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Contributing Editor:

Wes Misson

Cadwalader, Wickersham & Taft LLP

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Christopher P. Duerden
Arina Lekhel
Anthony Lombardi
Eric Zeng

Dechert LLP

Introduction

Over the past several years, collateralised fund obligations ("**CFOs**") have seen an explosion in popularity as a means of financing equity interests in private funds and other assets and providing an alternative liquidity solution to the more standard portfolio secondary sale. CFOs first came to market in the early 2000s, although their use has been hitherto relatively marginal. The recent growth of interest in CFOs has been driven primarily due to: (i) the strong desire of certain classes of investors (*e.g.*, insurance companies, sovereign wealth funds and other regulated investors) to gain exposure to non-traditional asset classes such as private credit, private equity and secondaries funds in a structured and capital-efficient rated format; (ii) the fund sponsor's growing need for alternative liquidity options while offering attractive investment opportunities for a wide variety of investors; (iii) the ability to diversify collateral with a variety of different financial assets with varying risk profiles, such as private equity funds, pension plan funds, credit opportunity funds, buy-out funds, infrastructure funds, real estate funds, private credit funds, co-investments, asset-based securitisations ("**ABS**") and residuals in collateralised loan obligations ("**CLOs**") and other securitisations; and (iv) the growing (but still inefficient) private funds' secondaries market, which can make sales of limited partnership ("**LP**") interests unattractive.

CFOs, despite their bespoke complex structure, can be tailored to the needs of investors and fund sponsors. Financing fund interests (as defined below) via a CFO offers a long-term capital markets solution with more favourable costs of funding than certain shorter-term financings executed in the private, bilateral/club market, such as net asset value ("**NAV**") facilities. In the case of the regulated investors (*e.g.*, insurance companies) subject to risk-based capital requirements, holding rated debt issued by a CFO offers better capital treatment than holding fund interests individually and directly. This is primarily due to the fact that CFOs generally (though not always) benefit from broad and diverse fund interests that are supported by structural credit enhancement features, such as overcollateralisation, subordination and liquidity support, which enable them to issue a majority of their capital structure in the form of investment grade rated debt.

What is a CFO?

A CFO is a structured transaction that involves the securitisation of various fund interests (such as equity interests in private funds or less liquid registered funds) and other assets. In a typical CFO, fund interests are transferred to an asset holding company that is in turn held by an issuing entity (CFO issuer) that issues debt (generally in the form of notes) and equity interests to investors. The debt and equity interests are backed by the payment streams received from the fund interests. Although CFO transactions often involve assets other than fund interests, this practice note will generally refer to assets of a CFO as simply "**fund interests**".

Notwithstanding the foregoing, there is no one "standard" CFO. As noted, they are tailored to accommodate the needs of the investors and/or fund sponsor. Given such no-one-size-fits-all feature, CFOs can be structured with assets that do not fit neatly into any of the more traditional channels and be designed in a way that takes into account the specific regulatory, capital and/or tax requirements of CFO Issuer (as defined below) and investors. While it can be complicated, its bespoke, no-one-size-fits-all structure offers flexibility, which in turn creates appeal to many market participants.

Basic structure of a CFO

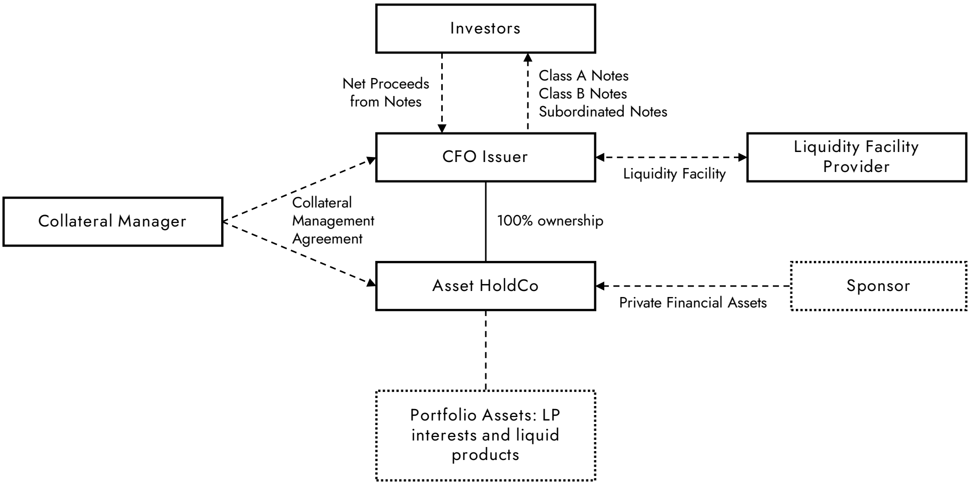
In a typical CFO, a bankruptcy-remote special purpose entity ("**CFO Issuer**") purchases and holds, directly or indirectly, a diversified portfolio of fund interests, which is financed by issuing one or more rated debt tranches and a single class of unrated equity, which may take the form of subordinated notes or an LP interest. Since the terms of fund interests often prohibit them from being pledged to secure a financing without the consent of the general partner ("**GP**") or investment manager of the relevant fund, the fund interests purchased by a CFO Issuer are often held in a subsidiary of the CFO Issuer ("**Asset Holdco**"). The assets of the Asset Holdco are not subject to a pledge or a security interest, but the equity interests of the Asset Holdco are pledged to secure the repayment of the debt and other obligations of the CFO Issuer.

