Monitoring underpins growth

Automated monitoring of payments and covenants is enabling debt funds to grow AUM substantially

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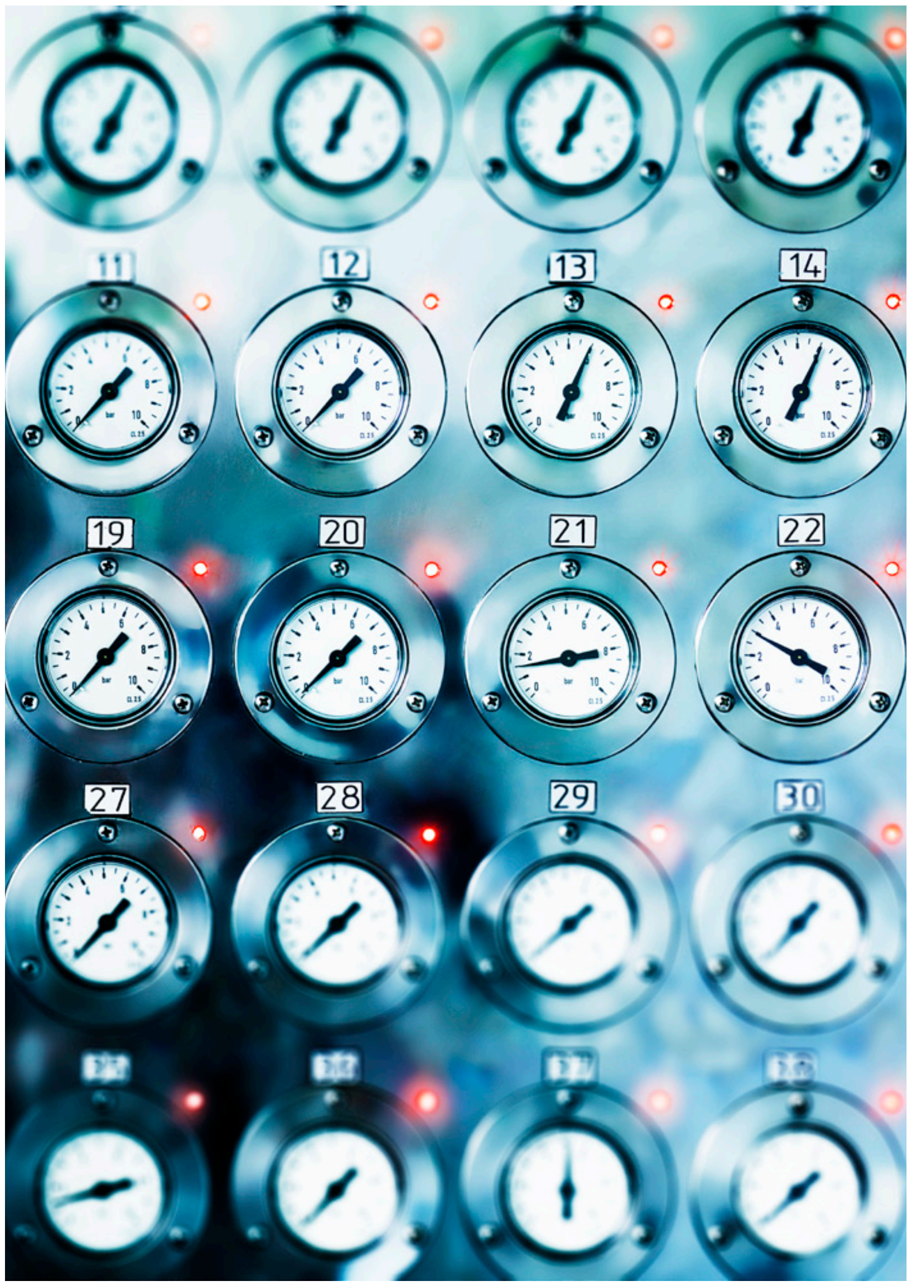
After the global financial crisis crippled banks 10 years ago, they were left with impaired loans, resulting in write-downs and diminished regulatory capital. An unexpected consequence has been a difficult financing environment for banks' traditional customers and the rise of private debt funds.



