

Methodology

*Subscription Loan (Capital Call)*

NOVEMBER 2009



*Insight beyond the rating.*

---

## CONTACT INFORMATION

**Matthew La Capra, CPA**

Senior Vice President - Structured Finance  
+1 212 806 3259  
mlacapra@dbrs.com

**Jerry Van Koolbergen**

Senior Vice President - Structured Credit  
+1 212 806 3260  
jvankoolbergen@dbrs.com

---

DBRS is a full-service credit rating agency established in 1976. Privately owned and operated without affiliation to any financial institution, DBRS is respected for its independent, third-party evaluations of corporate and government issues, spanning North America, Europe and Asia. DBRS's extensive coverage of securitizations and structured finance transactions solidifies our standing as a leading provider of comprehensive, in-depth credit analysis.

All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, Web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.

This methodology replaces and supersedes all related prior methodologies. This methodology may be replaced or amended from time to time and, therefore, DBRS recommends that readers consult [www.dbrs.com](http://www.dbrs.com) for the latest version of its methodologies.



---

# Subscription Loan (Capital Call)

---

## TABLE OF CONTENTS

Description of the Capital Call Lending Facility	4
Purpose of the Methodology	4
How the Capital Call Lending Facility Works	4
Who are the LPs?	5
What is Being Financed?	5
Example of Allowable Borrowing Base	5
The DBRS Capital Call Rating	5
General	5
Strengths of Capital Call Deals	6
LP's Incentives to Fund	6
Cross Collateralization of LPs	6
Net Loss Experience	6
DBRS's Capital Call Rating Reliance	6
Primary Risk	6
Enforceability Opinion	7
Timing Opinion	7
FPPSI	7
Rating the Capital Call Lending Facilities	7
Bank Lines of Credit	7
Timing on Bank Lines of Credit (The Worst Case Scenario - Mitigating Stay Risk)	7
Liquidity Facilities on ABCP Conduits	8
Timing on Liquidity Facilities	8
Rating Levels on the Capital Call Lending Facility	8
DBRS Rating Baseline: The LPs That Back the Capital Call Commitments	8
Weak Link Approach	9
Key Factors That May Increase Risk in a Deal (Weak Link Approach)	9
Key Factors That May Decrease Risk in a Deal (Weak Link Approach)	9
CDO Technology Approach	9
General	10
Eligibility of LPs	10
Substitution of LPs	10
Concentration Limitations	10
Ceiling on Rating	10
Covenants / Eligibility Criteria / Structural Triggers	10
Surveillance	10
Surveillance During the Investing & Managing Stages	11
Surveillance During the Ramp Up Stage	11
Operational Reviews	11



