

# Net Asset Value Finance Rating Criteria

## Master Criteria

### Scope

This report outlines Fitch Ratings' methodology for rating obligations backed by the net asset value (NAV) and cash flow of funds or other entities that primarily invest in limited partnership (LP) interests of alternative investment funds. These obligations are often referred to as NAV loans to secondary funds. This report should be read in conjunction with *Private Equity Collateralized Fund Obligations (PE CFO) Rating Criteria*, which describe the modelling approach referenced here.

### Key Rating Drivers

The NAV loan rating is anchored by Fitch's cash flow modelling, which maps to a quantitative rating indication (QRI). Qualitative factors contribute to an overall qualitative assessment (QA) that can result in notching from the QRI, with the rating subject to a rating cap.

**Quantitative Rating Indication:** Fitch uses its proprietary PE CFO model to project portfolio cash flows based on the characteristics of the assets and loan-specific structural features such as maturity, amortisation schedule and loan-to-value (LTV) triggers. The stressed residual LTV at maturity generated by the modelling is mapped to a QRI between 'a' and 'ccc'. The QRI is the anchor from which the NAV loan rating is notched by the QA, and as such is usually expected to have the highest influence on the rating.

**Qualitative Assessment:** The QA is guided by the factors described below – Asset Quality, Additional Sources of Repayment and Liquidity, Fund and Manager, and Structure – and can result in notching from the QRI. The notching range is limited to +5 notches, but there is no limit to the number of downward notches.

**Asset Quality:** Fitch evaluates asset-quality attributes that are not directly or fully addressed through modelling, such as the quality and diversification of the assets backing the NAV loan, as well as the experience of the fund managers of underlying funds. The notching range for this factor is -2 to +2 notches.

**Additional Sources of Repayment and Liquidity:** The availability of additional sources of repayment and liquidity for the NAV loan can potentially have a positive impact on the rating. These sources may include excess cash beyond the contractual sweep requirements of the NAV loan, uncalled capital commitments (UCC), liquidity facilities at the fund level or assets outside the collateral pool, which are available to repay the outstanding loan. The notching range for this factor is 0 to +2 notches.

**Fund and Manager:** The fund manager's (sometimes referred to as the general partner, or GP) resources, operational capabilities, experience and market access can influence the risk profile of the NAV loan. The notching range for this factor is -2 to +2 notches.

**Structure:** Fitch expects the terms of the NAV loan agreement and limited partnership agreement (LPA) to typically be neutral to its rating analysis, except where terms are unusually strong or weak. The notching range for this factor is -3 to +1 notches.

**'A+' Rating Cap:** Fitch applies a 'A+' rating cap to NAV loans to reflect the limited availability of performance history for the product, uncertainty related to fund investment performance and timing of cash flows, subjectivity of asset valuations, lags in performance reporting and refinancing and market value risks if portfolio cash flows are insufficient to repay the loan by maturity.

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This criteria report replaces the exposure draft dated 3 September 2024.

### Related Criteria & Research

- [Private Equity Collateralized Fund Obligations \(PE CFO\) Rating Criteria \(January 2025\)](#)
- [Net Asset Value Facilities: A Primer \(April 2024\)](#)
- [Subscription Finance Rating Criteria \(June 2023\)](#)

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## Overview of the Rating Framework

In assigning a rating to an NAV loan, Fitch follows the process described below and, in further detail, throughout this report.

The cash flow modelling maps to a QRI between 'a' and 'ccc', with potential notching based on the qualitative factors, with the final rating subject to a 'A+' cap. Each qualitative factor includes several attributes assessed, as described below.

