.

Total Return to Middle Market Loans

Index	Year-end Level (Indexed to 1,000 at 3Q04)																CAGR 2004 - 2019
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Income Return	1,016	1,109	1,231	1,364	1,524	1,714	1,925	2,158	2,429	2,713	3,011	3,334	3,685	4,059	4,483	4,948	11.1%
%Δ Y/Y	-	9.2%	11.0%	10.8%	11.7%	12.5%	12.3%	12.1%	12.6%	11.7%	11.0%	10.7%	10.5%	10.2%	10.4%	10.4%	
Realized Gains / (Losses)	1,000	1,009	1,015	1,033	1,027	956	927	911	905	904	904	897	885	869	861	854	(1.0%)
%Δ Y/Y	-	0.9%	0.6%	1.7%	(0.6%)	(6.9%)	(3.0%)	(1.6%)	(0.6%)	(0.2%)	0.0%	(0.7%)	(1.4%)	(1.7%)	(0.9%)	(0.9%)	
Unrealized Gains / (Losses)	1,008	1,008	1,027	1,003	840	906	962	959	977	988	975	935	955	958	946	943	(0.4%)
%Δ Y/Y	-	(0.0%)	1.9%	(2.3%)	(16.2%)	7.9%	6.2%	(0.4%)	1.9%	1.1%	(1.3%)	(4.1%)	2.1%	0.3%	(1.3%)	(0.3%)	
Total Return	1,024	1,127	1,281	1,412	1,321	1,495	1,731	1,899	2,166	2,441	2,674	2,822	3,139	3,410	3,685	4,022	9.6%
%Δ Y/Y	-	10.1%	13.7%	10.2%	(6.5%)	13.2%	15.8%	9.8%	14.0%	12.7%	9.6%	5.5%	11.2%	8.6%	8.1%	9.1%	

Source: Cliffwater LLC and Oppenheimer & Co. Inc. Note: results presented above cannot and should not be viewed as an indicator of future performance. Return calculations exclude applicable costs, including commissions and interest.

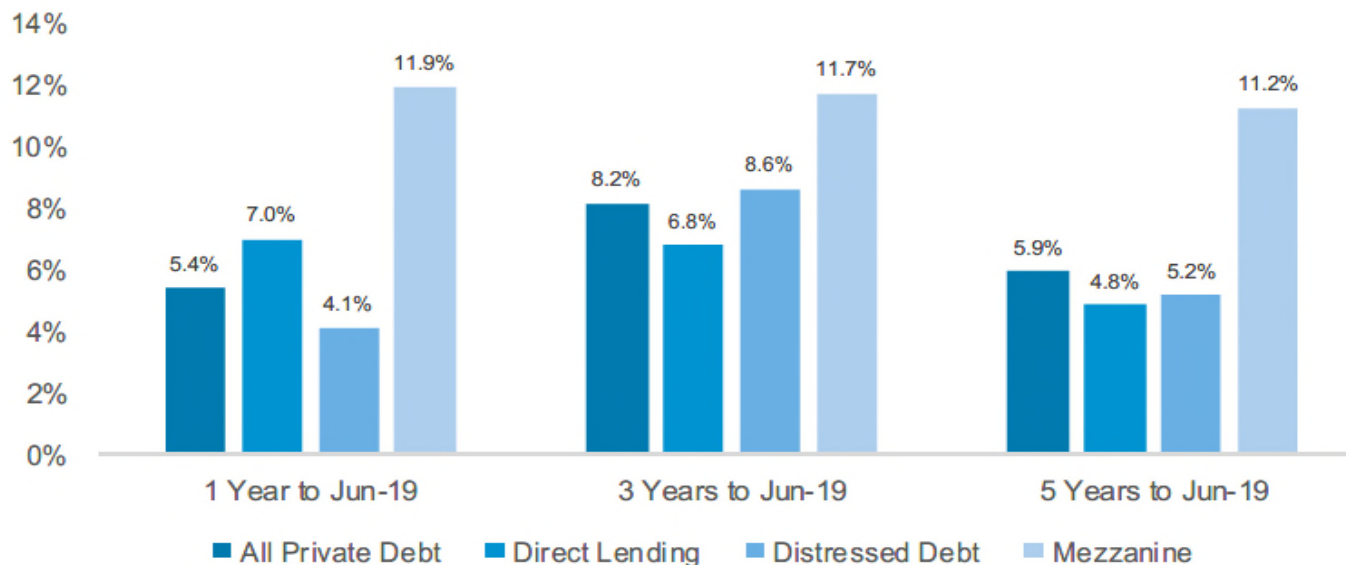
Private Debt Investment IRR



Source: Preqin and Oppenheimer & Co. Inc. Updated as of July 2019.

Volatility by Asset Category

Private Credit Horizon IRR Breakdown



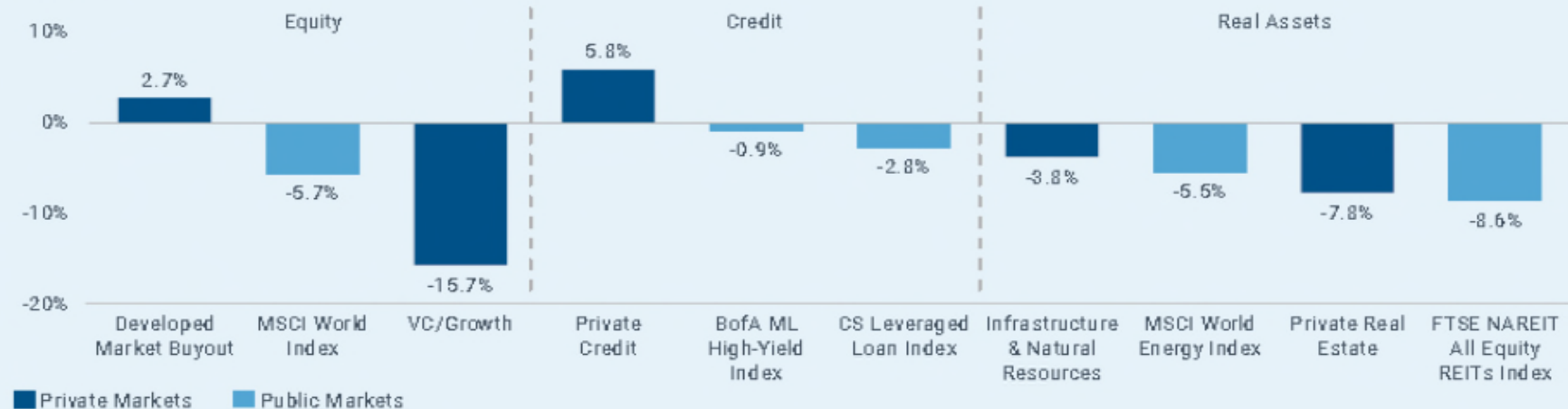
Source: Preqin and Oppenheimer & Co. Inc. Updated as of April 2020.