## Description of the Capital Call Lending Facility

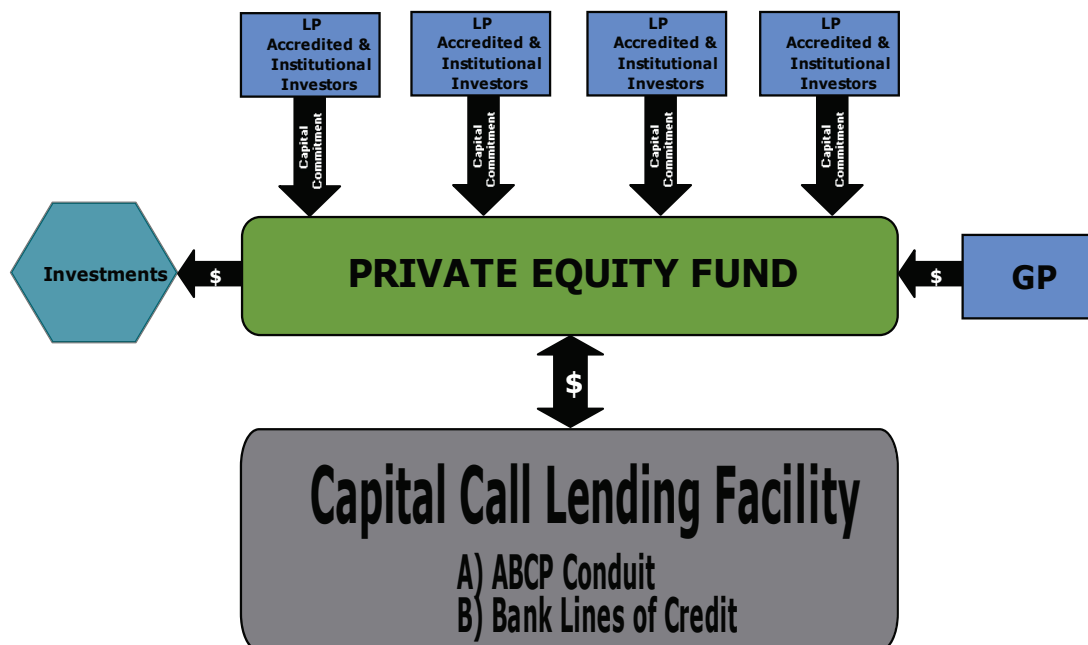
### PURPOSE OF THE METHODOLOGY

Private Equity, Real Estate and other related funds (“Private Equity Funds”) raise funds for investment purposes from the General Partner (“GP”) and the Limited Partners (“LPs”), (taken together, the ‘Investors’). The GP of the fund typically invests between 1% to 2% of total capital raised. The remaining balance of funds are raised from the LPs. The GP is charged with managing the fund on behalf of all of the fund’s Investors. For the purposes of this report, DBRS will disregard the GP’s portion of the investment to the fund since it is not germane to this methodology. The LP’s unfunded commitment is at the forefront of the DBRS rating on capital call lending facilities.

There has been a dramatic increase in capital call lending facilities as a means for the GP to act quickly to fund opportunities. These facilities have primarily been ABCP conduits and bank lines of credit. DBRS puts forth this methodology to rate the ultimate payment of P&I on the capital call lending facilities to the fund.

### HOW THE CAPITAL CALL LENDING FACILITY WORKS

The LPs have agreed, typically via a subscription agreement and partnership agreement, to fund investments or to repay fund liabilities when called upon by the GP of the fund. The LP’s commitment period to fund investments is generally 2 to 3 years; however, the LPs can generally be called upon to repay fund liabilities (which include capital call lending facilities) through the term of the partnership (generally up to 10 years). The capital call lending facility relies on the LP’s obligation to fund the unfunded portion of their capital commitment, herein referred to as ‘unfunded commitment’. When the GP targets an investment, the GP will ask the LP to fund its share of the investment (via a capital call). The LP generally has about 15 days to fund. If the GP needs to act quickly, or if it would rather finance the investment via the capital call lending facility, it will ask such facility to fund the investment.





## WHO ARE THE LPs?

The LPs are either qualified institutional investors or sophisticated accredited investors. They primarily consist of pension plans (public and private), endowments, institutional investors, funds of funds, family offices and high net worth individuals (HNWIs). These LPs typically sign a subscription agreement and partnership agreement which commit them to fund capital when called upon.

## WHAT IS BEING FINANCED?

The unfunded commitments of the LPs are the source of payment that will ultimately repay the capital call lending facility. The capital call lending facility will use an agreed upon advance rate to advance funds against the LP's unfunded commitment. The advance rate is generally 90% for rated institutional LPs and 65% for non-rated institutional LPs and HNWIs. As a result, capital call lending facilities, which may advance against both rated and non-rated institutional LPs and HNWIs, will have a blended advance rate of usually between 65% and 90%. The example below assumes an advance rate of 78% and applies it to the allowable borrowing base of the LPs which has been reduced for concentrations and other eligibility criteria.