### Rating Derivation Diagram

Stressed Residual LTV	QRI Generated Between 'a' and 'ccc' Based on the Matrix 'Residual LTV Mapping to QRI'					
Notching from the QRI	+2 Notches	+1 Notch	No Notching	-1 Notch	-2 Notches	-3 Notches
Asset Quality	←————→					
Additional Sources of Repayment and Liquidity	←————→			————→		
Fund and Manager	←————→					
Structure	————→	←————→				
QA notching from the QRI	Overall QA notching is guided by the notching ranges for the qualitative factors above, subject to a limit of +5 notches					
Rating cap	'A+'					
Assigned rating	QRI +/- QA adjustment, subject to cap					

Source: Fitch Ratings

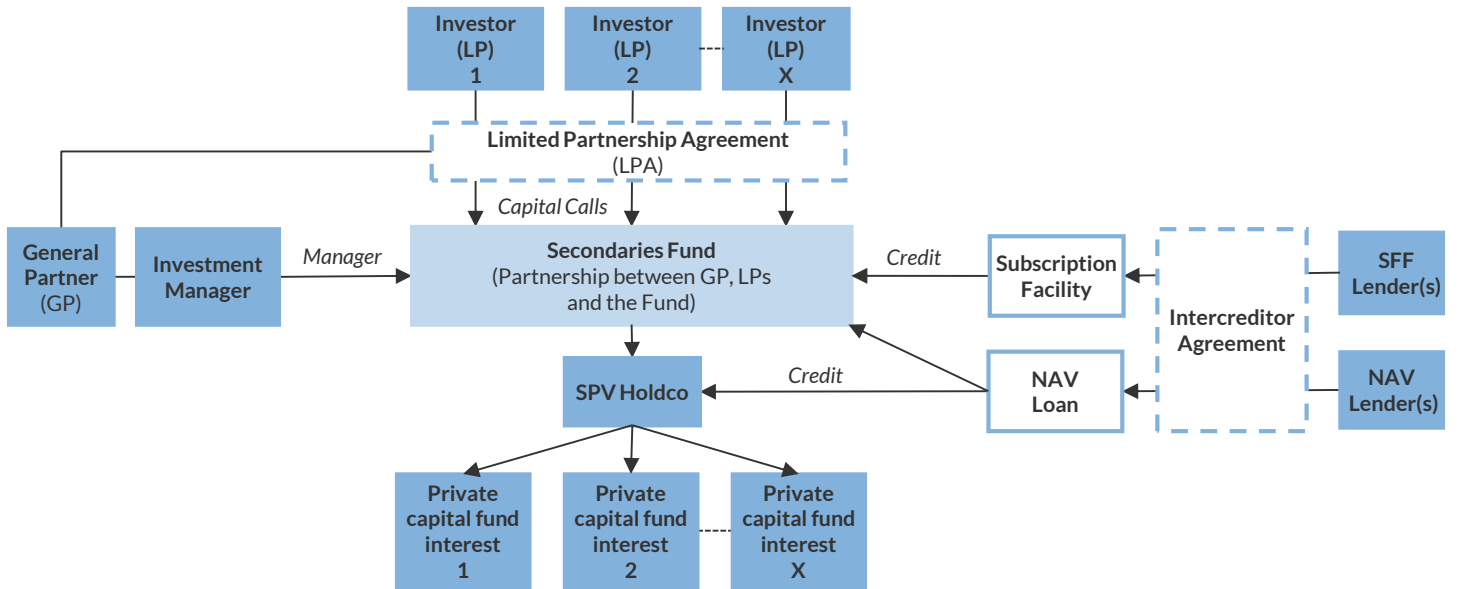
### Rating Process

Subject to a preliminary review of the NAV loan originator/lender, the governing documents of the fund and the loan, and other legal documentation indicating that an NAV loan is rateable, Fitch applies the following rating process:

1. Modelling the portfolio's cash flow using Fitch's PE CFO model under various stress scenarios.
2. Applying the modelled portfolio cash flows to the NAV loan waterfall to determine the QRI as a function of the rating stress-based matrix outlined herein, potentially adjusted further depending on Fitch's sensitivity analysis.
3. Assessing the Asset Quality, Additional Sources of Repayment and Liquidity, Fund and Manager, and Structure qualitative factors, to arrive at an overall QA notching adjustment, up, down or neutral, from the QRI, and applying the overall 'A+' cap, to arrive at the NAV loan rating.
4. After the initial rating assignment, monitoring and assessing the NAV loan's ongoing performance based on a review of the modelling and qualitative factors.

The rating framework seeks to address the loan's relative vulnerability to default and will be applicable on a global basis to both initial ratings and surveillance. The ratings are assigned on the 'A+' to 'C' scale, at a notch-specific level, with a 'D' rating assigned upon default as described in this report. Fitch assigns Outlooks to the ratings, including at inception (see Fitch's *Ratings Definitions* for additional details).