The most senior tranche issued by a CFO Issuer will have the highest rating in such CFO. Each successive tranche will be more junior to, and have debt that is lower rated than, the immediately prior tranche. The most subordinated tranche will be an equity tranche. The returns on subordinated or equity tranches, in turn, can vary in line with gains or losses on the underlying investments. This tranched capital structure allows the investors in a CFO to determine their preferred risk/return investments.

Each tranche (other than the most junior tranche) has a seniority or priority over the other tranches, with "tighter" loan-to-value ("**LTV**") or similar collateral quality tests, which, if not satisfied, will result in the diversion of some or all available cash to pay down the principal balance of the rated tranches of each class of debt in the order of seniority until such LTV or collateral quality tests are satisfied, with the equity last in line in the so-called "waterfall" of repayment.

The proceeds of a CFO offering are used to finance the underlying fund investments, provide liquidity to the underlying funds, purchase more fund investments, seed new vintage funds and/or for any other permitted purposes.

Continued overleaf



The vast majority of CFOs issued over the past several years are led by the GPs to raise capital for new funds by diversifying their investor base. CFOs led by the limited partners are generally established by underlying fund investors to get liquidity without giving up any upside potential over time and to get leverage to finance risk-based capital charges, etc.

Basic terms of a CFO transaction

The terms of a CFO transaction vary significantly from one transaction to another. However, some of the more common terms and features are as follows.

Addressing liquidity concerns

One key structuring and modelling challenge of CFO transactions is the uncertainty regarding the timing and amount of distributions on the underlying assets. Unlike an ABS or CLO transaction, the fund interests that comprise the underlying assets of a CFO typically do not have any stated principal amount that matures on a set date or an obligation to make interest payments regularly. Thus, sources of short-term liquidity, as well as structural features built into the transaction, are necessary to ensure that the CFO Issuer can make timely payment of interest, fees and expenses, and that the Asset Holdco can satisfy any capital calls from the underlying funds associated with its fund interests.

In order to provide short-term liquidity for a CFO transaction, the Asset Holdco may be required to hold some percentage of its assets in money market funds, as well as lower-risk, liquid assets that can be redeemed within a relatively short period of time (but at least quarterly ahead of CFO payment dates), such as diversified bond funds and U.S. treasuries. In addition, the CFO Issuer will often enter into a revolving liquidity facility with a third-party liquidity lender. The nature and amount of the liquidity facility can vary significantly.

Additionally, some CFOs include staggered vintages of fund interests in which certain "older" fund interests that are closer to their final distribution date are combined with other "newer" fund interests that are several years away from their final distribution. This can help ensure adequate cash flow during the life of the CFO, with older vintages distributing cash in early years and newer vintages distributing cash during later years.

Use of liquidity facilities in CFO transactions

The CFO Issuer usually enters into a revolving liquidity facility that it can draw upon to fund capital commitments of underlying funds and pay interest on rated debt and other fees and expenses of the CFO transaction. The liquidity lender, typically an insurance company or bank, will charge an upfront fee and an ongoing commitment fee for the non-used portion. Although it is generally not expected that these liquidity facilities will ever have to be fully utilised, having access to a liquidity facility minimises the likelihood that the CFO Issuer will be unable to pay ongoing obligations and protects the CFO transaction from the punitive consequences of failing to fund capital commitments on underlying funds. As such, ensuring there is adequate liquidity to support the CFO transaction, including through the use of liquidity facilities, is necessary to obtain the desired ratings on the CFO's rated debt. Although the terms of liquidity facilities vary, they generally have a term of three to five years (often aligning with the reinvestment period of the CFO), subject to extension at the discretion of the liquidity lenders and upon payment of an extension fee. Liquidity facilities usually terminate upon redemption unless the CFO Issuer is able to negotiate a feature in which the facility does not terminate if the CFO is subject to a refinancing. The commitment size is generally 10–15% of total CFO issuance. In addition, if a liquidity facility is an essential component for the CFO transaction to achieve the desired ratings, rating agencies will require such facility to include counterparty ratings requirements for the liquidity lenders, along with mechanics for replacing downgraded liquidity lenders.