### *Example of Allowable Borrowing Base*

Total Investor commitments to the fund	1,500,000,000
Investor commitments ineligible for the borrowing base of the Capital Call facility	500,000,000
Borrowing Base eligible commitments	1,000,000,000
Less: Excess concentrations	350,000,000
<b>Allowable Borrowing Base</b>	<b>650,000,000</b>
<b>Blended Advance Rate</b>	<b>78%</b>
<b>Borrowable amount</b>	<b>507,000,000</b>
Effective advance rate against Borrowing Base eligible commitments	50.70%
Effective advance rate against total fund capital commitments	33.80%

It should be noted that DBRS applies the blended advance rate to the allowable borrowing base without regard to the total investor commitments to the fund. However, all investor unfunded commitments are available to repay the capital call lending facility.

---

## The DBRS Capital Call Rating

---

### GENERAL

The DBRS capital call rating relies on the source of payment from the unfunded commitments of the LPs. More specifically, DBRS relies on the enforcement of such commitments, including enforcement following the bankruptcy of the fund itself. The LPs in the fund have agreed, typically in the relevant partnership agreement and a separate investor letter delivered to the capital call lending facility, to fund their capital commitments without defense, setoff or counterclaim. Analyzing the effect of the bankruptcy of the fund itself is necessary to this analysis because it is not a bankruptcy-remote entity. Thus, the worst case



scenario must address the bankruptcy of the fund at the worst possible time. More on this in the Rating the Capital Call Lending Facilities section on Pg.7. The DBRS rating is issued based upon the expectation of the ultimate payment of P&I.

## STRENGTHS OF CAPITAL CALL DEALS

- 1) The LP's Incentives to Fund
- 2) Cross Collateralization of LPs
- 3) Net Loss Experience

### *LP's Incentives to Fund*

If an LP in a Private Equity Fund decides not to fund its unfunded commitment, the LP will face a penalty, which generally includes a diminution of its ownership interest in the fund. Penalties are set in each partnership agreement and generally range between 20% to 100% in diminution. Thus, each LP, after it has funded capital, has a strong incentive to continue to fund future capital calls of its unfunded commitment. Further, in the event that the LP is unable to fund its unfunded commitment, it, often along with the GP, will look for a replacement to assume that LP's commitment (rather than lose its investment). While this is a clear strength in capital call lending facilities, the potential sale of the partnership interest is not relied upon in the DBRS rating. It should also be noted that the agent for the capital call lending facilities and the GP typically must consent to the transfer or sale of the partnership interest to an LP, thereby safeguarding the quality of the capital call lending facility's borrowing base. Further, at no time can the borrowing base not be in compliance with the advance rate agreed upon with the lenders.

### *Cross Collateralization of LPs*

If an LP were unable to replace itself and defaulted on its commitment to fund, the other LPs would be obligated to fund up to their unfunded commitments. Thus, there is a cross collateralization among LPs that benefits the capital call lending facility.

### *Net Loss Experience*

It is widely understood that the historical loss on capital call deals have been remarkably low. Nonetheless, DBRS will review the prior net loss experience for each fund sponsor seeking a capital call lending facility rating.

## DBRS's CAPITAL CALL RATING RELIANCE

The DBRS capital call rating relies on:

1. An enforceability opinion
2. An opinion as to timing of ultimate payment after a fund bankruptcy
3. A First Priority Perfected Security Interest ("FPPSI") on the source of payment (the unfunded commitments of the LPs)

## PRIMARY RISK

The primary risk with respect to the ultimate payment of the capital call lending facility is that the LPs will not fund. Considering the aforementioned strengths of capital call deals mentioned above, the risk is very low. However, DBRS considers the bankruptcy of the fund itself to be the primary risk in capital call deals because the LPs lose their natural incentive to fund but are still legally obligated up to their unfunded commitments. The DBRS capital call rating addresses this risk.



## ENFORCEABILITY OPINION

The LPs waive all rights, namely:

1. Setoff
2. Counterclaim
3. All Defenses<sup>1</sup>

DBRS must be satisfied that the enforceability of the LP's unfunded commitment is enforceable both pre and post-bankruptcy of the fund.