Simplified Structure of Typical Secondaries Fund and NAV Loan



Source: Fitch Ratings

Key Rating Drivers

This section outlines how Fitch assesses each of the key rating drivers (KRDs). A committee determines the QRI, as well as the overall potential notching adjustment based on the QA, which is guided by the Asset Quality, Additional Sources of Repayment and Liquidity, Fund and Manager and Structure qualitative factors. In determining the magnitude of the QA notching, Fitch will consider the attributes described under each qualitative factor in a holistic manner based on available data for the attributes considered most relevant, not as an average or weakest link of the attributes described.

While this report primarily addresses NAV loans in the context of secondaries funds, other types of secured or unsecured NAV loans, such as to non-fund entities, can also be considered, and, in those cases, some of the factors described below may be more or less relevant, or applied with adjustments as appropriate. Fitch may also consider other qualitative or quantitative attributes within the KRDs if appropriate, and may use proxy data to inform its analysis.

Quantitative Rating Indication

To generate the QRI, Fitch uses the PE CFO model to derive stressed residual LTVs at the maturity of the NAV loan. Residual LTV is the value of the loan remaining outstanding at the loan's maturity as a percentage of the value of the assets remaining at the loan maturity. For example, if the modelled remaining loan balance at maturity is USD20 and the value of the remaining assets is USD100, the residual LTV would be 20%.

Within each rating stress level ('BB', 'BBB' and 'A'), Fitch runs multiple 'launch year' scenarios simulating different economic conditions, corresponding to historical market cycles, as described in the PE CFO Rating Criteria report. The launch year scenarios are meant to simulate how the portfolio and loan structure would have performed if the transaction was launched at various periods in the past. The scenarios include at least one historically observed material stress period relevant to the assets in the portfolio, for example, the 2008 downturn.

For each launch year scenario within each rating stress, Fitch calculates the residual LTV at the maturity of the loan, which could be 0% if the loan is repaid at or prior to maturity under the scenario. For each rating stress level, Fitch selects the highest (worst) residual LTV of all underlying launch year scenarios to capture the interaction between the portfolio, the structure of the transaction and potential economic conditions. For example, if the 'A' stress scenarios generate residual LTVs ranging from 6% to 18% under various launch years, then the overall

residual LTV applied for the 'A' stress will be 18%, the highest residual LTV, with similar approaches applied for the 'BBB' and 'BB' stresses.

Fitch will use the highest residual LTV generated at the 'A' stress to derive the QRI, based on the mapping table below. QRIs for the 'BBB' and 'BB' stresses will serve as a floor to the overall QRI. This is done to avoid the QRI derived under a higher stress scenario (i.e. the 'A' stress) being lower than the QRI under a lower stress, such as 'BBB'.

For example, if the 'A' stress generated a residual LTV at maturity of 32% in the worst launch year scenario, then the QRI at the 'A' stress would be 'bbb-' based on the table below. However, if the 'BBB' stress generated a residual LTV at maturity of 0% then the QRI at the 'BBB' stress would be 'bbb'. Under this scenario, the transaction-level QRI would be 'bbb', the higher of the 'A' and 'BBB' stress level QRIs.

### Residual LTV Mapping to QRI (%)

QRI	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-	ccc
'A' model stress-level residual LTV (anchor)	0	≤10	≤20	≤30	≤40	≤50	≤60	≤70	≤80	≤90	≤100	>100
'BBB' model stress-level residual LTV (floor)	-	-	-	0	≤10	≤20	≤30	≤40	≤50	≤60	≤70	>70
'BB' model stress-level residual LTV (floor)	-	-	-	-	-	-	0	≤20	≤40	≤50	≤60	>60

Source: Fitch Ratings

Fitch uses its PE CFO model given the similarity of the cash flow characteristics of the underlying LP portfolio interests between PE CFOs and NAV loans to secondaries funds. Please refer to [these criteria](#) for more in-depth detail of the model.