Annualized Returns of Private Asset Classes

Worst Case Performance

Lowest 5-Year Annualized Performance

1995-2019

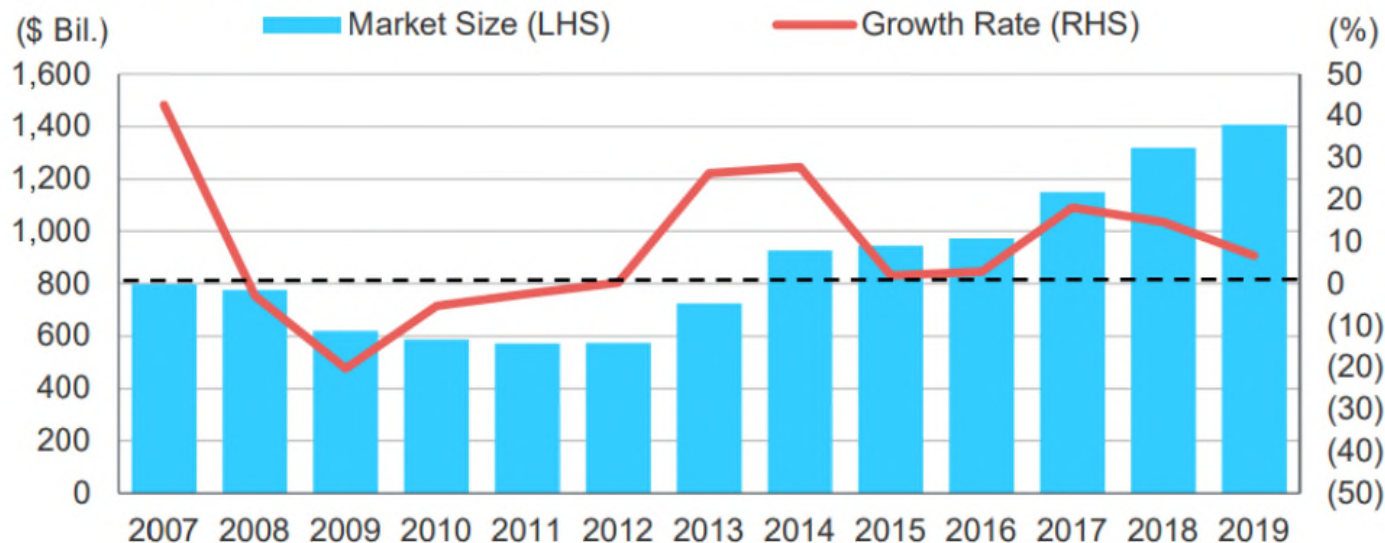


Note: Infrastructure & Natural Resources from 1995-2019
Source: Hamilton Lane, BofA via Dealog, Bloomberg (October 2019)

Source: Bloomberg, Hamilton Lane and Oppenheimer & Co. Inc.

State of Leveraged Loan Universe

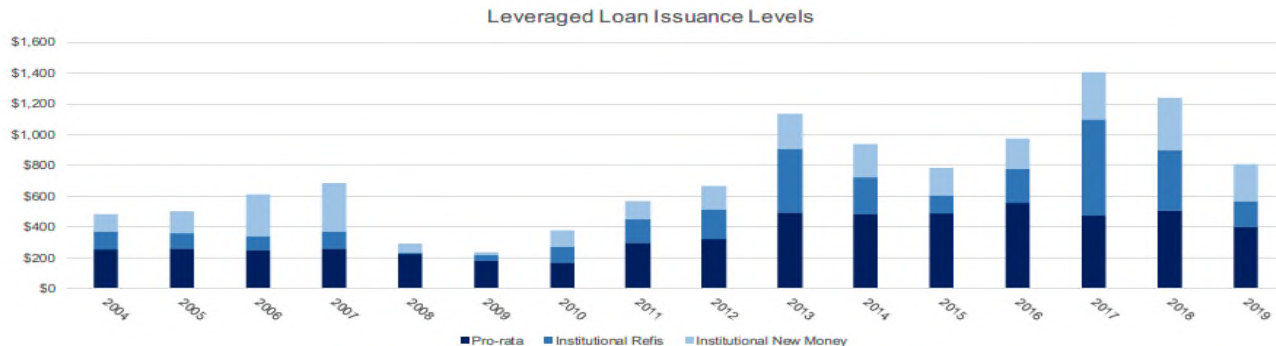
Leveraged Loan Universe Still Growing Despite Lower Volumes (Market Size and Growth Rate)



Source: Bloomberg, Fitch Ratings, Fitch U.S. Leveraged Loan Default Index, Refinitiv LPC and Oppenheimer & Co. Inc.

