

Rated Notes and EU/UK Insurers

Rated Note Fund Structures – Overview

Structure

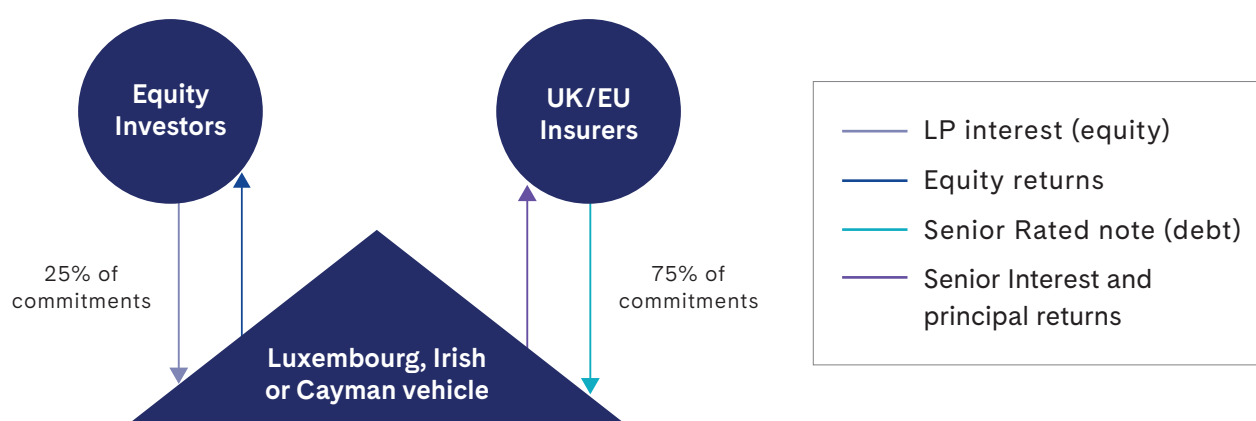
- Rated Note Feeders emerged in the U.S. as a product targeted at U.S. regulated insurers. They are now being adapted for the UK and EU market.
- In the typical U.S. structure the issuer is a limited partnership or LLC domiciled Delaware that invests in one or more master funds and issues both equity and rated debt (typically the rating is under the Closed End Fund methodology). In issuances targeted at European investors, the issuer is more often a Cayman, Irish or Luxembourg vehicle and may invest alongside the master fund in underlying assets rather than purchasing LP interests from the master fund. This vehicle is not necessarily structured as a fund, the common link with a US structure being that the issuance of rated notes giving the fund manager a long term investment and the purchaser a return that in many ways is similar to an LP investment in the fund.
- 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 the U.S. market, multi-tranche structures permitting a thinner layer of equity are common, however multi-tranche note issuances in the UK and EU market require careful analysis to determine the applicability of securitisation rules and the impact of securitisation treatment on the capital charges borne by the insurer.
- 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.
- The structure is 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

- UK and EU regulated insurance companies and other global insurance companies. As noted, insurers in each jurisdiction are likely to have different requirements driven by their regulatory capital approach.

Reason for Rated Notes

- UK and EU regulators provide for a look-through approach on investments in funds. This can lead to high capital charges on certain types of fund investment, however there should be no look-through on rated debt issued by a corporate.
- UK regulators allow for preferential treatment of investments that satisfy matching adjustment criteria – these are essentially criteria that match the cashflow on a pool of investments to the cashflows on a pool of liabilities. Matching adjustment is easier to obtain with investments that have a relatively long duration, certainty on drawdowns and amortisation and regular interest payments. Due to recent regulatory reforms there is increased interest in rated notes that satisfy matching adjustment criteria.
- Larger UK and European insurers can use an internal model to calculate their capital requirements, insurers using an internal model can be more flexible about the terms of structures than insurers using the standard model. This has sometimes led to transactions that focus on the treatment available under other parts of the Solvency II regime.



Current Legal Considerations

- The EU and UK continue to reform insurance capital rules and managers should speak with Dechert for ongoing updates if considering raising this type of vehicle.

Equity and Debt Mechanics

- Regulated European insurers will take debt tranches but equity usually needs to be held by the sponsors or placed with third parties.
- 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. In matching adjustment structures certainty on the timing of draws can be important.

Market Leading Rated Notes Team

Dechert recognises the intersection of private funds and structured finance involved with rated note structures 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, CPPI 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 note clients by prioritising 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 UK, EU, US and global distribution of rated fund projects.
- ▼ The rated funds team additionally includes experienced lawyers 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 note issuance platforms 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's rated funds specialists are continually keeping abreast of developments in the regulatory space, including EU and UK regulatory developments and speaking with trade associations, managers, investors and other practitioners in this space to ensure this market continues to develop in a way that brings the most benefit to funds and insurers.

Rating Agencies

- ▼ Dechert is regularly involved in early stage discussions with the rating agencies regarding the development of new products and documentation that addresses the concerns and considerations of applying structured ratings methodology to products whose cashflows involve funds.

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, UK, Middle East and Asian structures), M&A, securitisations, real estate and leveraged finance, providing seamless end-to-end service for investment managers.

Key Contacts

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