The model incorporates transaction expenses, interest payments, LTV covenants, subordination of tranches, and amortisation schedules into its projections. Fitch may also consider scenarios where cash flows modestly in excess of contractually required amounts are directed to pay down the NAV loan. This may be the case if Fitch believes the manager has a record of operating in this manner and/or appropriate incentives to manage risk in this manner. For example, if the maximum LTV covenant is 50%, Fitch may model that the manager will use available cash to maintain the LTV at 45%, below the maximum contractually stipulated, as a prudent risk management strategy to avoid triggering an event of default.

The starting point for the PE CFO model is the NAV of the underlying funds, with potential adjustments to valuations as discussed in the *PE CFO Rating Criteria*. To model asset performance, Fitch maps a sufficiently material portion of the portfolio to historical data cohorts similar to the funds in the portfolio, and may use proxy, average, or aggregated data where information is limited or exposures are less material.

Fitch may estimate modelling of certain transaction terms where such assumptions are likely to be immaterial to the analysis. Use of proceeds for the NAV loan is implicitly considered in the modelling based on the assets and liabilities of the fund, but is otherwise not generally explicitly adjusted for qualitatively. Where new investments are expected to be added to the portfolio, Fitch will model these assets based on its expectations for the fund's strategy and the manager's prior experience, as further described in the PE CFO criteria.

Given the less-structured nature of NAV loans compared with PE CFOs, as well as due to the greater emphasis on the assessment of the fund manager in the NAV criteria, Fitch adjusts certain assumptions it makes in the PE CFO model when applying it to NAV loans. For example, Fitch does not apply additional foreign-exchange (FX) stresses in the model, since FX exposure is assessed in the Asset Quality factor. Fitch does not apply a limit on exposure to continuation funds in the portfolio holdings of secondaries funds, subject to the assessment of the manager's experience in the Fund and Manager factor. Additional adjustments may be made where appropriate.

In cases where Fitch has access to the GP's cash flow projections, and a sufficient understanding and confidence in the drivers and likelihood of the projections, Fitch may consider these cash flows in its sensitivity scenarios and in determining the QRI. Fitch may also incorporate information provided by the GP or lenders, such as expectations for capital calls or imminent distributions, into its modelling assumptions.

## Qualitative Assessment

Fitch's QA of the transaction results in an overall notching adjustment, up, down or neutral, from the QRI. The QA is based on the qualitative factors described below – Asset Quality, Additional Sources of Repayment and Liquidity, Fund and Manager, and Structure. The QA notching adjustment is guided by the factors noted herein and will typically not materially deviate from the sum of the notching for individual factors. The QA is subject to a maximum upwards adjustment of +5 notches, although it is not limited to a maximum number of downward notches.

## Asset Quality

This factor considers the quality of the portfolio backing the NAV loan, and is assessed by evaluating the underlying funds in the portfolio, as well as certain portfolio-wide attributes (see table *Notching Guidelines for the Asset Quality Factor (Based on Attributes of the Portfolio)*). The quality and diversification of the portfolio will affect its performance, as well as the manager's ability to sell assets or refinance liabilities if needed. The factors in the tables below also reflect additional qualitative considerations not directly or fully taken into account in the cash flow modelling.

The notching range for the Asset Quality factor is -2 to +2 notches. The typical attributes for notching are described below.

### Notching Guidelines for the Asset Quality Factor (Based on Attributes of the Underlying Funds in the Portfolio)

	+2 Notches	+1 Notch	No Notching	-1 Notch	-2 Notches
Manager assets under management (USDbn)	≥ 50	20 ≤ x < 50	10 ≤ x < 20	3 ≤ x < 10	< 3
Manager's experience managing alternative assets (years) <sup>a</sup>	≥ 20	15 ≤ x < 20	10 ≤ x < 15	5 ≤ x < 10	< 5
Fund size (USDbn) <sup>b</sup>	≥ 5	2 ≤ x < 5	1 ≤ x < 2	0.5 ≤ x < 1	< 0.5

Note: In evaluating attributes of underlying funds, Fitch will score each fund, or a material portion of the funds, and then compute a weighted average score for each attribute.

<sup>a</sup> In cases where a manager was operating within another entity and spun out of it, Fitch will consider the experience of the manager based on the earliest founding date of the relevant group. Where the founding date is not available Fitch may use the vintage of the manager's first fund.