Decrease of Loan Issuances Prior to COVID-19

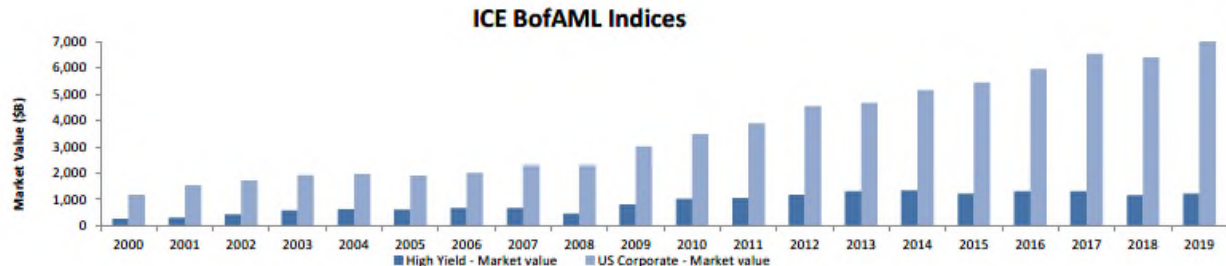
Issuances of leveraged loans peaked in 2017, and in 2019 were at their lowest level since 2012.



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Leveraged Loans Issuance																
Institutional Refs	117	101	92	111	10	32	102	155	194	409	235	119	221	503	390	167
Institutional New Money	106	140	274	315	59	24	104	112	148	231	220	175	200	305	341	239
Pro-rata	257	260	246	262	225	183	170	299	322	495	485	489	554	594	509	402
Total	480	501	612	688	294	239	376	566	664	1,135	940	783	975	1,402	1,240	808
Issuance Breakdown																
Institutional Refs	24.4%	20.2%	15.0%	16.1%	3.4%	13.4%	27.1%	27.4%	29.2%	36.0%	25.0%	15.2%	22.7%	35.9%	31.5%	20.7%
Institutional New Money	22.1%	27.9%	44.8%	45.8%	20.1%	10.0%	27.7%	19.8%	22.3%	20.4%	23.4%	22.3%	20.5%	21.8%	27.5%	29.6%
Pro-rata	53.5%	51.9%	40.2%	38.1%	76.5%	76.6%	45.2%	52.8%	48.5%	43.6%	51.6%	62.5%	56.8%	42.4%	41.0%	49.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Institutional Loans % of Total																
Refs	52.5%	41.9%	25.1%	26.1%	14.5%	57.1%	49.5%	58.1%	56.7%	63.9%	51.6%	40.5%	52.5%	62.3%	53.4%	41.1%
New Money	47.5%	58.1%	74.9%	73.9%	85.5%	42.9%	50.5%	41.9%	43.3%	36.1%	48.4%	59.5%	47.5%	37.7%	46.6%	58.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Fitch Ratings, Fitch U.S. Leveraged Loan Default Index, Refinitiv LPC and Oppenheimer & Co. Inc.

High Yield Bonds Market Share Loss



	Year																			CAGR				
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2000-2007	2011-2019	2000-2019	
High Yield																								
Par Value (\$B)	337	373	495	561	588	621	665	709	728	825	983	1,065	1,096	1,241	1,337	1,341	1,298	1,283	1,232	1,207	11.2%	1.6%	6.9%	
Market Value (\$B)	263	306	425	585	622	615	676	669	457	801	1,018	1,056	1,163	1,304	1,344	1,212	1,313	1,311	1,154	1,221	14.3%	1.8%	8.4%	
U.S. Inv Grade Corporate																								
Par Value (\$B)	1,178	1,481	1,575	1,730	1,799	1,812	1,935	2,246	2,497	2,833	3,188	3,525	3,973	4,377	4,732	5,272	5,679	6,121	6,386	6,671	9.7%	8.3%	9.6%	
Market Value (\$B)	1,180	1,542	1,724	1,916	1,960	1,905	2,006	2,297	2,301	3,017	3,476	3,889	4,549	4,670	5,152	5,441	5,959	6,537	6,400	7,312	10.0%	8.2%	10.1%	
Total																								
Par Value (\$B)	1,515	1,854	2,070	2,291	2,388	2,433	2,600	2,955	3,225	3,659	4,171	4,590	5,069	5,618	6,069	6,613	6,978	7,404	7,618	7,878	10.0%	7.0%	9.1%	
High Yield % of Total	22.3%	20.1%	23.9%	24.5%	24.6%	25.5%	25.6%	24.0%	22.6%	22.6%	23.6%	23.2%	21.6%	22.1%	22.0%	20.3%	18.6%	17.3%	16.2%	15.3%				
U.S. Corporate % of Total	77.7%	79.9%	76.1%	75.5%	75.4%	74.5%	74.4%	76.0%	77.4%	77.4%	76.4%	76.8%	78.4%	77.9%	78.0%	79.7%	81.4%	82.7%	83.8%	84.7%				
Market Value (\$B)	1,442	1,848	2,149	2,502	2,581	2,521	2,682	2,966	2,758	3,818	4,494	4,945	5,712	5,974	6,496	6,653	7,272	7,848	7,554	8,534	10.8%	7.1%	9.8%	
High Yield % of Total	18.2%	16.6%	19.8%	23.4%	24.1%	24.4%	25.2%	22.6%	16.6%	21.0%	22.7%	21.4%	20.4%	21.8%	20.7%	18.2%	18.1%	16.7%	15.3%	14.3%				
U.S. Corporate % of Total	81.8%	83.4%	80.2%	76.6%	75.9%	75.6%	74.8%	77.4%	83.4%	79.0%	77.3%	78.6%	79.6%	78.2%	79.3%	81.8%	81.9%	83.3%	84.7%	85.7%				

Source: Bloomberg, Dealogic, and Oppenheimer & Co. Inc.

Current Credit Market Observations

Secondary Loan Market

- While in March, the S&P/LSTA Leveraged Loan Index (LLI) produced its second lowest monthly reading on record (-12.4%), the LLI gained 4.5% in April as mark-to-market (MTM) prices generally rebounded.
- In April, 75% of loans reported MTM price gains and only 20% reported losses.
- The average bid level climbed back to 86.1, almost 10 points higher than March's low. This is more than 11 points below 2020's high-water mark of 97.35.

