

Introducing Fund Finance and Private IG Credit

How can defined benefit pension schemes use new alternatives to investment grade credit?



We consider these new opportunities to be attractive diversifiers for schemes that have the time horizon and broader liquidity to allocate to monthly dealt funds.



These new areas offer diversification through their differentiated underlying risk exposures relative to other liquid credit strategies.

Background

The maturing profiles of DB schemes has led to increased allocations to liquid credit, such as corporate bonds and ABS, as LDI collateral and liquid growth holdings.

Whilst we like these areas and support allocations, we see potential to increase portfolio efficiency by diversifying liquid holdings and recycling illiquid distributions into new areas.

We believe investment grade-rated credit strategies with different risk drivers are suitable options to achieve this.

Opportunities

Fund finance and private IG can diversify DB portfolios and maintain high credit quality without materially extending a portfolio's liquidity profile.

Fund finance targets cash +2.0-2.5% through short-term lending to private market funds, backed by investor commitments.

Private IG credit targets a higher return of cash +2.5-3.0% – delivering a premium over public IG without compromising on credit quality.

Strategic Role

These strategies could be used outside of a collateral waterfall to diversify / de-risk existing credit exposures.

Allocations could be funded from excess LDI collateral holdings.

Conversely, clients expecting illiquid distributions and/or looking to de-risk from semi-liquid funds could recycle into these new areas.

Monthly dealing terms and lock-in periods should be considered before making an allocation.

Please speak to your local Isio investment advisory contact if either of these strategies are of interest.

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Fund Finance Overview

Fund finance (also known as subscription-line finance/capital call finance) involves providing short-term loans to private market funds. These loans are secured against the uncalled capital commitments of the funds' investors. These loans are used as bridge financing by private market managers to manage the timing of investor capital calls.

The loans are often arranged by banks, who partner with investment managers to provide revolving credit facilities and fixed term loans.

The market for these loans has grown both in tandem with the private markets industry and as bank lending has become more constrained. The existing market is predominantly bank-driven; the value of total outstanding loans is estimated to be c.£1trn, with potential to grow further.

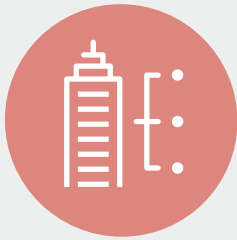


Isio View

We believe this opportunity has a similar risk/return profile to liquid ABS strategies and adds diversification through the differentiated nature of the underlying collateral – i.e. backed by investor commitments rather than corporate risk.

Whilst the underlying loans are illiquid, their short maturities help to mitigate liquidity risk – allowing managers to distribute funds quickly to meet redemption requests.

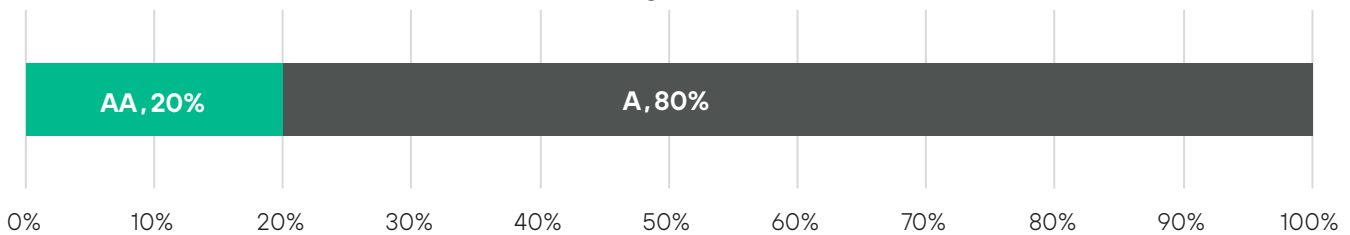
This is an evolving market – whilst there appears to be capacity, c.£1-2bn of new deal flow per year is less than traditional IG-rated areas. However, we believe investors are well-compensated for the credit and liquidity risk involved with in this strategy.



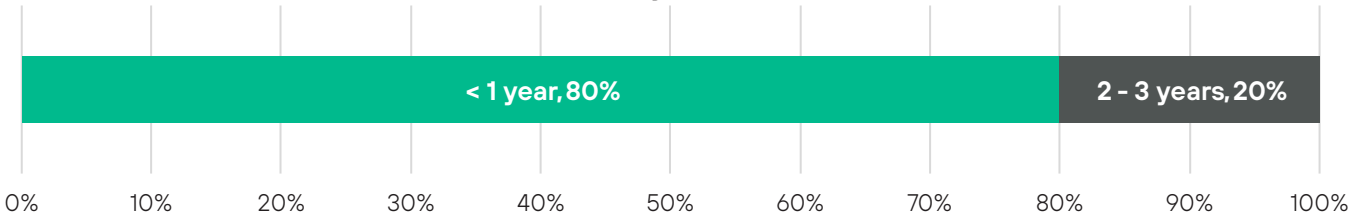
Asset Class Characteristics

Investment Purpose:	Working capital to bridge private fund drawdowns
Issuers:	Private market funds
Credit Spread (vs cash):	2.0-2.5% (gross of fees)
Credit Rating Exposure:	AA – A (100% IG credit exposure)
Geographic Breakdown:	Globally diversified (US, Europe, UK)
Fees (AMC):	0.25 - 0.35% p.a.
Interest Rate Duration:	Minimal due to floating rate structure
Liquidity Terms:	Monthly, with distribution tail