<sup>b</sup> Fitch may instead review the size of the most recent flagship fund in the relevant strategy as reflecting the manager's franchise, if material to the analysis.

Source: Fitch Ratings

### Notching Guidelines for the Asset Quality Factor (Based on Attributes of the Portfolio)

	+1 to +2 Notches	No Notching	-1 to -2 Notches
Portfolio diversification by funds, managers, underlying holdings, and vintages	High	Medium	Low
Geographic diversification	Diversified globally, or within a large market, such as the US or Europe, with funds focused on developed markets, and limited exposure to funds focused on developing markets	Concentrated in smaller but developed markets, or a moderate exposure to funds focused on developing markets	High concentration to funds focused on developing markets
FX exposure <sup>a</sup>	Immaterial unhedged FX exposure, or no material impact on the QRI expected from FX	Limited unhedged FX exposure (<=10%), or limited impact on the QRI expected from FX	Moderate-to-material unhedged FX exposure (>10%), or material impact on the QRI expected from FX
Strategy stability	Portfolio skewed towards funds exposed to less volatile segments of broad fund strategies, such as core real estate within real estate funds, senior debt within debt funds and core infrastructure within infrastructure funds	Funds exposed to typical or mixed segments of broad fund strategies, or insufficient information to assess	Portfolio skewed towards funds exposed to more volatile segments of broad fund strategies, such as opportunistic real estate within real estate funds, distressed debt within debt funds and opportunistic infrastructure within infrastructure funds

<sup>a</sup> FX exposure may be hedged at the asset level, portfolio level or through the structure, and Fitch's assessment of the level of hedging may be quantitative or qualitative. Fitch may also conduct sensitivity scenarios based on potential FX movements to assess the impact on modelling results.

Source: Fitch Ratings

### Additional Sources of Repayment and Liquidity

This factor considers the availability of additional sources of repayment and liquidity, beyond the collateral pool, to repay the NAV loan and meet capital calls from underlying funds in the portfolio. While these sources are usually not contractually committed to address NAV loan repayment, they may be available, and Fitch believes there are often strong economic and reputational incentives for the manager to access them.

For example, if an NAV loan has a very low residual LTV at maturity, it would likely be in the economic interest of the fund to use unfunded commitments available to it or sell some assets to repay the NAV loan, rather than face potential foreclosure on the assets and lose value in a forced sale. Similarly, the fund manager may suffer reputational damage with both LPs and lenders if a fund it manages defaults on a debt obligation rather than access available, but not contractually committed, sources of repayment and liquidity.

The notching range for the Additional Sources of Repayment and Liquidity KRD is 0 to +2 notches. The typical attributes for assessing this factor are described below. Fitch will evaluate these attributes holistically, and not all of them need to be available to achieve a strong score. For example, very high UCC coverage relative to the NAV loan could be sufficient to achieve +2 notches, even if no other resources are available. Where multiple entities own the collateral pool, Fitch will generally consider in its analysis these entities on an aggregate basis, or only the main entity, based on information availability.

**Collateral Pool Cash Flow Generation**

Beyond the cash flow sweep for the NAV loan modelled for the QRI, there may be additional cash flow generated by the collateral pool that the manager may redirect, on a voluntary basis, towards repayment of the NAV loan over time. The ability to generate cash is assessed by comparing the modelled distributions generated from the portfolio (on a gross or net basis after accounting for capital call payments, as appropriate) over the life of the loan relative to the outstanding NAV loan.

**Uncalled Capital Commitments**

The manager of the collateral pool may call capital from the owners of the collateral pool, typically LPs of the secondary fund and other higher-level entities within the legal structure holding the portfolio, and use the proceeds, on a voluntary basis, to repay the NAV loan. Fitch will calculate the level of UCC available to repay the NAV loan throughout the life of the NAV loan, including using projections of remaining UCC. UCC may also be used to meet capital calls from the underlying funds in the portfolio.

**Assets Outside the Collateral Pool**

The fund, or other owners of the vehicle holding the collateral pool, may hold other assets generating cash flows outside of the collateral pool, and these cash flows and assets may be used, on a voluntary basis, to repay the NAV loan. Fitch will consider any additional assets based on their likely availability, including net of current or expected debt to which the assets may be pledged, and the alignment of interests between the NAV loan lenders and the assets’ owners.