## TIMING OPINION

Assuming the fund enters bankruptcy on the day before the stated maturity date of the repayment of the rated liability, DBRS must be satisfied that an opinion states that all payments should be paid out within the timeframe of one year after the fund bankruptcy. The section below, called Timing on Bank Lines of Credit (The Worst Case Scenario - Mitigating Stay Risk), will detail the importance of this opinion.

## FPPSI

The agent for the capital call lending facility has a First Priority Perfected Security Interest ("FPPSI") in the uncalled commitments of the LPs in the fund. Specifically, the agent, on behalf of the lenders, has a security interest in the contractual obligation of the LPs to fund capital when called upon, up to their unfunded commitment amount. The agent also has been given an assignment of the right to call such unfunded commitment. Upon the occurrence of any default under the capital call lending facility (including the bankruptcy of the fund (further discussion below)), the agent for the capital call lending facility has the sole right to call the LPs to fund their unfunded commitments, the right to receive the capital contributions and the right to direct those funds into a segregated account for the benefit of the capital call lending facility.

## RATING THE CAPITAL CALL LENDING FACILITIES

Generally, the two types of capital call lending facilities are:

1. Bank Lines of Credit
2. Liquidity Facilities on ABCP Conduits

## BANK LINES OF CREDIT

A bank may provide financing for Private Equity Funds. DBRS rates to the ultimate payment of P&I. This analysis must consider worst case scenario timing to be comfortable that P&I will ultimately be paid within a specified period of time following the initial stated maturity date of the bank line of credit under the related loan documents. As such, the DBRS rating is based upon an expected final 'Collection Date'<sup>2</sup>. The term 'Collection Date' is discussed further on the following page.

### *Timing on Bank Lines of Credit (The Worst Case Scenario - Mitigating Stay Risk)*

DBRS assumes the fund enters bankruptcy one day before the stated maturity date on a bank line of credit. DBRS also assumes a *Stay*<sup>3</sup> is put into place and the stated maturity date will not be paid timely.

---

1. All Defenses include any defense against fraud.  
2. For the purposes of this report, the term 'Collection Date' will mean the date that is, at a minimum, 18 months after the initial stated maturity date on bank lines of credit. Details can be found in the Timing on Bank Lines of Credit above.  
3. A Stay can be described as a judicial order holding any payments from a recently bankrupt entity in abeyance.



DBRS must be satisfied that an opinion conveys that upon such events, all monies due from LPs will be paid within one year of the bankruptcy of the fund.

It naturally follows that the term 'Collection Date' on bank lines of credit must have a due date comfortably in excess of a year after the initial stated maturity date. The Collection Date for capital call deals should be defined as no shorter than 18 months after the initial stated maturity date. The DBRS rating will address the ultimate payment of P&I on or before the Collection Date (or similar meaning term) in the legal documents. This is a sufficient mitigation of stay risk in capital call deals.

It is important to note that all funds are expected to be collected at the initial stated maturity date and will be enforced to the full extent possible for collection on and after that date. Also, the legal contract should extend, at a minimum, through the Collection Date.

## LIQUIDITY FACILITIES ON ABCP CONDUITS

ABCP conduits are increasingly financing capital call deals. Specifically, when an ABCP conduit funds a capital call deal, it initially does so through the ABCP market. If the funds from the LPs are not adequate to pay the ABCP timely, the conduit will fund the ABCP through the liquidity facility and thus the payment is ultimately due to the liquidity facility supporting the capital call deal in the conduit. Therefore, the ultimate timely payment of the liquidity facility must be addressed in the DBRS rating.

### *Timing on Liquidity Facilities*

Because the liquidity facilities are provided by the sponsor bank, often the due date on the principal is after the funds have been received. The interest portion can also be handled this way for specific deals but, nonetheless, the DBRS rating addresses the ultimate payment of P&I. Further, the over-collateralization in a typical capital call deal effectively covers any accrued interest payments through the time it would take to settle.

