

Fund Finance Friday



Interview With Greg Fayvilevich of Fitch Ratings

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Industry Conversations

Capital Call Securitization Ratings:
A Conversation with Greg Fayvilevich



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The intersection of fund finance and securitization is an intense focus of the fund finance industry. So much so that just yesterday, Cadwalader hosted a first-of-its-kind Capital Call Securitization Conference in our New York office to an absolutely packed house with a standing room only crowd.

We here at *Fund Finance Friday* have been bringing our readers content to contextualize this developing market. The first publicly-rated cash capital call securitization hit the street in 2024 in a transaction formally called Capital Street Master Trust Series 2024-1. The market has cracked wide open to this possibility now and the brightest minds in fund finance and securitization are putting their heads to together to see what other approaches, structures and solutions may be possible.

In this week's FFF we follow up our [primer on capital call securitization](#) and our [overview of different approaches to these structures](#) by turning our focus to ratings.

First, a quick refresher on this topic. As most of our readers know, a capital facility or subscription facility (also known as a "subline") is a loan, generally a revolving credit facility, that is secured by the right to call for and collect capital calls from investors and the accounts into which investors fund capital contributions when capital is called. The uncalled capital of the fund's investors also forms the borrowing base for the financing.

Securitizations can take many forms but a general example of a securitization of loans involves a lender (generally a bank) selling a pool of receivables to a bankruptcy remote vehicle, which then issues securities backed by those receivables to investors. This is an example of a cash securitization where the assets are sold in a true sale and removed from the issuer's balance sheet. Securitizations may also be in the form of a synthetic securitization like a SRT/CRT transaction where the risk of the assets are transferred through a derivative contract (or other contract) but ultimately remain on the lender's balance sheet. Also, it is worth pointing out that a securitization is defined by the tranching of credit risk, so the issuance of securities is common but senior-sub loan interests also fit the bill.

I was delighted to speak with Greg Fayvilevich, the global head of Fitch Ratings' fund and asset management group. Greg has worked at Fitch Ratings for over fifteen years and has held senior analytical positions in Fitch's U.S. funds and financial guarantee groups. Greg said that "not a week goes by where they don't have a call on securitization" and was kind enough to give us his views of what he is seeing in the market, answer our questions, and explain Fitch's ratings methodology for capital call securitization.

Q: How does Fitch's ratings methodology for securitizations of sublines work ?

A: Fitch has a methodology for subline securitization that utilizes the tools we have for different products and uses that technology to apply it to capital call securitizations. Fitch employs a hybrid analytical approach which involves using the subline ratings criteria to assess the credit risk of each of the underlying subline facilities and couples that with CLO and global structured finance rating criteria to assess the portfolio in the aggregate and also consider the securitization structural features.

On the asset level, we conduct a look through analysis to the underlying sublines in the pool, which would include an assessment of LP overlap, individual facility advance rates, and qualitative factors, which is consistent with our subline methodology. We then model the LPs as one large pool, and this approach determines the final expected loss at the securitization level.

Q: What are some of the challenges with rating a subline securitization?

A: The biggest issue with a pool of sublines is the revolving structure of these facilities and that they are short term in nature. There are some lenders that have used term tranches to address this and that has been a solution that works but which is not possible for all lenders.

The question is how to address the revolvers; if the full loan, and not just the funded portion is included in the securitization then that may introduce counterparty risk and potential ratings caps that are not desirable.

Q: What about the risks to consider at the securitization portfolio level?

A: Key risks to consider in a pool of sublines include GP and LP diversification, the maximum advance rate, and qualitative factors like the size and sale of the GPs in the pool and the presence of key LPA terms which can impact the credit quality of the facilities. In addition, information disclosure limits can hamper the ability to analyze the collateral or can present operational hurdles. Ensuring these factors are sufficiently addressed is crucial to maintaining a stable and measurable risk profile over the life of the securitization.

Q: The Fitch ratings criteria for subline securitization leverages CLO methodology, why is that so useful for sublines?

A: CLOs are more straight forward to rate relative to subline securitizations, because the underlying leveraged loans in a CLO are all rated, providing a clear view on their credit quality. Other securitizations, like RMBS or ABS, can have thousands of loans in the securitization, which are not rated. These securitizations can be rated given the high level of diversification and good standardization among them and standard underlying documents. For example, each credit card loan has the same terms so it works. With leveraged loans in a CLO and sublines, they are both more bespoke loan products that are individually negotiated with different terms. The way to standardize the measurement of risk is a rating. In a CLO the leveraged loans are rated – many publicly – and the manager takes the loans and puts them in a CLO.