Fig.1: MTM Price Performance

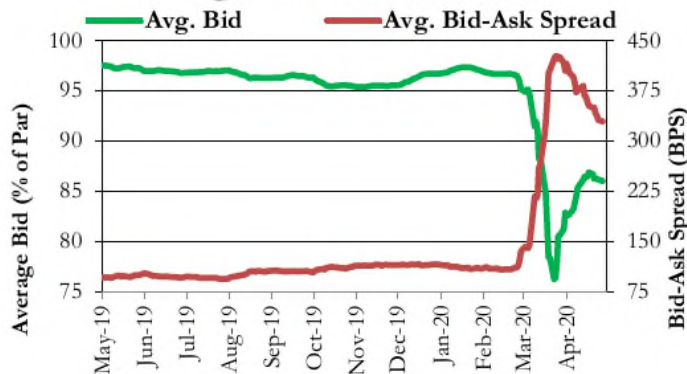
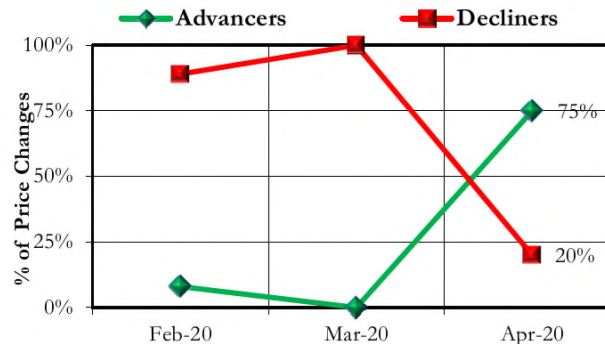


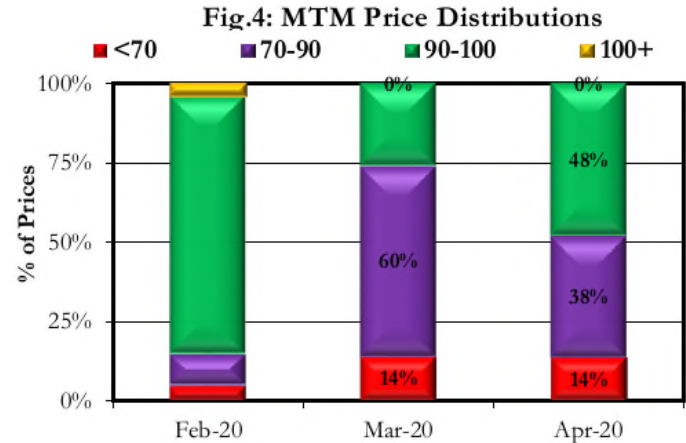
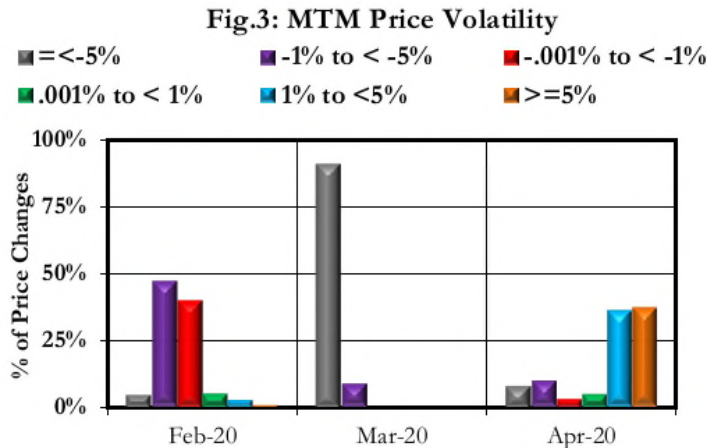
Fig.2: MTM Market Breadth



Current Credit Market Observations

Secondary Loan Market

- The percentage of loans bid in a 92-98 context increased 21 percentage points to a 47% market share (loans bid between 95 and 98 demonstrated the largest increase in market share, nearly tripling to 22%).
- The 98 and above price cohort barely changed – rising from less than 1% to 2%.
- The percentage of loans bid below 80 decreased eight percentage points to a 17% market share.



Impact of COVID-19

The KBW Nasdaq Bank Index (BKX) (designed to track performance of leading banks and thrifts that are publicly-traded in the US) is down 34%, leveraged loans down about 7% and high yield down ~6-7% depending on the index.