**Liquidity Facilities**

A liquidity facility, such as a subscription facility, may be available to the fund, or other owners of the vehicle holding the collateral pool, and may be used to repay the NAV loan or meet capital calls from the underlying funds in the portfolio.

**Notching Guidelines for the Additional Sources of Repayment and Liquidity Factor**

+2 Notches	+1 Notch	No Notching
Significant sources of additional capital or liquidity available	Some sources of additional capital or liquidity available	No or immaterial levels of additional capital or liquidity available (or insufficient information to assess such sources)

Source: Fitch Ratings

**Fund and Manager**

This factor considers the capabilities of the fund manager (or other owner/manager of the collateral pool), including its operational capabilities to effectively manage the NAV loan, its franchise, the extent of its market access if seeking to refinance liabilities or sell assets, its experience managing similar strategies and its performance record. The notching range for the Fund and Manager factor is -2 to +2 notches.

Larger and more diversified managers typically show greater financial stability, while longer established operations may indicate more consistency in processes and experience through down cycles. Larger and more experienced staff with better controls reduce the risk of fraud or mismanagement that could affect the fund’s performance and LPs’ propensity to meet capital calls. Larger managers can apply their resources and market position towards the funds’ performance to reduce downside risks, as well as lean on banking relationships to refinance the fund’s debt. A bigger fund is indicative of a stronger manager franchise, often underpinned by good historical performance, as well as a higher quality and more diversified investor base.

Unless stated otherwise below, references to the manager relate to the highest-level parent entity where investment, operations, asset allocation, treasury and risk management staff operate, taking into consideration aggregate assets under the management of various subsidiaries or brands. Fitch’s analysis focuses on the main fund and the manager that controls the assets.

### Notching Guidelines for the Fund and Manager Factor

	+2 Notches	+1 Notch	No Notching	-1 Notch	-2 Notches
Manager's assets under management (USDbn) <sup>a</sup>	≥ 50	20 ≤ x < 50	10 ≤ x < 20	3 ≤ x < 10	< 3
Manager's staff (number) <sup>a</sup>	≥ 200	150 ≤ x < 200	100 ≤ x < 150	50 ≤ x < 100	< 50
Manager's experience managing alternative assets (years) <sup>ab</sup>	≥ 20	15 ≤ x < 20	10 ≤ x < 15	5 ≤ x < 10	< 5
Manager's experience managing relevant or related strategy (years) <sup>ab</sup>	≥ 20	15 ≤ x < 20	10 ≤ x < 15	5 ≤ x < 10	< 5
Latest flagship fund size in the strategy (USDbn)	≥ 5	2 ≤ x < 5	1 ≤ x < 2	0.5 ≤ x < 1	< 0.5
Fund size (USDbn) <sup>c</sup>	≥ 5	2 ≤ x < 5	1 ≤ x < 2	0.5 ≤ x < 1	< 0.5
Manager's experience with NAV loans <sup>b</sup>	Experience using multiple NAV loans (>=3)	Limited experience using NAV loans (1-2)	No experience with NAV loans, or insufficient information to assess		
Manager's historical performance in relevant strategy <sup>d</sup>	Performance record consistently positive, generally in line with market standard		Performance record inconsistent	Consistent underperformance	

<sup>a</sup> Downward notching for a small or inexperienced manager may not be applied if robust manager replacement provisions are present.

<sup>b</sup> Fitch may consider the performance record of key staff of a new manager based on their prior experience, if relevant and applicable. Experience with NAV loans is more relevant for smaller managers, where it could be a positive factor, but would not have a material impact on the scoring of an otherwise strong manager.

<sup>c</sup> Where multiple entities own the collateral pool, Fitch may consider in its analysis the main entity or multiple entities on an aggregate basis or based on their proportional shares in the collateral pool, as relevant and based on information availability.

<sup>d</sup> Performance is measured compared to long-term expectations for similar funds, with an emphasis on consistency of positive returns, not relative outperformance or quartiles.  
Source: Fitch Ratings

### Structure

This factor considers the structural features and terms of the NAV loan credit agreement and LPA (or similar agreements). The LPA terms and loan covenants influence the behaviour of the fund's investors and manager, and may impact the level of overall risk to the NAV loan. The notching range for the Structure factor is -3 to +1 notches. The Structure factor typically has a neutral influence, except where there are exceptionally strong or weak terms.

