Securitizations and Ratings in Fund Finance[1]

By Mark Nesdill and Tim Powers

The "Securitizations and Ratings in Fund Finance" panel provided perspectives of lenders, ratings agencies, counsel and GPs on how the fund finance market has become increasingly focused on finding a capital markets solution to demand for fund finance products outpacing supply and the important role ratings play in facilitating such a solution. The changing regulatory landscape has accelerated the need for a capital markets solution as lenders are having to address both internal limits on types of loans/loan portfolios and regulatory capital constraints. Ratings play an important role in relieving both types of pressure as rated loans and portfolios of the same are viewed as less risky, which can relieve both types of pressures, and open up the market to alternative sources of capital and liquidity. Ratings do this in several ways, such as: (1) enabling many foreign (i.e. European, Japanese and Canadian) banks to better manage their capital; (2) facilitating an influx of institutional capital into the market by providing rated term tranches or securitizations; and (3) applying a consistent standard across transactions.

Public vs. Private Ratings

The panel discussed the difference between public and private ratings, as market participants have different views on the topic. Whether a rating needs to be public or not is generally driven by the regulatory regime that the relevant market participant is subject to because regulators dictate what is required, but the nature of the rating must ultimately be agreed to by the relevant parties. Lenders generally prefer public ratings because they are transparent, portable and provide a more consistent standard. However, a competing consideration is what level of disclosure the GP and the related fund's investors are comfortable with. GPs are comfortable with disclosing their performance and track record, as that information is readily available, but investors commonly have confidentiality concerns and GPs may, therefore, prefer private ratings to alleviate these concerns and prevent the investor base from being disclosed.

These concerns have resulted in private ratings being far more common in the market, however, GPs are getting more comfortable with public ratings due to the benefits associated with them. One of these benefits is to help fill a syndicate, as ratings are required by some non-bank lenders and preferred by some banks. A panelist even noted one instance where a lender saw a publicly rated facility and reached out to the GP with an offer to join the syndicate.

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[1] Panelists included Vicky Du, Global Head of Fund Finance at Standard Chartered, Greg Fayvilevich, Global Head of Funds Group at Fitch Ratings, Dan Marcus, Associate at Latham & Watkins, Michael Orphanides, Managing Director at BMO Capital Markets, and Kevin Purcell, Managing Director at Blue Owl Capital. The panel was moderated by Ana Arsov, Managing Director at Moody's Investors Service.

Standardized Terms

A major and recurring topic of discussion was the need for standardized terms to facilitate transactions being rated and securitized. A panelist noted that commercial real estate loans that will be distributed through CMBS transactions all include standard terms and something similar was needed in the fund finance market for securitizations to become common. This lack of standardization in the fund finance market makes rating a transaction a much more involved process and a true securitization model extremely difficult, with one panelist predicting that the market is at least a couple of years away from such a model.

The fund finance market has been difficult to standardize for a multitude of reasons. Standards, practices and credit policies vary from bank to bank, the relationship nature of the business, differing strategies and practices of GPs and their funds and the desire of market participants to have facilities address the needs of specific lenders and GPs/funds all work against standardized terms. Despite the variance among banks, the panelists generally agreed that banks and other lenders prefer standardizing terms, but GPs generally resist to make sure their aforementioned concerns are addressed. However, the panel was hopeful that ratings will help institutionalize the market, standardize terms and, correspondingly, standardize the ratings and related process, which will be capital accretive and foster a robust syndication and distribution market.

Innovation in the Market

Once terms and ratings become standard, the panelists identified a number of transaction aspects that could see innovation. An example of a GP with a strategy that provides consistent cash flows was cited as a test case for both ratings and potential securitizations because its funds have high utilization rates across their subscription credit facilities and often leave draws outstanding for the tenor of the facility, both of which lend themselves well to term facilities and tranches and therefore ratings and securitizations. Based on this example, the panelists discussed options for overcoming the challenges related to the revolving nature of subscription credit facilities, such as bifurcating facilities into term and revolving tranches, shorter tenors for certain term tranches to address issues associated with clean-downs and looking to a commercial paper solution and potentially rating the funds and their uncalled capital. Additionally, the panelists predicted that ratings will continue to be refined and developed to expand to specific types of subscription credit facility products, such as facilities that provide borrowing base credit for high net worth investors/feeders and separately managed accounts.