Ticker	Price						Total Returns *								
	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	4/9/2020	Period			Cumulative					
							2015	2016	2017	2018	2019	YTD	1Y	3Y	5Y
ARCC	\$14.25	\$16.49	\$15.72	\$16.58	\$18.85	\$13.10	1.4%	26.4%	4.5%	8.9%	30.5%	-27.6%	-14.9%	2.3%	21.6%
FDUS	\$13.69	\$15.73	\$15.18	\$11.89	\$14.84	\$7.21	3.0%	26.6%	6.7%	-12.5%	40.6%	-48.6%	-32.0%	-32.0%	-6.9%
MRCC	\$13.09	\$15.38	\$13.75	\$9.60	\$10.86	\$6.89	0.2%	28.2%	-1.5%	-20.0%	27.7%	-33.3%	-32.5%	-28.5%	-8.9%
NMFC	\$13.02	\$14.10	\$13.55	\$12.58	\$13.74	\$7.32	-3.7%	18.7%	5.7%	2.9%	20.0%	-44.3%	-37.0%	-20.8%	-5.0%
SCM	\$9.64	\$12.06	\$13.14	\$12.95	\$14.23	\$7.57	-6.6%	39.2%	20.2%	8.9%	20.4%	-44.4%	-38.8%	-17.6%	16.8%
SLRC	\$16.43	\$20.82	\$20.21	\$19.19	\$20.92	\$13.92	0.1%	36.5%	4.8%	3.1%	16.0%	-30.5%	-27.4%	-16.6%	7.9%
SUNS	\$14.90	\$16.44	\$17.76	\$15.12	\$17.60	\$11.60	9.0%	19.8%	16.6%	-6.9%	25.7%	-32.1%	-25.4%	-12.1%	13.1%
TCPC	\$13.93	\$16.90	\$15.28	\$13.04	\$14.05	\$7.17	-8.4%	31.7%	-1.1%	-5.2%	18.8%	-46.4%	-39.8%	-33.0%	-10.7%
WHF	\$11.48	\$12.17	\$13.42	\$12.72	\$13.70	\$7.24	11.7%	18.4%	21.9%	5.4%	20.4%	-44.6%	-37.0%	-16.4%	13.9%
Average BDC							0.7%	27.3%	8.7%	-1.7%	24.5%	-39.1%	-32.6%	-19.4%	4.6%
APD	\$15.16	\$19.36	\$33.47	\$24.54	\$47.71	\$39.16	-27.3%	35.8%	62.4%	-20.9%	102.6%	-16.1%	42.4%	77.2%	122.2%
ARES	\$12.93	\$19.20	\$20.00	\$17.78	\$35.89	\$35.15	-19.4%	54.9%	10.1%	-4.4%	107.9%	-0.4%	53.7%	102.1%	131.2%
BX	\$29.24	\$27.03	\$32.02	\$29.81	\$55.94	\$49.17	-3.2%	-1.9%	27.0%	0.7%	94.1%	-11.0%	43.9%	93.9%	53.3%
CG	\$15.02	\$15.25	\$22.90	\$16.75	\$32.08	\$24.06	-30.9%	8.4%	58.3%	-25.8%	112.3%	-24.2%	32.6%	73.3%	11.7%
HLNE	NA	NA	\$35.39	\$37.00	\$59.60	\$58.99	NA	NA	NA	6.8%	63.9%	-0.6%	25.8%	231.0%	NA
KKR	\$15.59	\$15.39	\$21.06	\$19.63	\$29.17	\$25.30	-26.0%	2.8%	41.2%	-3.8%	51.1%	-12.8%	10.5%	56.7%	27.7%
Average Alternative Asset Manager							-21.4%	20.0%	43.8%	-7.9%	88.7%	-10.8%	34.8%	105.7%	69.2%
BAC	\$16.83	\$22.10	\$29.52	\$24.64	\$35.22	\$24.86	-4.8%	32.8%	35.3%	-14.7%	45.6%	-28.9%	-15.3%	18.9%	70.9%
C	\$51.75	\$59.43	\$74.41	\$52.08	\$79.89	\$47.41	-4.1%	15.7%	26.8%	-28.0%	57.1%	-40.0%	-26.7%	-10.1%	0.3%
GS	\$180.23	\$239.45	\$254.76	\$187.05	\$229.95	\$184.26	-5.7%	34.3%	7.6%	-33.2%	40.1%	-15.3%	-9.1%	-12.7%	1.3%
JPM	\$66.03	\$86.29	\$106.94	\$97.62	\$139.40	\$102.76	8.2%	33.5%	26.3%	-6.4%	46.2%	-25.0%	-4.5%	32.0%	82.6%
MS	\$31.81	\$42.25	\$52.47	\$38.65	\$51.12	\$41.99	-16.6%	35.0%	26.3%	-22.3%	32.2%	-19.0%	-9.1%	9.4%	24.5%
PNC	\$95.31	\$116.96	\$144.29	\$116.91	\$159.63	\$105.42	6.7%	24.9%	25.6%	-16.6%	40.1%	-33.2%	-17.2%	-0.1%	28.1%
USB	\$42.67	\$51.37	\$53.58	\$46.70	\$59.29	\$38.05	-2.8%	22.9%	6.8%	-12.2%	33.2%	-35.1%	-21.0%	-0.4%	2.0%
WFC	\$54.36	\$55.11	\$60.67	\$46.08	\$53.80	\$33.20	1.9%	4.2%	12.9%	-21.3%	20.9%	-37.3%	-24.3%	-25.2%	-23.5%
Average Banks							-2.2%	25.4%	20.9%	-19.3%	39.4%	-29.7%	-15.9%	-10.4%	23.3%
AMJ	\$26.97	\$31.61	\$27.47	\$22.32	\$21.81	\$10.35	-32.0%	16.3%	-7.1%	-11.9%	5.8%	-50.6%	-53.0%	-50.2%	-54.2%
HYG	\$80.58	\$86.55	\$87.26	\$81.10	\$87.94	\$82.36	-4.8%	13.1%	6.0%	-1.9%	13.8%	-5.1%	-0.3%	9.7%	15.2%
IYR	\$75.06	\$76.94	\$81.01	\$74.94	\$93.08	\$78.68	1.5%	7.0%	9.2%	-4.2%	28.0%	-14.6%	-7.3%	9.3%	20.0%
Average Yield Group							-11.7%	12.1%	2.7%	-6.0%	15.9%	-23.4%	-20.2%	-10.4%	-6.3%
LSTA	\$1,604.55	\$2,000.94	\$2,067.14	\$2,054.36	\$2,273.18	\$2,119.13	-2.8%	10.9%	3.3%	-0.6%	10.7%	-6.8%	-4.4%	3.4%	10.1%
JNK	\$101.73	\$109.35	\$110.16	\$100.77	\$109.54	\$101.64	-6.4%	14.0%	6.4%	-3.1%	14.6%	-5.9%	-1.1%	8.6%	12.1%
BKX	\$73.08	\$91.79	\$106.71	\$85.79	\$113.36	\$75.26	-1.8%	25.6%	16.3%	-19.6%	32.1%	-33.6%	-24.4%	-14.5%	3.0%
XLF	\$23.83	\$23.25	\$27.61	\$23.82	\$30.78	\$23.38	-1.8%	22.6%	21.8%	-12.9%	31.6%	-23.5%	-11.6%	8.9%	30.9%
S&P 500	\$2,043.94	\$2,238.83	\$2,673.61	\$2,506.85	\$3,230.78	\$2,789.82	-0.7%	9.5%	19.4%	-6.2%	28.9%	-13.6%	-4.0%	19.8%	33.1%