Credit Rating Breakdown



Loan Maturity Breakdown



Source: Investment Managers

Note: Characteristics and example exposures are indicative based on model portfolios/draft terms only

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Private IG Credit Overview

Private IG credit refers to debt provided to investment grade-rated issuers outside of traditional public bond markets. These loans are negotiated directly with the borrower, often with customized terms and conditions tailored to the borrower's specific needs.

The loans' bespoke nature, reduced liquidity versus publicly traded bonds, and a complexity premium from their structuring, offer a yield premium (c.1.5-2.0%) over equivalently rated publicly traded bonds.

IG-rated corporates utilise this option to diversify their funding sources and obtain more bespoke financing where required. These can be structured as bilateral loans or asset-backed positions. The securitisation markets also utilise this to obtain warehouse financing before issuing to the public debt market.



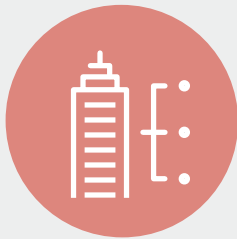
Isio View

We believe private IG debt is an attractive solution as it offers an additional credit spread over traditional publicly traded IG debt without comprising on credit quality.

From a risk perspective, it offers diversification across risk exposures, including a blend of corporate and consumer. These positions are often senior secured positions, providing strong security and downside protection. The bilateral nature of negotiations also provide lenders with greater control over the loan terms.

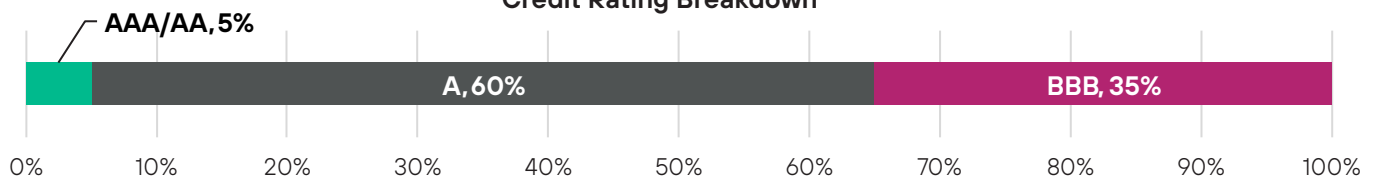
The underlying positions can be complex and less liquid given their bespoke nature – however, this drives the excess spread over liquid IG markets.

Asset Class Characteristics

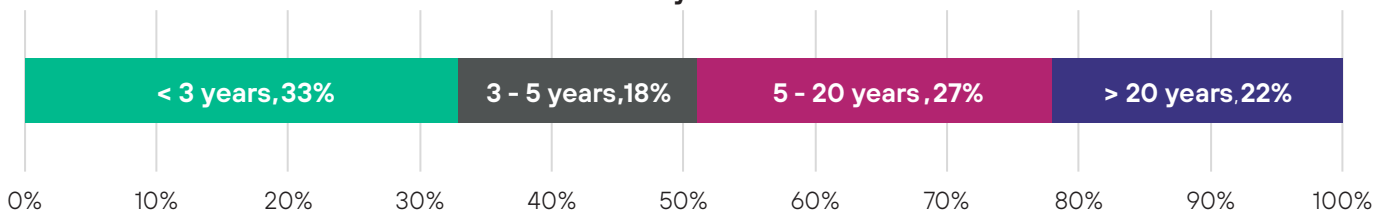


Investment Purpose:	Used by corporates to diversify their funding
Issuers:	Corporate, asset-backed
Credit Spread (vs cash):	2.5-3.0% (gross of fees)
Credit Rating Exposure:	A – BBB (100% IG credit exposure)
Geographic Breakdown:	Globally diversified (US, Europe, UK)
Fees (AMC):	0.40 - 0.60% p.a.
Interest Rate Duration:	2 – 4 years
Liquidity Terms:	Monthly, subject to notice periods

Credit Rating Breakdown



Loan Maturity Breakdown



Source: Investment Managers

Note: Characteristics and example exposures are indicative based on model portfolios/draft terms only

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