Reinvestment of CFO assets

Some CFOs will have a set portfolio of assets at close and no ability or only a limited ability to reinvest, whereas others have an investment period of three to eight years, during which time proceeds of the offering and/or distributions from the underlying assets can be deployed and reinvested. In some CFOs, the manager may also have the ability to cause the Asset Holdco to sell fund interests (typically subject to an overall per cent limitation) and reinvest the proceeds from such sales into new fund interests. However, even in a "static" CFO that does not contemplate active reinvestment, such CFO may have the ability to recycle proceeds corresponding to the recycling that takes place at the underlying fund level.

Amortisation of CFO debt

Following the reinvestment period (if any), CFOs typically include an amortisation period of up to another five to eight years, during which time the debt will be paid down according to an amortisation schedule to the extent cash proceeds are available (or, if not available, catch-up payments would be made on subsequent payment dates); *however*, interest rates on the debt could step up in the event of a failure to pay down a certain amount of principal by a certain time frame or to pay off all principal by the end of the amortisation schedule. Although CFOs usually have an LTV or similar overcollateralisation test, while any breach would typically restrict or cut off distributions to the holders of the equity tranche of CFO, it generally would not result in an event of default. In addition, in many CFO structures, interest payments on senior notes are only required if the CFO has adequate cash flow; to the extent the CFO does not have sufficient cash to make interest payments, the interest payments would be deferred until the next payment date (unless such CFO provides that the liquidity facility may be drawn to make interest payments). CFOs also have a long maturity date relative to the underlying assets in order to ensure eventual repayment of principal, typically at least 15 years.

Satisfying capital calls of underlying fund interests

The underlying fund interests held by a CFO usually require the holder to satisfy ongoing capital calls. In some cases, the CFO Issuer may issue delayed draw debt to help ensure that it can make capital calls on the funds in which it owns fund interests and to ensure a more efficient capital deployment. In other cases, a cash reserve account may be established for such purpose and/or a larger proportion of liquid assets may be required to be held by the CFO. Cash reserves may also be set up to ensure that the CFO Issuer has sufficient amounts for fees, expenses and interest for the next payment date(s). Finally, although less common, the sponsor or an affiliate may also contractually agree to stand behind capital calls on the fund interests held by the CFO, but only to the extent this does not impair the bankruptcy remoteness of the CFO Issuer. Even absent a contractual obligation to make capital contributions required to satisfy capital calls on fund interests, many CFOs allow the holders of the equity tranche to make capital contributions for various reasons, including to satisfy capital calls.

Types of asset portfolios in a CFO

The portfolios of a CFO differ significantly in the type and diversity of assets:

- *Identified pool vs blind pool*: A majority of CFOs have an identified pool of assets transferred by a sponsor or alternative platform on or prior to the closing of the CFO, while some are "blind pool" fundraising vehicles in which the pool of assets is not yet identified at close. Blind pools offer a great deal of flexibility for the manager, as the CFO can add new funds after closing and are used generally for fundraising purposes. On the other hand, identified pools offer less flexibility in terms of underlying assets but are often easier for rating agencies and investors to evaluate, and are generally used as a method of monetising a specific pool of assets. In some cases, a CFO is a hybrid of the two, including some identified assets at closing but also the ability to continue to buy new assets after closing.
- *Third party vs affiliated funds*: While some CFO transactions only contain fund interests in funds managed by the CFO's manager and/or its affiliates, others have significant portions (up to 100%) of the portfolio comprising fund interests managed by third parties.
- *Number of funds*: Some CFO transactions have only one fund or a handful (*e.g.*, three to six) of different funds in which they invest, while others invest in upwards of 100 funds.
- *Fully drawn vs ongoing commitments*: In some CFOs, the LP interests are fully drawn or almost fully drawn, while in others there remain significant outstanding capital commitments. Those with outstanding capital commitments to the underlying funds generally require the CFO Issuer to demonstrate ongoing liquidity to fund such capital commitments via liquid assets, a liquidity facility, delayed draw notes or otherwise. To the extent a CFO Issuer issues delayed draw notes or relies on any kind of unfunded commitment from its investors, the ability of such holders to fund will be a consideration that needs to be addressed, including by way of minimum ratings requirements applicable to the holders of the delayed draw notes and any transferees.
- *Types of assets*: While most fund interests consist of LP interests in private equity funds, venture capital funds, credit funds, hedge funds, real estate funds, energy funds, infrastructure funds and business development companies, a CFO transaction can also include interests in CLO equity and CLO equity funds, equity in ABS securitisations, direct co-investment in portfolio companies' broadly syndicated loan assets, and other assets. While some portfolios are concentrated, a method to ensure that cash is available for distribution includes adding a mixed portfolio of equity interests in funds with credit or other income bearing strategies combined with more equity or real estate concentrated portfolios. Furthermore, while most fund interests comprise minority investments in underlying funds, some fund interests may be the sole interest in a "fund-of-one". CFOs can accommodate many different products and asset classes, so long as appropriate liquidity can be demonstrated and stress tests can be satisfied.