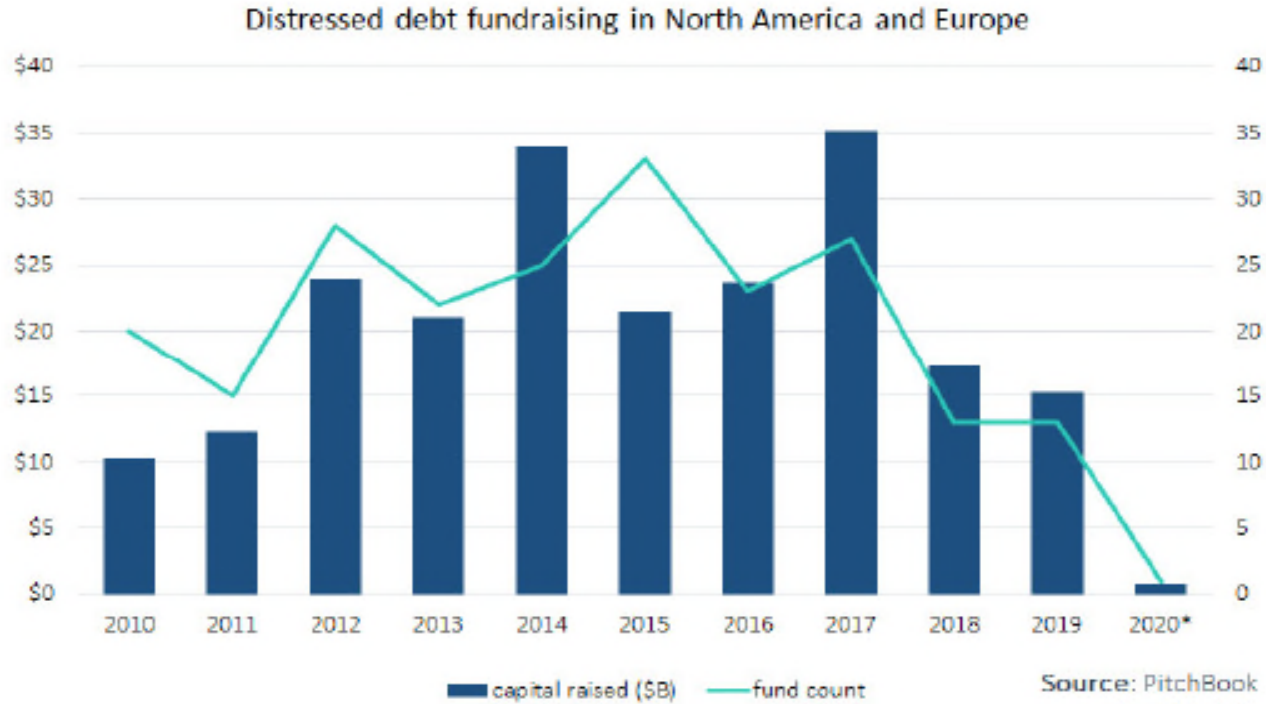
Notes:

* Total returns assume simple dividend returns (not reinvested).

Opportunities for Hedge Funds

- Junk-bond spreads have more than tripled, hitting 1,100 basis points compared to about 350 basis points in September.
- The amount of debt trading at a distressed level reached almost \$1 trillion.
- While distressed debt fundraising has declined, distressed investors are sitting on dry powder raised over the last two to three years, which is ready to be deployed.
- Firms reported by Bloomberg to be seeking money for credit dislocation portfolios include:
 - Highbridge Capital Management: \$2.5 billion for two credit-dislocation funds
 - Knighthead Capital Management: \$450 million in additional cash for its distressed-debt fund
 - Bardin Hill Investment Partners: raised \$300 million to go after stressed credits
 - Silverback Asset Management: preparing to start a \$200 million credit fund

Distressed Debt Fundraising



Federal Lending Programs

- Given the status of the lending market, government funding is taking the place of private credit in the near term as a source of bridge liquidity until the credit markets normalize.
- Two such facilities are the SBA's Paycheck Protection Program and the Main Street Lending Program.

Paycheck Protection Program Loans

- 1.00% interest rate and 2-year maturity.
- Loan amount: lesser of the \$10 million maximum and 2.5 times the borrower's average monthly payroll for the past 12 months.
- Loan proceeds can cover: payroll costs; group healthcare benefits; mortgage interest payments, rent, utilities, and other debt interest.
- Up to 100% loan forgiveness for funds used in the first 8-weeks post-disbursement.



PPP Loans and Bankruptcy

- PPP contains no express limitation on the granting of loans to debtors in bankruptcy. However, based solely on the applications, an applicant's bankruptcy is a disqualifying fact.
- The Bankruptcy Court for the Southern District of Texas found that the Bankruptcy Code likely prevents the SBA from discriminating against potential borrowers strictly on the basis of a pending bankruptcy.
- What About Companies that File for Bankruptcy *After* a PPP Application Is Filed?
 - With the SBA clearly signaling that it does not wish to be a provider of debtor-in-possession or exit financing, courts will need to carefully balance interests, as well as the policy underlying different sections of the Bankruptcy Code.

Main Street Lending Program

- \$600 billion in loans purchased through the following three facilities:
 - **New Loan Facility**
 - **Expanded Loan Facility**
 - **Priority Loan Facility**
- Eligible Lenders may originate new Main Street loans or use Main Street loans to increase size of existing loans to eligible businesses.
- Among other requirements, an eligible business is one that meets at least one of the following two conditions:
 - Has 15,000 employees or fewer; or
 - Had 2019 annual revenues of \$5 billion or less

Covenant Relief/Amendments

- In connection with PPP loans, incumbent lenders have been open to:
 1. Excluding interest and principal payments of PPP loans from Fixed Charges but limited only to the portion of PPP loans forgiven; and
 2. Excluding PPP loans from Leverage Ratio



Going Concern and Material Adverse Effect

- The COVID-19 crisis provides new known and unknown factors for management to consider when making a going-concern evaluation.
- When evaluating an entity's ability to meet its obligations, management should consider:
 - The entity's financial condition, liquidity sources, and conditional and unconditional obligations
 - Changes in forecasted operating results and/or cash flow projections
 - The funds necessary to maintain the entity's operations
- COVID-19 and its fallout increase the risk that parties may try to terminate transactions, or renegotiate central deal terms by asserting that the target or borrower suffered a material adverse effect or material adverse change.
- This will depend on the specific wording of the provision at issue and the effects on the particular company, and whether pandemics or similar events were excluded from provisions.