Debt funds manage almost US$600bn

Nature abhors a vacuum, as does capitalism. The shortage of bank financing has benefitted a new market participant: the closed-end private debt fund. According to the Financial Stability Board, 60% of global non-bank intermediation was provided by private debt funds in 2015. Preqin estimates that these funds command around US$600 billion in assets, which is quadruple their size in 2006.

Private debt funds have enjoyed success because they provide advantages to borrowers, investors and the stability of the system. Their fund managers are sophisticated judges of credit risk and they analyse and manage credit portfolios that include assets that fall outside the scope of traditional banks, including mid-market company loans, transitional real estate loans and personal unsecured loans. Furthermore, unlike banks, closed-end funds do not provide continuous liquidity, so they are not prone to 'bank runs'.

Infrastructure requirements

Some commentators have expressed doubts about whether the young debt fund management business has the infrastructure needed to closely monitor loans. Investment managers entering what was previously the territory of banks find themselves in need of a unique set of back office requirements, which vary by asset class. There are also differences when a manager originates a loan rather than buying it in the secondary market.

page 2 ▶

> A team that's familiar with each asset class can properly review loan documents

This is where an administrator with a dedicated bank debt team can play an invaluable role. The administrator's team can bring the necessary expertise in a wide range of asset classes, as well as loan closing and monitoring capabilities. Also key to a comprehensive administration service is the provision of dedicated portfolio management software, such as ClearStructure, which automates asset monitoring and accounting.

Working with pools of loans

Deal tracking differs depending on whether the debt fund manager buys pools of loans or originates assets, and administrators should be prepared for both scenarios. They should also be able to monitor loans after closing, to reconcile them with third-party servicers, custodians and the manager's systems. An administrator with a robust debt team that's familiar with each asset class can properly review loan documents, set up investments, monitor them and report consistently.

In the case of high yield or 'loan-to-own' investors, which operate in a niche area of the market, the administrator must understand the nuances of debt workouts. This includes debt-to-equity conversions, bifurcation of single loans into multi-tranche structures, and dual sets of books for bankruptcy.

Turning to the front office, the administrator's deal team needs reporting functions that consolidate the entire portfolio into easily digestible reports that cover exposures across borrowers, interest rate conventions, credit ratings, geography and industry.

Supporting debt fund managers

For debt fund managers filling the funding gap left by retrenching banks, loan monitoring is vital. But with specialist administrators expanding their services, and offering systems and people that can handle all the nuances of a complex debt portfolio, it should not hold back the continuing growth of private debt funds. □

For more on this topic, please refer to "Finding finance in an unpredictable era", page 9, Citco Industry Spotlight, Spring 2017

Key requirements for debt fund service providers

Debt funds rely on the skills and expertise of their fund management team.

But the team's job is made easier – and they will have more time to spend on analysis – if they have access to dashboards that provide quick access to deal summaries and can also depend on a service provider to deliver day-to-day loan management services.

Dashboards
- Capture all aspects of the loan portfolio in one place
- Monitor credit trends and pipeline
- Maintain deal specific asset summaries

Loan management
- Day-to-day loan administration (profit and loss, rate resets, fee calculations, drawdowns, repayments, reserve monitoring, earn outs)
- Track loan attributes (fixed / floating / payment-in-kind, borrower data, credit, industry, geography, term, participants)
- Monitoring (agent / servicer / custodian reconciliation / covenant tracking and reporting)
- General work flow (position reconciliations, participation reporting, cash movements, accounting, tax tracking, notices, document storage)

Citco's debt fund offering

If your fund is asset class specific or invests across different types of debt you need to be able to call on systems and people that can handle all the features of a complex debt portfolio.

Citco has a core team of industry professionals with expertise in private lending, real estate and bank debt, who can handle all loan administration needs.

Between our staff and our proprietary technology we have built an end-to-end solution for our clients' debt needs.

Citco continues to invest in the debt space and we are currently expanding our servicing offering as we seek to continue to provide best-in-class service.

> **Citco has built an end-to-end solution for debt managers**