To date, there has been no one "standard" for a CFO asset portfolio. As such, the CFO structure offers flexibility to a sponsor or asset owner for fundraising and/or monetising with respect to assets that do not fit neatly into any of the more traditional channels.

Cash distribution in a CFO

As a general matter, due to the unique liquidity considerations of a CFO transaction, interest and principal payments to the noteholders are more variable than in CLO or ABS transactions (given that debt may defer and capitalise interest if insufficient funds are available for any given payment date), and distributions to the equity tranche are more restricted. Furthermore, a reserve account may be funded for the purpose of supporting the liquidity needs of a CFO prior to being available for distribution.

In a CFO, the priority of payments before acceleration typically provides for the following:

1. administrative expenses (typically subject to a cap);
2. fees, expenses and interest for any liquidity facility;
3. mandatory repayment (if any) of principal outstanding on any liquidity facility;
4. interest on the rated debt (in order of priority), subject to deferral if insufficient cash is available at this step;
5. optional repayment of principal outstanding on any liquidity facility;
6. during the amortisation period (or while certain trigger events are continuing, such as an LTV or overcollateralisation trigger), scheduled amortisation on the debt (in order of priority), subject to deferral if insufficient cash is available at this step;
7. administrative expense catch-up (if any remain unpaid following step 1); and
8. payments on the equity tranche, subject to restrictions on timing (which is often not allowed until at least three years after the closing date) and amount (which is usually limited relative to the LTV ratio, liquid asset balance and a percentage of the initial principal balance on the equity tranche) to the extent such payments are made prior to the payment in full of the rated debt, as well as a reserve for any senior fees/expenses and interest for the next payment date.

Additionally, to the extent the CFO has the ability to reinvest proceeds from fund interests into additional fund interests, or there is an obligation to fund further capital calls, cash may be diverted for such purposes in the waterfall prior to any distributions to the equity tranche.

Disclosure and confidentiality

Given that a CFO includes underlying funds that themselves are subject to a variety of risks and securities laws' considerations, preparing a CFO's offering documents involves a balancing act between maximising disclosure and preserving confidentiality. While including the names of each underlying fund and attaching the "risk factors" section from each private placement memorandum ("**PPM**") for each such fund would provide investors with the most fulsome set of information, the fund interests are often subject to legal or contractual confidentiality restrictions that prohibit broadly sharing the PPM or even the name of the fund and the manager. Moreover, some CFOs do not have all of the funds determined at the outset (or none in the case of completely "blind" pools). Depending on the provisions of the limited partnership agreement ("**LPA**") of the underlying fund, consent may be necessary to provide basic information about the CFO's investments, such as the names of the funds in which the CFO invests. Private funds may also be sensitive to sharing the fact that a CFO is one of its limited partners; and sometimes an LPA may need to be revised, or specific consent from the GP or the investment manager may be required, to permit a securitisation vehicle like a CFO to invest as a limited partner. Obtaining consent to include the PPM's risk factor section in a CFO's offering documents can be even more difficult, as such material is often considered highly proprietary. However, to the extent the CFO consists mainly or entirely of funds affiliated with the sponsor, this may be a viable alternative.

In scenarios where the CFO Issuer cannot disclose the funds or attach the PPM's risk factors associated with each fund, or there are too many underlying funds proposed to be invested by the CFO Isser to make the disclosure practically meaningful, an alternative would be to summarise the primary risk factors associated with each asset class that the CFO is investing in without disclosing specific funds. Many CFO sponsors opt for a hybrid of the two approaches; for instance, a CFO's offering materials may attach the PPM's risk factors for three or four of the largest funds (measured as a percentage of the CFO's aggregate investments) but include only a generic summary of risk factors for the remaining funds included in the

CFO's portfolio. Additionally, in some cases, CFO offering materials may include anonymised data for the fund interests.