Covenants/Amendments/Consent Issues

1. Principal and interest holidays;
2. Financial covenant deferrals and amendments;
3. Going concern qualification issues/deferral of audited financial statement delivery; and
4. Requirements to fund additional equity by sponsors or other investors

LAWYER BIOGRAPHIES

Kristen V. Campana



Kristen V. Campana represents a wide variety of direct and alternative lenders, particularly those involving private sources of capital, including private debt funds, hedge funds, specialty finance companies, business development companies, private equity investors, and issuers in domestic and cross-border financings across the capital structure in connection with acquisitions, leveraged buyouts, convertible debt, equity investments, letters of credit, and project financings.

New York

T +1.212.309.6030

F +1.212.309.6001

kristen.campana@morganlewis.com

Kristen has experience in bankruptcy reorganizations and liquidations, work-outs, and distressed debt purchases and sales, as well as second lien and mezzanine financings, and other subordinated debt financings. She represents debtors, debtor-in-possession lenders, pre-petition lenders, and unsecured creditors' committees, as well as other creditors in bankruptcy proceedings. She also advises clients on energy company and real estate restructurings, and provides general credit review analysis for lenders and potential debt purchasers.

Daniel A. Losk



Boston

T +1.617.341.7783

F +1.617.341.7701

daniel.losk@morganlewis.com

Daniel A. Losk advises sponsors and investment managers of real asset-related private equity funds on fund formation matters and structuring and implementing co-investment transactions. He also counsels insurance companies, global pension funds, and other institutional investors in connection with consortia, joint venture, and platform investment transactions. Daniel's diverse transactional experience has also included advising clients on matters involving mergers and acquisitions, project finance, and general corporate transactions.

Daniel has experience working on Latin American transactions and is fluent in Spanish. Before joining Morgan Lewis, Daniel was an associate in the energy and project finance practice of an international law firm in Boston, and in the project finance and infrastructure practice of another international law firm in New York City.

Prior to attending law school, Daniel worked at a strategy consulting firm, advising domestic beverage and food companies on their international market expansion into Latin America and Europe.

Gerald J. Kehoe



Boston

T +1.617.341.7840

F +1.617.341.7701

gerald.kehoe@morganlewis.com

Gerald J. Kehoe focuses on private investment capital formation and investment product structuring. He advises fund sponsors managing vehicles investing in energy, infrastructure, renewables, buyouts, and other strategies. Jerry also advises sponsors and global institutional investors on structuring and implementing co-investments, direct investing pools, master feeder partnerships, and other complex investment structures.

Jerry advises US and international sponsors in fund launches, raising substantial commitments for investments in power and energy generation and transmission assets, real estate, solar and wind projects, patent royalty strategies, leveraged buyouts, clean technology, and other infrastructure assets. Commitments are sourced from institutional US and international investors, including sovereign wealth funds, US and global pension plans, insurance companies, endowments, family offices, and foundations.

Since 2009, *Chambers USA: America's Leading Lawyers for Business* has recognized Jerry for his work. He is active in international business associations and committees promoting the development of commercial law and trade, and he maintains an active pro bono practice. He was previously a partner in the investment management practice of an international law firm, where he spent four years as the managing partner of its London office.

Daniel A. Nelson



Boston

T +1.617.341.7830

F +1.617.341.7701

daniel.nelson@morganlewis.com

Daniel A. Nelson advises clients on the US and international tax and commercial considerations related to the efficient structuring of transactions and business relationships. He counsels global institutional investors—including investment managers for some of the world’s largest pension funds, sovereign wealth funds, and insurance companies—in connection with investments in real estate, infrastructure projects, and other real assets. Dan also advises sponsors regarding the formation and operation of customized investment platforms, private investment funds, and joint ventures involving pension funds, sovereign wealth funds, insurance companies, and other institutional investors.

Much of Dan’s work with institutional investors and sponsors is cross-border, involving both inbound investments into the Americas region as well as outbound investments. In addition to this work, Dan maintains a broad-based transactional tax practice.

In his tax practice, Dan advises clients on the tax issues that accompany merger and acquisition transactions and the formation of partnerships and joint ventures. He also counsels clients on transactions involving real estate, real estate investment trusts (REITs), the energy sector (including project finance transactions), and the formation and operation of private equity funds. Dan has experience with a wide range of capital markets transactions, business restructurings, and other transactional tax planning matters.

Dan also helps clients obtain administrative rulings from the US Internal Revenue Service (IRS).

Peter M. Phleger



San Francisco

T +1.415.442.1096

F +1.415.442.1001

peter.phleger@morganlewis.com

Peter M. Phleger advises sponsors and institutional investors, including corporate strategic investors, on private investment fund formation, including venture and private equity funds, fund-of-funds, secondary funds, and captive corporate funds. He counsels on fund structure, formation, governance, and investing activities, including both primary investments and secondary transactions. His work encompasses fund structuring, partnership agreement terms and conditions, securities law compliance, investor relations, and general partner separations.

Peter's clients include fund sponsors of multibillion dollar partnerships and early-stage venture capital firms; strategic corporate investors such as pharmaceutical companies partnering with early-stage life science focused funds and energy companies partnering with renewable energy funds; and institutional investors such as public pension plans, insurance companies, fund-of-funds, family offices, and sovereign wealth funds. He also counsels both secondary buyers and sellers of portfolios of fund interests.

Matthew Edward Scherneck



New York

T +1.212.309.6135

F +1.212.309.6273

matthew.scherneck@morganlewis.com

Matthew Edward Scherneck advises direct lenders, mezzanine investment funds, and venture capital investors on loans and other investment transactions with a wide range of borrowers across industry classes and of all sizes, types, and structures. Matthew also advises private equity clients and corporate borrowers on domestic and cross-border acquisition financings, out-of-court restructurings and workouts, bankruptcy matters, and real estate financings. Matthew leads transactions spanning diverse industries, including media and telecommunications, Internet and technology, food and beverage, real estate, retail, and healthcare. Matthew serves as the New York office local practice group leader for the finance group.

