

Rated Note Fund Structures & Dechert's Rated Fund Practice

Rated Note Fund Structures – Overview

Structure:

- A limited partnership or LLC, typically domiciled in Delaware, that issues both equity and rated debt (typically a private letter rating under the Closed-End Fund methodology of KBRA, DBRS or Moody's).
- There will typically be a fixed ratio of equity to debt which will be required by the rating agency. In a single note structure, the ratio is typically between 30%:70% and 20%:80%. In multi-note structures the equity largely remains between 20% and 30% and the debt tranches will be split so as to give the greatest percentage to the senior note (for example, 50% A Note, 25% B Note; or 50% A Note, 20% B Note and 5% C Note). Funds that are levered at investment level will generally require higher equity, and we have seen up to 30% needed.
- The rating will be based on an existing or mock portfolio of the loans/instruments underlying the fund.
- The underlying assets should be debt related or otherwise produce regular income.
- Well suited to standalone or feeder fund structures, including over perpetual life vehicles such as private BDCs and evergreen private funds. The feeder structure allows managers to provide a capital efficient structure while allowing traditional investors into the master fund.

Target market:

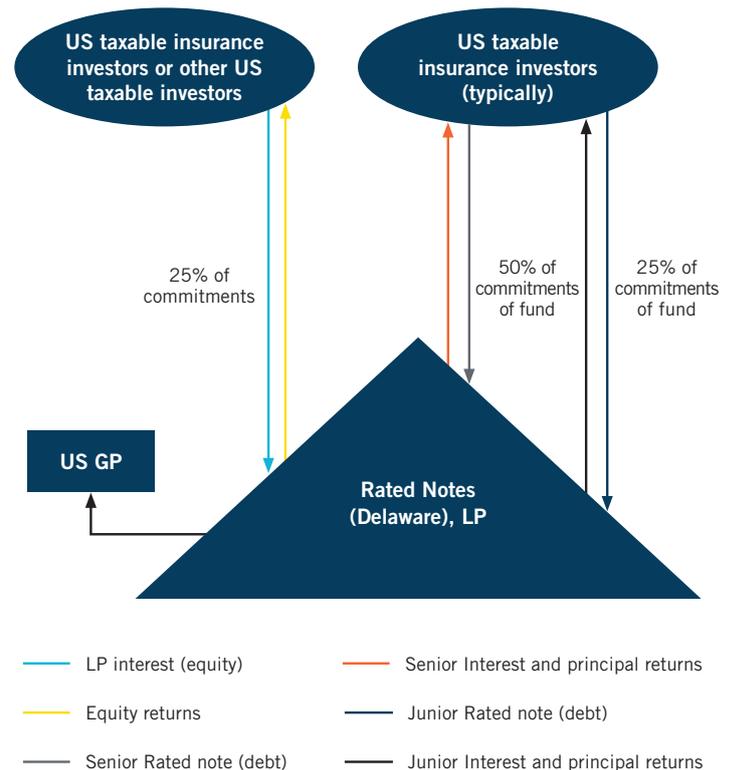
- US regulated insurance companies and other global insurance companies (Korea, Bermuda, Canada, Mexico (structure may vary for other jurisdictions)).

Reason for Rated Notes:

- US and certain other global insurance regulatory authorities do not provide a "look-through" to underlying investments in a private fund for the purposes of calculating an insurer's risk based/solvency capital. This leads to an insurer receiving penalizing risk based/solvency capital charges related to holding equity rather than the charges that would be assigned if the insurer held the fund's underlying assets on its balance sheet. By holding rated debt, this charge is significantly decreased and holding both equity and debt will generally result in a blended charge on par with a look-through treatment. This is intended to bring an insurer's risk based/solvency capital more in line with the underlying assets of the fund.
- The use of this structure can significantly assist smaller and medium-sized insurers with greater access to the private assets market and diversification of their exposure to both managers and assets.

Current legal considerations:

- The NAIC continues to consider the use of these structures and managers should speak with Dechert for ongoing updates if considering raising this type of vehicle.



Equity and Debt Mechanics:

- Debt and equity can be offered separately or together; however, in order to seek to ensure the indicia of credit tests of the NAIC's considerations, the instruments are not stapled.
- The noteholders receive an interest coupon which may be a set percentage or a spread above a benchmark. Due to the set interest coupon, provided the notes and coupon are repaid in full, the fees and economics will all be borne/attributed to the equity interests.
- Generally the operation of the Notes and the equity is the same as any normal drawdown fund interest with regard to capital contributions and equalization; however, due to the first loss nature of the equity and creditor relationship with noteholders, there are some differences to normal private fund terms. The Notes act like a revolving credit facility for the investment period and in the case of follow-ons.

Dechert's Market Leading Rated Funds Team

Dechert recognizes the intersection of private funds and structured finance involved with rated funds structure and is proud to offer multi-dimensional advice to its rated fund clients through the combined expertise of its award winning private fund formation and structured products team.

Early Entry:

- Dechert began forming rated funds in the very nascent stages of the market, drawing on its experience with CFOs and other structured products as well as its fund formation practice. Over time, as a market has developed and regulatory considerations have put pressure on the structures, Dechert has drawn from its wide-ranging expertise to adjust structures to meet both market and regulatory demands.

Dynamic Fund-Focused Approach:

- Dechert's team approaches work for rated fund clients by prioritizing the funds roots of the products while simultaneously addressing the structured nature of the products. Our combined team advises on structuring and rating, all aspects of formation, investor negotiation and onboarding in addition to advice in relation to US and global distribution of rated fund projects.
- The rated funds team additionally includes experienced attorneys in fund finance and tax with specific expertise in the nuances applicable to rated funds in these areas.

Market Leading Team:

- Our market leading team has set up numerous rated funds for top private fund and BDC sponsors and continues to work with such sponsors to develop new rated note structures in various jurisdictions.

Regulatory Insight and Collaboration:

- Dechert has an open line of communication with ratings agencies and has had several calls directly with the new legal review team for these products to develop documentation that addresses the concerns and considerations of ratings with such products in light of traditional fund features.
- Dechert's rated funds specialists are continually keeping abreast of developments in the regulatory space, including attendance at relevant NAIC meetings and speaking with managers, investors and other practitioners in this space to ensure this market continues to develop in a way that brings the most benefit to insurers.

End-to-End Service:

- Dechert also offers full-service capabilities in relation to investments, including master fund formation and related work for feeders (including US (private and registered funds) EU, Middle East and Asian structures), M&A, securitizations, real estate and leveraged finance, providing seamless end-to-end service for investment managers.

To learn more on Dechert's rated funds practice, follow the **QR codes**.

Also be sure to visit Dechert's site to learn more on our market leading approach.

Dechert Rated Funds Practice



Dechert Webinar with featured speakers from KBRA (Examining Rated Note Fund Structures for Insurance Company Investors)



Dechert On Reg Podcast (NAIC Updates)



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