Sponsors considering utilising new fund interests in a CFO should consider negotiating provisions similar to a fund of funds or third-party feeder fund in relation to confidentiality matters when investing.

Rating agency considerations

Although different rating agencies employ different methodologies, the following are some of the key factors that most rating agencies take into consideration when evaluating CFOs:

- *Manager track record*: Rating agencies focus specifically on how funds managed by the GP or investment manager have performed historically, including their internal rate of return. This analysis looks separately at how such investment manager or GP has fared among different vintages of funds, as well as different fund strategies/asset classes. Alignment of interest is also key: whether and how much of the GP's own money is employed in such funds is usually a positive indication of aligned interests.
- *Ability to satisfy ongoing obligations*: Rating agencies take into account the CFO Issuer's ongoing obligations and its ability to satisfy these obligations through its expected sources of liquidity (*i.e.*, liquid assets, liquidity facility, delayed draw notes, cash reserve mechanics, etc.).
- *Ratio of liabilities to assets (i.e., LTV or overcollateralisation)*: Although there is no standard "haircut" that can be applied to any specific fund interest or portfolio of fund interests, the rating agencies will examine the principal balance of the debt and liquidity facility relative to the NAV of the underlying fund interests, liquid assets and other CFO assets.
- *Diversification of CFO assets*: Rating agencies will evaluate the diversity of the underlying funds in terms of strategy (private equity, credit fund, real estate, etc.), geography (U.S. *vs* non-U.S., developed markets *vs* undeveloped markets, etc.), number of funds, and vintages. Rating agencies may also take a look-through approach (looking through to the assets held by the underlying funds) to determine concentration limits. Additional asset types and mixing of underlying fund strategies can also assist with cash flow diversification.

Regulatory considerations

U.S. risk retention rules

U.S. risk retention rules generally require the sponsor to retain at least 5% of the securitised assets in a securitisation involving the issuance of asset-backed securities. However, an "asset-backed security" is defined as a fixed-income or other security collateralised by any type of self-liquidating financial asset (including a loan, a lease, a mortgage or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from such asset. Since repayment of CFO notes primarily depends on fund interests, and most fund interests are *not* "self-liquidating" (*i.e.*, interests in private funds do not convert to cash within a finite period of time), most sponsors take the position that the U.S. risk retention rules do not apply to CFO transactions. However, given that the structure of the CFO transaction and the debt issued utilise some of the technology and legal documentation that are commonly seen in traditional securitisation transactions and given the lack of guidance on CFOs from any rulemaking authority, there remains some uncertainty on this subject. Furthermore, to the extent CFOs include fund interests other than LP interests (for instance, ABS notes, broadly syndicated loans, or other debt-like investments), this would further complicate the analysis.

Different considerations apply in Europe due to the broad scope of the UK/EU Securitisation Regulations. As such, the fund sponsor will need to involve counsels and carefully analyse the CFO, particularly in relation to matters such as risk retention, transparency and disclosure obligations.

NAIC scrutiny

As mentioned above, investment in the rated tranches of debt in CFOs can offer an attractive risk-based capital charge for the U.S. insurance companies.

As such, any proposed CFO must be evaluated under the applicable National Association of Insurance Commissioners ("**NAIC**") guidance and statutory accounting principles to ensure that the rated debt tranches qualify for regulatory capital treatment as a "bond".

The new "principles-based" bond definition adopted by the Statutory Accounting Principles (E) Working Group ("**SAPWG**") of NAIC on August 13, 2023, which redefined what types of debt instruments qualify as "bonds" for statutory accounting purposes, became effective on January 1, 2025. Certain categories of debt securities owned by U.S. insurance companies on or after January 1, 2025 are required to satisfy the new "principles-based" bond definition in order to be eligible for reporting on Schedule D-1 as bonds, and there is no "grandfathering" available. Under the new "principles-based" bond definition, the sponsor's ability to demonstrate that the structure of the proposed CFO, despite being collateralised by equity assets, redistributes the credit risk, such that the investor is in a different economic position (determined as of the date of origination) than if it owned the CFO Issuer's underlying assets directly *as a result of "substantive" credit enhancement* through guarantees (or other similar forms of recourse), subordination, liquidity support and/or overcollateralisation, is an important factor in achieving the "bond" status and therefore should be considered at the outset when structuring a CFO.

Also, the risk-based capital charge on residual tranches (the "first loss" tranche that absorbs losses before the debt instrument) of ABS, which includes CFOs, has increased from 30% to 45%, effective 2024, for insurance companies. This percentage is subject to review and may increase or decrease in the future.