---

## Rating Levels on the Capital Call Lending Facility

---

### DBRS RATING BASELINE: THE LPs THAT BACK THE CAPITAL CALL COMMITMENTS

The DBRS rating relies on the LP's commitment to fund. There are generally two groups of LPs that are included in the allowable borrowing base<sup>4</sup>:

1. The first group are those institutions that have or have implied senior unsecured ratings (generally highly rated) from an acceptable NRSRO. This group will typically have an advance rate under the capital call lending facility equal to 90% of the aggregate unfunded commitments of these LPs. That is, the facility will lend \$90 against \$100 of unfunded commitment of these LPs.
2. The second group are those Institutions / HNWI's that do not have a rating. This group will typically have an advance rate under the capital call lending facility equal to 65% of the aggregate unfunded commitments of these LPs. That is, the facility will lend \$65 against \$100 of unfunded commitments of these LPs.

Depending on the mix of LPs, the advance rate will typically be a blended rate.



DBRS employs two distinct methods by which a rating can be reached by analyzing a pool of LPs:

1. Weak Link Approach
2. CDO Technology Approach

For both approaches, DBRS will ask for Rating Agency Notification (RAN) if any LP is replaced or defaults.

## WEAK LINK APPROACH

The weak link approach is applicable if a fund has nine or less rated (or implied rated) LPs. The DBRS rating on the capital call lending facility will then be capped at the lowest rated LP. Because of the nature of the weak link approach, a change in LPs could materially change DBRS's view on the risk profile of the deal. That said, DBRS will ask for Same Day RAN<sup>5</sup>. At such point, DBRS will re-analyze the deal to see if any rating action should be taken.

The weak link approach should be considered a baseline benchmark for capital call deals with less than 10 LPs. There are key factors that can increase or decrease the risk within a deal.

### *Key Factors That May Increase Risk in a Deal (Weak Link Approach)*

- The possible substitution of LPs rated lower than the present LPs.
- The possible downward migration of highly rated LPs.

### *Key Factors That May Decrease Risk in a Deal (Weak Link Approach)*

- The magnitude of the cross collateralization of highly rated LPs relative to the lower rated LPs in the pool.
- The amount of excess overcollateralization within the allowable borrowing base relative to the deal advance rate.
- On an exception basis, DBRS will consider the credit worthiness of LP(s) outside the allowable borrowing base upon request. If DBRS can formulate a credit opinion on such LP(s), the uncommitted funded amount can be used to mitigate some or all of the reliance of the unfunded amount of the lower rated LP(s) in the pool.

It should be noted that any of the above enhancing factors can be used in conjunction with each other to mitigate weaknesses in the deal.

## CDO TECHNOLOGY APPROACH

The CDO technology approach is an application of DBRS's CDO Toolbox<sup>6</sup> used to derive ratings based on advance rates for individual capital call lending facilities.

The application of CDO technology assumes that the entities within the pool have a measurable level of credit worthiness and are sufficiently homogenous both within and across these types of facilities. The CDO Toolbox will derive attachment points, which will be compared to the advance rate for that particular fund to derive the expected performance of the capital call lending facility in order to assign individual rating grades.

---

5. Same Day RAN – DBRS will ask for Notification of any LPs that are being replaced or defaulting. The term 'same day' should be understood to mean that as soon as the Lender has notice of the above, DBRS expects to know the same day.

6. Applications are based on DBRS methodologies: 1) The CDO Toolbox (April 07) and 2) Rating Global High Yield Loan Securitizations, Structured Loans and Tranching Credit Derivatives (March 09).



---

## General

---

### ELIGIBILITY LPs

Because the DBRS rating for capital call lending facilities relies on payments from the LPs under all circumstances, DBRS will review the eligibility of the LPs for each transaction.

### SUBSTITUTION OF LPs

As noted prior in this presentation, the ability of one LP to ‘step in’ for another is an added strength in capital call deals. However, due to the reliance on the payments from LPs, DBRS will review the substitution criteria in place for each deal. The protection of the borrowing base is at the forefront of this specific analysis.

