
S&P Global

Market Intelligence

CASE STUDY

Leveraging a Comprehensive Alternative Investment Fund (AIF) Credit Assessment Scorecard

THE CLIENTS:

Financial institutions, prime brokers, and insurance companies

THE USERS:

Credit risk and fund finance teams

AIFs provide an option to invest in different asset classes – such as venture capital, private credit, and hedge funds – primarily for Limited Partners (LPs) that are typically large pension funds, endowments, and family offices. The trend toward fund financing for AIFs, where a lender takes risk against the uncalled capital of the underlying investors, has become popular since it can help aid a fund's liquidity and boost the Internal Rate of Return (IRR). Fund financing methods include subscription-line facilities, Net Asset Value (NAV) or asset-backed facilities, and a range of other structures at the fund level. This increased leverage within the AIF universe poses potential credit risks to various lenders to the funds. As such, the credit risk and fund finance teams at financial institutions and other lending organizations need a method they can rely on to assess the creditworthiness of AIFs.



Pain Points

Fund financing continues to grow in popularity. It is especially attractive in today's environment as funds actively seek liquidity due to the economic slowdown caused by the COVID-19 pandemic and lenders look to enhance yield given low interest rates. Subscription lines of credit, in particular, have expanded beyond their initial deal-related, short-term bridging function for private equity funds. As the AIF market matures, however, more transparency is needed to address a number of issues:

- **The AIF universe comprises mostly unrated entities and transactions**, so there is not an assessment of credit risk readily available.
- **AIFs normally involve multiple LPs with different levels of creditworthiness**, making it difficult to fully understand possible risks.
- **There is the potential for regulators to begin to sharpen their focus on AIFs** given concerns about how the use of leverage within the AIF sector may contribute to the build-up of systemic risk in the financial system.¹

AIFs are typically unrated and involve multiple LPs, making it difficult for fund finance teams to fully understand the potential risks associated with their lending activities.

With the significant increase in subscription-line facilities, credit risk and fund financing teams are looking to better understand their exposure. Several financial intuitions contacted S&P Global Market Intelligence ("Market Intelligence") to discuss the type of solutions and support that were available.

¹ "ESMA consults on guidance to address leverage risk in the AIF sector", European Securities and Markets Authority (ESMA), March 27, 2020, www.esma.europa.eu/press-news/esma-news/esma-consults-guidance-address-leverage-risk-in-aif-sector.



The Solution

Market Intelligence discussed its proprietary AIF Credit Assessment Scorecard that is an essential tool to identify and manage potential default risks with fund portfolios, as well as understand the various factors affecting a fund's creditworthiness.

The AIF Scorecard includes:

- An[®] Excel[®]-based model that provides a **consistent framework for calculating credit risk**.
- The **ability to identify default risk** through quantitative and qualitative factors tailored for AIFs. Users can generate probability of default (PD) values for AIF portfolios and perform sensitivity analyses, scenario analyses, and stress tests.
- **Credit scores** that are designed to broadly align with S&P Global Ratings credit ratings,² supported by historical default data back to 1981.
- **Technical documentation** describing the analytical/statistical processes used to develop the underlying model, identifying the data used in construction, and providing testing performance results.
- Scorecard implementation and application **training workshops**.
- Ongoing analytical and operational **support**.

² S&P Global Ratings does not contribute to or participate in the creation of credit scores generated by S&P Global Market Intelligence. Lowercase nomenclature is used to differentiate S&P Global Market Intelligence PD credit model scores from the credit ratings issued by S&P Global Ratings.



Key Benefits

The financial institutions felt that Market Intelligence offered a sound methodology and model to evaluate the credit risk of AIFs, as well as fund financing instrument-level credit risk. The teams value having:

- **An efficient and easy-to-use approach** for scoring portfolios for a wide range of AIFs.
- **Transparency** with in-depth model development documentation that identifies how the Scorecard was created and its use of data.
- **A rigorous annual review process** that validates the model to maintain its performance and reflect updates in a User Guide.
- **Training and on-going support** to understand the range of applications for the Scorecard and to receive on-going analytical support and updates.

To learn more about our AIF Credit Assessment Scorecard, [contact us here](#).

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