Additionally, in summer 2024, NAIC's policy and procedures manual for the Securities Valuation Office was updated to provide for a process in which NAIC's Investment Analysis Office and its Securities Valuation Office may flag a specific filing-exempt security for further review and, following a documented process, may be removed from the filing-exempt process and assessed a different NAIC risk designation than that which would correspond to the filing-exempt designation for risk-based capital charges. This process, which is expected to become effective January 1, 2026 (although implementation may be delayed), is designed to be utilised in a limited manner and provides for appeals procedures.

Closing a CFO: timing and execution

CFOs, unlike CLOs, typically do not feature any traditional warehousing of assets. Rather than a manager selecting assets, financing them in a warehouse, and then undertaking a takeout securitisation, CFOs are initially conceived with a sponsor meeting with the rating agency and investment bank and identifying a portfolio or a model for a portfolio. Subject to confidentiality restrictions discussed in more detail below, investors and other parties to a CFO will often diligence the underlying assets (*i.e.*, the underlying funds) held by the CFO as if they were directly investing in such assets; thus, there is significant time spent upfront agreeing upon a portfolio and a structure before going to market. To the extent the manager or sponsor is not expecting to retain the equity tranche in the CFO transaction, it is also imperative to have investors lined up to either purchase or retain the equity CFO before launching, as the CFO itself will likely never materialise without securing the equity piece. Although timing varies from deal to deal, sponsors should expect the entire process to take anywhere from three months to nine months.

In addition to a more extensive due diligence and structuring process, sponsors and their counsel must also simultaneously undertake "onboarding" of the CFO's assets. In CFOs that involve an established pool of assets, the sponsor of a CFO will usually "seed" the CFO with the existing fund interests it holds, receiving cash or equity in the CFO (*i.e.*, the equity tranche) or some combination of the two in exchange for such fund interests. However, transferring fund interests to the Asset Holdco of a CFO presents unique challenges and considerations that are not present in CLOs or ABS transactions, including compliance with securities laws, anti-money laundering ("**AML**"), "know your customer" ("**KYC**") considerations, tax ramifications for the underlying fund and confidentiality. Given the interdisciplinary nature of a CFO transaction and the complexities involved, it can require multiple separate work streams covering the negotiations and documentation around the financing and the transfer of the fund interests.

Some of the key considerations for GPs of transferring funds and CFO sponsors as transferring limited partners include:

- *Timing for transfers of fund interests*: Many funds have set fund interest transfer windows, which could be quarterly, every six months, or annual, and limitations on the amount of fund interests that can be transferred each year. The transaction parties need to track and manage the timing of each transfer in order to avoid substantial delays. Some GPs of private funds have placed the underlying LP interests in queues until the CFO Issuer's relevant permitted transfer date. Accordingly, it is important to communicate with the underlying GPs as soon as possible to ensure that the CFO contribution timing coincides with the transfer date at the underlying fund level.
- *CFO Issuer and CFO Issuer investor representations*: The CFO Issuer will need to make the required securities laws' representations (*e.g.*, "qualified purchaser" status, in some instances, on a look-through basis with respect to the underlying CFO Issuer investors) in order to hold the various underlying fund interests. Transaction parties need to consider when these representations need to be made, as the CFO Issuer will not generally be sufficiently capitalised until the transfers take effect. Similar timing considerations arise with respect to the AML/KYC representations that the CFO Issuer and the investors of the CFO Issuer will need to make. In addition, transaction parties need to ensure that the CFO Issuer investors make the appropriate back-to-back representations.
- *Defaults of transferee LPs*: Subscription lines are typically used to cover capital calls made by underlying funds. Where there is no subscription line, GPs often require transferring limited partners to represent that they will cover defaults of transferee LPs.
- *Subscription lines*: Many funds have a subscription line in which the original owner of the fund interest was part of the borrowing base. The GP should discuss with the credit provider early in the process to determine whether the transfer would affect the borrowing base.
- *Tax issues*: GPs should consult tax counsel for the fund in order to analyse the implications of any change in the investor's domicile (*e.g.*, if the CFO Issuer itself (or Asset Holdco) is a Cayman entity and the prior investor was U.S. based).
- *Side letters*: GPs need to consider whether side letters with respect to the fund interests are transferred in full or whether terms will be loosened, as well as the timing considerations involved with the renegotiation of any terms.
- *GP consent for transfers of interests*: A transfer of a limited partner's interest in each fund will require consent from each GP. GPs can withhold consent to the transfer of interests in a variety of ways pursuant to the respective fund's governing documents. Significant lead time and interfacing with the GPs will be required to achieve consent to the transfers.
- *Confidentiality and non-disclosure agreements*: Pursuant to the fund's confidentiality provisions in its LPA, each GP will likely require a non-disclosure agreement before providing any of the materials necessary for the transfer of the interest. Significant lead time will be needed to negotiate these agreements with the GP.
- *The sum of interests to be transferred and timing of CFO securitisation*: Each GP likely has a secondary/transfer programme where the GP is only willing to provide specific effective dates that can be quarterly, bi-annual or even annual. Funds can also be subject to restrictions on the amount of fund interests that can be transferred each year. The timing and representations made as part of the takeout need to be in line with the effective dates offered by the GP. If the timing benchmarks required by the GP are not met, the transfer risks being moved to the subsequent effective date.