### CONCENTRATION LIMITATIONS

Concentration limits for the LPs in each capital call deal are incorporated into the DBRS rating decision.

### CEILING ON RATING

As a policy matter, DBRS will not rate capital call lending facilities higher than AA.

### COVENANTS / ELIGIBILITY CRITERIA / STRUCTURAL TRIGGERS

DBRS reviews each capital call lending facility on an individual basis. The covenants, eligibility criteria, events of default and structural triggers of each facility are considered in the DBRS analysis.

---

## Surveillance

---

As a preface to this section, the stages of the Private Equity Fund are germane to the scope and nature of the surveillance DBRS will conduct. There are three distinct phases to the Private Equity Fund:

1. **Ramp Up Stage** - This stage is characterized by the GP raising commitments from the LPs to fund its venture. This stage typically lasts 9 to 12 months following the initial closing of the fund.
2. **Investment Period Stage** – This stage is characterized by a static pool of LPs that are expected to fulfill their commitments within this time period. This stage is usually 3 to 5 years. It should be noted that the LPs are contractually obligated to fund investments for the 3 to 5 year period noted above and are generally legally responsible through the entire life of the fund (which is usually not more than 10 years) to repay fund liabilities. This is clearly the most active phase for the capital call lending facilities. Typically, this is the stage in which the agent for the capital call lending facility will seek a rating.
3. **Managing Stage** – This phase is marked by the GP managing the investments until the fund winds down.



## SURVEILLANCE DURING THE INVESTING & MANAGING STAGES

DBRS will monitor capital call lending facilities as appropriate in order to capture unfolding risks that may occur. Primarily, DBRS will review a compliance certificate that, along with other information, should certify that:

- No transfers from LP to LP have occurred.
- No covenants have been breached.
- No triggers have been breached.
- No LPs have defaulted.

## SURVEILLANCE DURING THE RAMP UP STAGE

Surveillance during the ramp up stage includes, but is not limited to, the review of the compliance certificate and any other information DBRS deems necessary to ascertain that the risk profile of the rated deal remains unchanged. For those deals that were initially rated during the ramp up stage, the LPs are likely to change. Therefore, DBRS will conduct a re-evaluation of the deal after the ramp up stage has concluded and the investment period stage begins.<sup>7</sup>

## OPERATIONAL REVIEWS

DBRS will typically conduct an Operational Review on the capital call lending facility being rated and, if necessary<sup>8</sup>, the GP of the fund in order to reach and maintain such rating.

---

7. During the investment period stage, it would be highly unusual for LPs to change.

8. The decision on whether to conduct an operational review on a GP will be largely based on DBRS's familiarity with that GP.

Copyright © 2010, DBRS Limited, DBRS, Inc. and DBRS Ratings Limited (collectively, DBRS). All rights reserved. The information upon which DBRS ratings and reports are based is obtained by DBRS from sources DBRS believes to be accurate and reliable. DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance. The extent of any factual investigation or independent verification depends on facts and circumstances. DBRS ratings, reports and any other information provided by DBRS are provided "as is" and without representation or warranty of any kind. DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall DBRS or its directors, officers, employees, independent contractors, agents and representatives (collectively, DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of ratings and rating reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of DBRS or any DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. Ratings and other opinions issued by DBRS are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness or recommendations to purchase, sell or hold any securities. A report providing a DBRS rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. DBRS receives compensation for its rating activities from issuers, insurers, guarantors and/or underwriters of debt securities for assigning ratings and from subscribers to its website. DBRS is not responsible for the content or operation of third party websites accessed through hypertext or other computer links and DBRS shall have no liability to any person or entity for the use of such third party websites. This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of DBRS. ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AT <http://www.dbrs.com/about/disclaimer>. ADDITIONAL INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON <http://www.dbrs.com>.



*Insight beyond the rating.*

[www.dbrs.com](http://www.dbrs.com)

---

**DBRS, Inc.**  
140 Broadway  
35th Floor  
New York, NY 10005  
TEL +1 212 806 3277