The LPA terms attribute assesses the terms of the LPA (or other similar agreements) between the LPs, GP and the fund that relate to the fund's operations, investment strategy, ability to incur indebtedness, call capital and remedy LP defaults, among other terms.

The NAV loan terms attribute assesses the NAV loan's structural components that are not already accounted for in the modelling, usually including certain financial covenants, the security package, and risk- and cash flow-based events of default.

### Notching Guidelines for the Structure Factor

	+1 Notch	No Notching	-1 Notch	-2 or -3 Notches
LPA terms	n.a.	Standard LPA terms allowing incurrence of debt, remedies to LP defaults and other typical provisions	Modest deficiencies in LPA terms	Material deficiencies in LPA terms
NAV loan terms	In addition to standard credit agreement terms, additional full or meaningful partial guarantees or covenants to maintain unfunded commitments or other assets that could benefit the NAV loan	Standard credit agreement terms, including security over the assets (including through a holding vehicle) and distributions accounts, or limited security but where the borrower is a large and/or flagship fund whose default would cause material reputational damage to the manager, and typical covenants	Mostly standard credit agreement terms, although limited security over the assets or accounts, or heightened risk of acceleration and payment default due to breach of triggers such as maximum LTV	Material deficiencies in credit agreement terms, or no security over the assets or accounts

Source: Fitch Ratings

## Legal Considerations

Fitch reviews relevant documentation governing the fund and the NAV loan, which may include LPAs, credit and security agreements, legal opinions and other documents as applicable. Fitch will assess various factors, including the legal setup of the fund, the rights and duties of the manager, the rights of the NAV lenders, the loan's structural features and covenants, the enforceability of the agreements in relevant jurisdictions, the presence of multiple borrowings and other relevant terms.

Fitch will rate NAV loans in jurisdictions where appropriate legal regimes govern funds and partnerships, and the enforceability of creditors' rights.

Fitch expects notification of material amendments to the governing documents and will reflect the impact of such amendments on the assigned rating.

To address the risks associated with a fund manager failure, Fitch will also assess the manager itself, as described in the Fund and Manager section above. This typically entails an assessment of the manager's capabilities, franchise, performance, and resources and scale. In the case of the manager's bankruptcy or insolvency, the manager may continue operating the fund as continuing to generate fee streams would typically be in the best interest of both the manager and its creditors, and as the staff of the manager are typically economically incentivised to manage the fund until a restructuring or a suitable replacement manager can be appointed.

Fitch expects that in the event of a manager's bankruptcy, the risk of substantive consolidation of the assets and liabilities of the fund with those of the manager is low in the absence of evidence that the fund and the manager commingled assets and liabilities or otherwise disregarded separateness formalities. Fitch will therefore generally will not cap the rating of an NAV loan at the fund manager's rating.

Still, Fitch may more closely link the rating of the NAV loan with the rating of the manager in cases where the manager is rated lower than the NAV loan on a standalone basis, and certain factors increase the likelihood of substantive consolidation between the fund and the manager. Such factors may include a manager guarantee, indemnity or security interest provided to the lenders in connection with the NAV loan, absence of separateness between the manager and borrower and other relevant considerations.

## Hybrid Loans

For loans that are structured as hybrids, where the borrowing base is a function of both NAV as well as UCC, Fitch will assess the loan under this rating criteria as well as the *Subscription Finance Rating Criteria*. Fitch may use the rating resulting from the higher-of or the lower-of both rating criteria, or combine elements of both criteria, depending on the terms of the transaction. Fitch will describe the applicable approach in rating action commentary.

## Defaults

In accordance with Fitch's rating definitions, a default may take several forms. In the context of an NAV loan, this may include the non-payment of obligations beyond the available cure period, or a distressed debt exchange (DDE), defined as a debt restructuring or exchange, which imposes a material reduction in terms compared with the existing contractual terms and is conducted to avoid a probable and eventual traditional payment default.