- *Materials required for the transfers*: Although generally similar in terms of material provisions, each fund has its own fund governing documents consisting of a subscription agreement, an LPA, a PPM and, if initially negotiated, an associated side letter. Each fund's transfer agreements and subscription materials for the transfer of interest are borne out of these materials. The materials therefore present their own nuances and distinctions such as with respect to the fund's tax and AML/KYC requirements. For both tax and AML/KYC, the domicile of the transferee and the fund will present issues and challenges for the transferee to consider. For example, depending upon the size/sophistication of the GP of a given fund, the GP will handle AML/KYC internally or outsource to a third-party fund administrator. Generally, third-party fund administrators will present more stringent AML/KYC requirements.
- *Costs of transferring fund interests*: Depending upon whether the GP engages their own counsel to effect the transfer, each transfer of interest will likely incur legal costs to be borne by the transferring parties. These costs can be relatively significant (in addition to the costs associated with the CFO itself), depending on how many interests are being transferred.

Differences between CFOs and rated funds

CFO transactions are sometimes confused with the rated note fund transaction, often referred to as a "rated fund", since both allow regulated investors to invest in a fund or fund-like products via a rated debt instrument, which provides for a better risk-based capital treatment than an equity investment. In a rated fund, a private fund may be established as a standalone vehicle, or it may implement a feeder fund that issues both rated debt and equity. This allows for a regulated investor to invest in a private fund on a more capital-efficient basis by holding debt (and often the equity as well, but this is not required) as opposed to a more typical equity-only investment in a private fund.

Rated funds are first and foremost private funds with (generally) a single pool of directly held assets (or indirectly via a master-feeder structure), whereas a CFO is more akin to a fund of funds. Additionally, a CFO is generally intended as a leveraging vehicle with a goal of providing a levered return. In contrast, rated funds, despite having inherent leverage created by the notes, are less often utilised for leveraging purposes, with funds seeking a levered return taking out separate asset-backed leverage lines in order to enhance returns. Separately, the notes issued in a rated fund can be unsecured, whereas a CFO is supported by a security interest in the equity interests in the Asset Holdco.

However, the line between CFOs and rated funds has become increasingly blurred; for instance, some CFOs only invest in one fund (making it more like a rated fund), and rated funds are sometimes a "fund of funds" (making it more CFO-like). As CFOs and rated fund transactions continue to evolve, more overlapping characteristics will likely appear.

Differences between CFOs and NAV facilities

Another close cousin of a CFO is the NAV facility. NAV facilities involve a bank or other financing source lending against the value of the assets in a primary fund or the value of the LP interests in a fund or group of funds.

NAV facilities bear some structural resemblances: in both cases, the interests in the fund or group of funds are held by a holding company, which is in turn held by a special purpose entity borrower.

However, NAV facilities usually involve fewer parties; they are often bilateral facilities with a single lender or a small syndicate of lenders, with no tranching and no separate "equity" piece that can be sold to a third-party investor. As such, there is generally less execution risk and lower transaction costs.

The term of the debt issued under a CFO is much longer than under a NAV facility, the pricing is more favourable and the ability to tranche a senior, mezzanine and equity piece allows the sponsor to bring in a wider swath of interested investors with different investment goals.