Sublines are either not rated or privately rated. We need to figure out how to standardize that. Eligibility criteria in a subline securitization work for some market participants because they assume sublines are a zero loss asset class. Therefore they may perform less due diligence on certain factors, especially qualitative ones like GP quality or terms of the LPA or credit agreement, which lenders for individual sublines consider important.

If a subline securitization is like a CLO where underlying loans are already rated and there is a standardized view then that is easier, particularly if the ratings are public. But this would be challenging as many GPs are still reluctant to approve public ratings. Fitch has rated about 300 sublines so far, and only about 20 are publicly rated (less than 10%).

Q: You have indicated that a potential option being explored for subline securitizations is eligibility criteria. Can you explain what that means?

A: This is a way for the ratings agency to get some information on the LP pool and other features of the documents such as the GP, key LPA terms, etc., which allows for some information sharing without sharing all the information on the deals.

Q: How does your approach change for individual facilities as opposed to a diversified pool? Are eligibility criteria relevant there?

A: When it comes to individual facilities, we do a lot of qualitative analysis in which we score the credit agreement and LPA terms, for example the default remediation provisions. And we do see some facilities where terms are weaker, or

open to interpretations, where a conversation with counsel is required, and it would be difficult to write these types of issues into eligibility criteria for a securitization.

Q: Sometimes when a ratings agency is looking to get its arms around a dynamic pool of assets, it will look to the criteria other entities with expertise will use such as bank lender criteria. Is that relevant for Fitch?

A: Bank lender criteria would be difficult to use because there have been so few LP defaults and subline defaults. That means that all banks' criteria and policies will not be differentiated in terms of actual performance. However, in practice we have seen some differences in the quality of the analysis that different banks do. There may be certain tight criteria that could be constructed to correlate very strongly with a high rating, for example a very diversified institutional investor base, with concentration limits and a mild advance rate of 70%, and high quality GP with high levels of AUM and experience. But most lenders won't have a portfolio that looks exclusively like this, and generally they would want to include less clear cut loans, such as those with concentrated LP pools or small and less experienced GPs.

Q: It is clear that the Fitch fund finance methodology really focuses on the LPs, how do the underlying loan documents come into play?

A: The most important element to consider is the LP pool and its diversification quality and we use that to simulate the type of losses you could see from that pool. The second element is the advance rate. We are going to compare projected losses with the credit enhancement available through the advance rate. In addition to the quantitative element of the analysis we also look to qualitative factors, including "bankable provisions" in the LPA, credit agreement terms (including standard points and additive elements like a NAV covenant), the quality of the GP, and importantly how much capital has been called and how the fund is performing.

The level of credit enhancement (advance rate) for a subline securitization will vary by portfolio. For example, for 30 diversified AA rated sublines, required credit enhancement would likely be very minimal, although we would consider the securitization's ability to absorb at least one facility failing for any reason during the life of the securitization. If there are more A or lower rated facilities, that constitutes a lower quality portfolio and credit enhancement required will increase. The stated concentration limits are also important, as this would drive the stressed portfolio that we may model, even if the actual portfolio of sublines is more diversified.

Q: How does Fitch's ratings methodology differ from those of its competitors?

A: Fitch uses specific ratings criteria for specific products. Whether it is sublines, secondaries NAV, or something else. To produce our fund finance methodology, we spent a year collecting data and thinking through the relevant issues. We invested in infrastructure and added about 45 people to our team. We have now rated about 300 facilities which gives execution certainty to the market. Fitch is very committed to doing this and staying in this market.

Q: What challenges does the fund finance market have with ratings and using ratings generally?

A: The fund finance market is still learning how to deal with ratings. The market overall is having some growing pains understanding the information that needs to be shared to get a rating and, once a rating is assigned, how to keep up with quarterly surveillance where you send information on quarterly basis. There is also sometimes a lack of understanding how deal terms can affect a rating. Going back to credit enhancement, if the parties amend their credit agreement to change the advance rate, that could have an impact on the rating. If your advance rate goes from 60% to 75%, the quality has declined.^[1]

^[1] Credit enhancement is how much of a loss you can take on an LP pool. If LPs default, the question is how much is covered. If you expect 10% default then your advance rate should be less than 90%. This is analogous to considering the right level for the cumulative default test in a subline.