

Fund Finance Friday



Securitisation of Capital Call Facilities Under Cayman Law

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As bank balance sheet constraints intensify and private credit competition increases, fund finance lenders are turning to securitisation as a strategic tool for capital efficiency. Capital call facility securitisation—once a niche innovation—is emerging as a meaningful product category. Securitisation enables lenders to transfer risk off their balance sheets, free up regulatory capital, and access diverse funding sources. Securitisation techniques have been applied in fund finance structures in the form of securitisations of capital call and NAV facilities, CFOs, rated note and CLO-type platforms, and other SPV-based financing. This marks a shift from traditional subscription and NAV facilities toward capital-markets-style funding that resembles securitisation mechanics.

The focus of this article is the Cayman Islands aspects of securitisation of capital call facilities, with particular attention to structuring considerations, risks, and fund documentation due diligence.

Capital Call Facilities Securitisation Structure

Securitisation involves pooling of assets that generate cash flow into tradeable debt securities, the repayment of which relies on the performance of the underlying asset pool. In a securitisation of capital call facilities, the originator (the lender under the relevant capital call facilities, which may be an investment bank, specialist investment firm, or a private credit lender) transfers its rights to receive payments generated by a portfolio of such facilities to a bankruptcy-remote SPV by way of a “true sale.” The SPV funds the acquisition of the portfolio by issuing rated or unrated tranching structured notes to investors.

Cayman Islands SPVs

Securitisation SPVs are typically incorporated in offshore financial centres such as the Cayman Islands and held by a purpose trust or a foundation company. Given that the economics of securitisation structures operate on a pass-through basis, the use of Cayman Islands structures is attractive to prevent the imposition of any unnecessary additional tax during the life of the transaction. The SPV will be structured as a bankruptcy-remote, orphan entity, isolated from the bankruptcy risk of the originator.

Notes issued by a Cayman Islands SPV issuer and listed on the Cayman Islands Stock Exchange (CSX) will qualify for the Eurobond exemption. The CSX is recognised by HM Revenue & Customs (HMRC) in the UK as a qualifying exchange for this purpose. As a result, securities listed on the CSX can benefit from the exemption, making it a popular venue for listing loan notes, structured debt, and private credit instruments intended for UK or international investors. Non-petition clauses enhancing bankruptcy remoteness, which prevent a party from initiating insolvency proceedings, are generally recognised and enforceable under Cayman Islands law.

Risks and Structuring Considerations

One of the main drivers behind securitisation is diversification of risk. While this is certainly achieved in the case of more traditional assets, such as mortgage loans or trade receivables, diversification in the case of subline portfolios may prove more challenging. One feature of capital call facilities is that certain fund sponsors share the same general partners, meaning that outcomes across various funds may be aligned, which diminishes the diversification impact.

In addition, despite lending to a variety of sponsor groups, the funds in the bank's portfolio may have identical limited partners, which may lead to significant overlaps in limited partner exposures. This concentration risk can be mitigated by appropriate concentration limits relating to exposures to limited partners and general partners, applicable on a portfolio basis.

Another challenge in structuring a capital call securitisation is a mismatch between the duration of subscription finance facilities and securitisation facilities. Subscription lines are typically short-term bridging facilities, whereas securitisations are characterised as investments with longer tenures. This mismatch can be addressed by structuring the portfolio as revolving rather than static, where the cash flows received from repayment of the capital call facilities in the pool can be reinvested in replenishing the pool with facilities meeting certain predefined eligibility criteria and concentration limits.

Well-calibrated eligibility criteria and concentration limits play a significant role in pricing the various tranches of structured notes. Criteria applicable directly to capital call facilities are likely to serve as the relevant guideline for assigning ratings to securitisations backed by portfolios of capital call facilities. Key pricing and risk factors include pool diversification and concentration limits.

These limits typically address maximum single-loan size, exposure to any single general partner (or affiliate group), exposure to affiliated limited partner groups, and loan maturity. Other key features to consider include the presence of early amortisation triggers typical for securitisation transactions, such as minimum overcollateralisation and excess spread tests. Credit quality of underlying limited partners (ideally investment grade) and their concentration, as well as the originating lender's track record with capital call loans (i.e., lack of material historic losses), will also have an impact on the risk profile of the notes. Finally, fund documentation requirements are also significant in determining the subline pool composition and are a matter of local law relevant to the asset—that is, the rights and obligations related to cash flows due from the underlying fund obligor.

The eligibility criteria of a legal nature typically present in capital call securitisations include: (a) senior obligation of the fund obligor being secured by a first priority, validly perfected security interest in favor of the originating bank as secured party in the LP commitments and the bank accounts into which capital contributions are made; (b) the fund's organisational documents not containing rights of setoff, counterclaim, or defenses to payment for the fund's investors making capital contributions; (c) the fund and/or its investors being established in certain jurisdictions with no impediments to the fund calling capital from such investors; and (d) security over the right to call capital being transferred together with the receivables of the capital call loan. Due diligence with respect to these items is a matter of local law, namely the law of registration of the fund vehicle.

Fund Documentation Considerations and Due Diligence

Subscription credit lines are short-term bridging facilities advanced to private funds (typically limited partnerships registered in offshore jurisdictions such as the Cayman Islands), the repayment of which is secured against the rights of such funds to call capital from their investors (limited partners, "LPs"). The loan documentation is structured in a way that permits the lender to step in and call capital in place of the fund in case the fund defaults under the facility and apply the called capital to repay the loan.

Security is created over the contractual obligations of the LPs to fund capital and the corresponding right of the fund to call for such capital. The enforceability of LPs' commitments and the related security is therefore a cornerstone of a capital call facility. In the context of a securitisation backed by a portfolio of such facilities, repayment of the structured notes hinges on the performance of the underlying asset pool, and therefore enforceability of the security package over such pool is also paramount from the investor's perspective.

Depending on market practice, capital call security is typically governed by either local law (in the case of English law facilities) or the relevant U.S. law (in the case of U.S. law facilities), where it is unusual to take additional local law security. The Cayman Islands is the jurisdiction of choice for establishment of vehicles in the U.S. fund finance market; therefore, this article assumes that the facility documentation in the case of transactions involving such vehicles is governed by New York law. While enforceability of security in this scenario is a matter of New York law, the priority of the security interest as against any competing security (capital call rights and obligations governed by the Cayman Islands LPA or LLC agreement) will be determined in accordance with Cayman Islands law.

Prior to originating a subscription facility, a lender will conduct due diligence on the underlying fund documentation to determine whether the contemplated financing arrangements are permitted or feasible, including the matters largely covered by the typical eligibility criteria described earlier in this article. The results of local law due diligence will

therefore have a significant impact on structuring of the subline facilities portfolio (by way of excluding facilities whose features do not meet the eligibility criteria or additional stress testing of issues identified during the due diligence process) as well as modelling of the securitisation of such assets. This due diligence constitutes a key document from both the originating bank's and the investors' perspective.

As capital call securitisation matures, market participants can expect increasing standardisation of eligibility criteria, refinement of rating methodologies, and potentially, secondary market liquidity. While the deal structuring process will take place onshore, the foundations of due diligence and documentation at the fund level remain an offshore matter—and Cayman Islands practitioners will continue to play a central role in supporting these transactions.