Reasons for recent growth of CFO market

A variety of factors have contributed to the recent interest in CFOs. Some of these include:

- *Favourable terms*: Financing fund interests via a CFO offers a long-term capital markets execution on terms that are more favourable with regard to interest rate and advance rate than shorter-term financings executed in the private, bilateral/club market, such as NAV facilities.
- *Inefficiencies in the secondaries market*: Due to inefficiencies in the secondaries market for private fund interests, a platform that holds private fund interests may not be able to sell to a third party on favourable terms. CFOs offer an attractive alternative to selling into the secondary market, thus allowing a platform that holds CFO interests to reallocate or rebalance its holdings without giving up the upside associated with such holdings.
- *Flexibility of assets in a CFO transaction*: CFOs can be collateralised with a variety of different financial assets, including credit opportunity funds, buy-out funds, infrastructure funds, real estate funds, private credit funds, co-investments, ABS, CLO equity and residuals in securitisations.
- *Optimising risk-based capital treatment*: For investors subject to risk-based capital requirements (such as insurers, sovereign wealth funds and other regulated investors), CFOs offer an opportunity to gain exposure to fund interests in a structured and capital-efficient rated format. For these investors, holding rated notes issued by a CFO offers better capital treatment than holding fund interests individually and directly. This is primarily due to the fact that CFOs benefit from a broad base of fund interests, overcollateralisation, subordination, liquidity support and other structural features that enable them to issue a substantial percentage of their capital structure in the form of investment grade rated debt.

Conclusion

Although CFOs can have challenges and high transaction costs (relative to other structured products) and regulatory developments may continue to impact the wider adoption and usage of CFOs in the fund finance market, CFOs remain an effective and innovative financing, fundraising and liquidity solution. From the sponsor's perspective, the use of ABS/CLO technology to tranche fund cash flows provides the ability to raise capital in the form of (rated) debt. In turn, this attracts fixed-income investors and allows those investors to choose an alternative means to invest into a product meeting a particular risk-return appetite. From the perspective of the investors in the underlying funds, CFOs provide an opportunity to free up capital and make additional investments in favoured sponsors and/or rebalance its portfolios to desired investment styles and industries on vintages. Given the foregoing benefits, we expect CFOs to continue to gain momentum in 2026 as a viable alternative investment solution.

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Christopher P. Duerden

Tel: +1 704 339 3113 / Email: christopher.duerden@dechert.com

Christopher P. Duerden, a partner in Dechert's Global Finance Practice, focuses his practice on securitisation and capital markets transactions. Mr. Duerden leads Dechert's Structured Credit and CLO team, which has not only been ranked one of the most active in the CLO market since it restarted but also one of the most distinguished in terms of industry awards for best CLO law firm. Mr. Duerden has extensive experience with CLOs, leveraged loan warehouse facilities and a variety of asset-backed securities transactions. In particular, he has focused on transactions involving the middle-market sector but also has significant experience with securitisations of trade receivables.

Arina Lekhel

Tel: +1 212 649 8759 / Email: arina.lekhel@dechert.com

Arina Lekhel brings more than two decades of experience advising fund sponsors on the formation, structuring and management of private investment funds. Ms. Lekhel's practice spans a diverse range of asset-backed private funds, funds of funds, credit funds, hybrid and evergreen funds, private equity funds, rated funds, CLO equity funds and hedge funds. She also advises clients on compliance matters, secondary transactions, co-investment and alternative investment vehicle structuring. Her deep expertise advising institutional investors and management companies on complex structuring issues includes joint ventures, mergers, spin-offs, profit-sharing arrangements, seeding transactions and risk retention vehicles.

Anthony Lombardi

Tel: +44 207 184 7343 / Email: anthony.lombardi@dechert.com

Anthony Lombardi is a partner in Dechert's Global Finance Practice, focusing on a diverse range of fund finance and structured finance transactions. Mr. Lombardi has extensive experience acting on NAV-based facilities, CFOs, hybrid asset-backed facilities for funds, GP facilities, co-invest/partner financing facilities, LP NAV facilities, capital call/subscription lines and other secured lending facilities backed by a variety of asset classes and financial products in both European jurisdictions and the U.S. Mr. Lombardi regularly acts for private equity funds, hedge funds, real estate funds, infrastructure funds, private debt, secondary funds, private banks, family offices and ultra-high-net-worth individuals.

Eric Zeng

Tel: +1 704 339 3119 / Email: eric.zeng@dechert.com

Eric Zeng focuses his practice on a broad range of structured finance and securitisation transactions, with an emphasis on leveraged loan warehouse facilities, loan to SPV facilities, CLOs and other asset-backed finance and securitisation transactions. He represents managers, arrangers and investors in finance facilities and securitisations backed by broadly syndicated loans, middle-market loans, infrastructure loans, bridge loans, insurance products and commercial mortgages. Mr. Zeng also advises managers and borrowers in a variety of fund financing structures, including CFOs, NAV facilities and rated feeders.

Dechert LLP

Three Bryant Park, 1095 Avenue of the Americas, New York, NY, 10036-6797, USA

Tel: +1 212 698 3500 / URL: www.dechert.com

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