Matthew has worked with Morgan Lewis teams on multiple deals worth more than \$1 billion.

Prior to joining Morgan Lewis, Matthew served as a law clerk to Federal Magistrate Judge Cheryl L. Pollak of the US District Court for the Eastern District of New York. While in law school, Matthew was twice elected president of the student body, served as senior comments editor for the *University of Chicago Roundtable* journal, and was awarded the Donald C. Egan Scholarship. At The Johns Hopkins University in 1998, Matthew was elected president of the student body and was awarded the Alexander K. Barton Cup for the graduating senior who most faithfully served the interests and ideals of the university.

Joseph D. Zargari



New York

T +1.212.309.7020

F +1.212.309.6001

[joseph.zargari@
morganlewis.com](mailto:joseph.zargari@morganlewis.com)

Joseph D. Zargari focuses on the structuring, formation, investment in, and governance and regulation of US domestic and international hedge funds, private equity funds, funds of funds, venture capital funds, hybrid funds, captive funds, and other private investment funds. He also counsels on the investment activities of these funds, and provides legal and other transactional advice for investment managers.

Actively engaged in all aspects of the private funds practice, Joe represents many major financial institutions, fund managers, and investment banks in connection with the formation of their funds and their investment activities, as well as placement agents and other parties connected to these activities. He also represents managers and clients of separately managed accounts and captive funds.

Joe regularly represents clients engaged in secondary transactions (including traditional purchases and sales of fund interests, fund recapitalizations and restructurings, tender offers, and structured, stapled, and synthetic secondary deals) and is a frequent speaker on the subject. Joe advises secondary funds, institutional investors, pension plans, endowments, family offices, and other institutions in their capacities as buyers and sellers of private fund interests on the secondary market and has counseled clients in many of the recent leading secondary transactions.

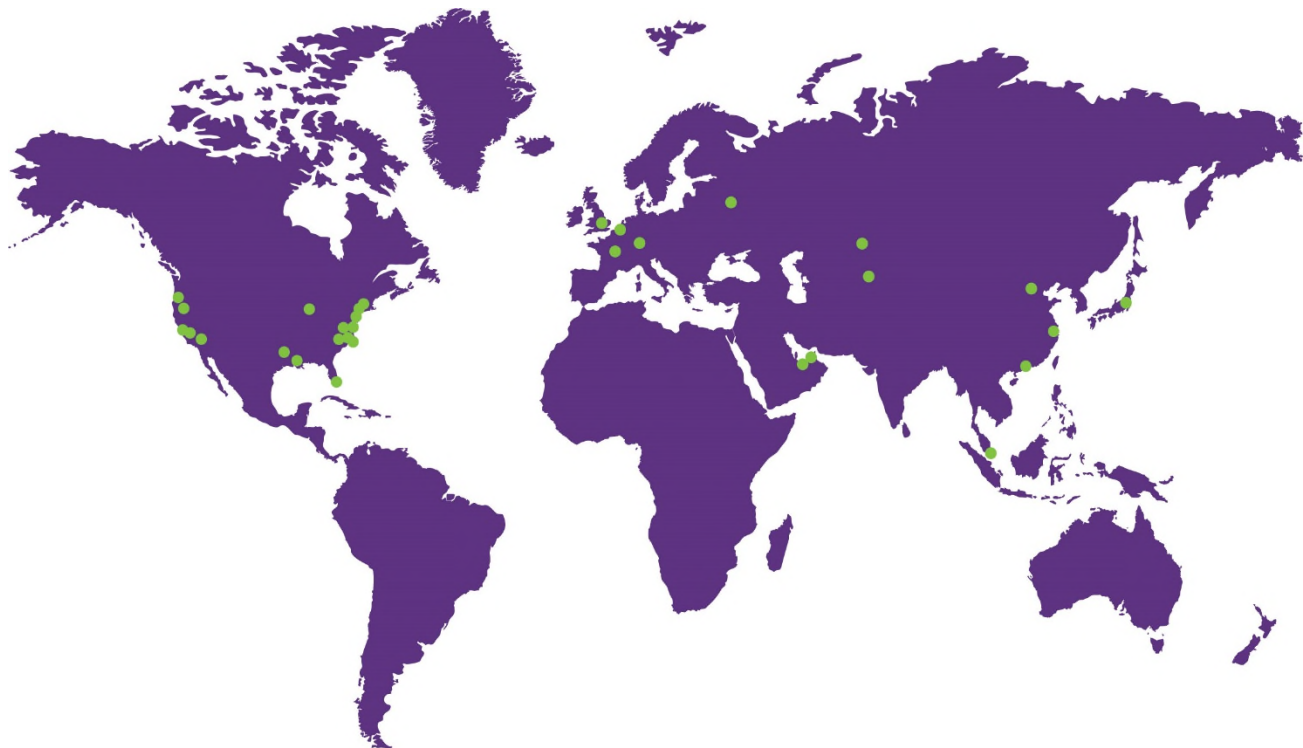
Joe has presented at a number of industry conferences on investment management-related matters, including at conferences sponsored by the Managed Funds Association and the National Association of Public Pension Attorneys, as well as at conferences sponsored by Morgan Lewis in New York, London, Chicago, Boston, and Dallas. Joe has also published articles on fund formation, investment management, and secondary transaction matters in *Hedge Fund Legal & Compliance Digest*, HedgeFund Intelligence's *Absolute Return* magazine, PEI's *Secondaries Investor* publication, and the Morgan Lewis Hedge Fund Deskbook. Joe also serves as the New York office local practice group leader for the investment management practice.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



Morgan Lewis

*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

THANK YOU

© 2020 Morgan, Lewis & Bockius LLP

© 2020 Morgan Lewis Stamford LLC

© 2020 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.