### Grace Periods

Fitch considers an actual failure to pay interest or principal when due and payable based on the terms and conditions of the NAV loan (plus a grace period of the lesser of 30 calendar days or the time allowed under the documentation following failure to pay) to be a default (denoted by a 'D' obligation rating). Where no grace period is specified in documentation, Fitch may rate to a grace period consistent with similar obligations in the market, but typically not exceeding 30 calendar days. For non-payment caused by certain operational interruptions outside the obligor's control (see *Payment Force Majeure* below), Fitch would typically apply a grace period of up to 30 calendar days before downgrading to a default.

### Payment Force Majeure

Fitch uses this term to describe a failure to make timely payment in the case of operational interruptions to payments outside the obligor's control (e.g. civil unrest, natural disaster, cyber-attack, financial infrastructure lapse or other force majeure affecting the payment process itself). While this may not immediately represent a default, Fitch would nonetheless typically deem an extended non-payment of this nature as a default on the NAV loan, at the latest after 30 calendar days have elapsed from the payment date, and the rating would typically be downgraded to the level consistent with defaulted obligations. For the avoidance of doubt, a rating action may also be taken on the obligation's ratings at any time before the expiry of such 30-day period.

### Distressed Debt Exchanges

When considering whether a DDE has occurred, Fitch expects both of the following factors to apply: the restructuring or exchange imposes a material reduction in terms from the existing contractual terms; and the restructuring or exchange is conducted to avoid a probable and eventual traditional default.

For NAV loans, the most likely application of a DDE determination would be in the context of an extension of an NAV loan at or prior to maturity if the loan will not be repaid via cash flow alone prior to maturity, or a waiver of a material covenant.

A maturity extension or covenant waiver by itself would not necessarily lead Fitch to classify the event as a DDE, for example if the LTV of the loan is sufficiently low, appropriate compensation is paid to the lender for the amendment/waiver or additional terms are imposed, if the fund would have likely had other ways of repaying the loan (selling assets or calling capital), or recovery for the lender would have been highly likely to be 100% upon enforcement. Conversely, a reduction in an NAV loan's principal or an extension where the LTV is high and repayment in full is uncertain may be deemed a DDE. An NAV loan subject to a DDE will be rated 'D', and subsequently re-rated based on the KRDS in this report.

## Data

Fitch's rating analysis is reliant on materials provided by the NAV lender or fund manager, and Fitch will assess the reliability of the information, including based on the data provider's capabilities and experience. Requested data may include documents and qualitative and quantitative information on the underlying funds, and portfolio holdings and cash flows for funds in the portfolio, as well as governing documentation for the borrower.

### Data Adjustments

Fitch relies on robust historical cash flow performance data through a full market cycle to model performance of portfolios of LP interests. Third-party data providers have robust cash flow performance data for developed alternative investment asset classes. For cohorts where historical data are more limited, Fitch may use proxy data, using historically observed relationships between different strategies, or use data for the same strategy but from a different time period. Fitch may apply additional haircuts to any such extrapolations or otherwise not afford credit to such an asset class depending on the relevance of the data available.

### Valuations

Fitch generally accepts valuations of holdings as reported by GPs, as long as market conditions have not changed materially between the valuation date and Fitch's review date. In cases where market conditions have materially changed since the reported valuation dates, particularly to the downside, Fitch will estimate the change in NAV based on available data and incorporate the estimated updated NAV in its analysis.

To project the change in NAV since prior reporting dates, Fitch maps portfolio exposures to relevant public indices, and applies a ratio to the public valuations that reflects historical relationships between public and private valuations. Public valuations tend to be more volatile, up and down, relative to private valuations. Fitch will also incorporate publicly and privately available data on expected valuation changes for similar exposures as those in the portfolio from sources that include GPs, lenders or internal sources within Fitch.

## Rating Sensitivities

NAV loan ratings may be subject to downgrade if cash flows are materially lower than expected. A material increase in LTV that, in Fitch's view, would be sustained and indicate insufficient forthcoming cash distributions to support the outstanding obligation could also lead to negative rating actions, with the rating action dependent on the level of clarity about fundamental economic conditions and expectations for cash flow generation. If a fund's NAV declines due to a broad market downturn, Fitch may place less emphasis on modelling scenarios that simulate another similar economic downturn immediately thereafter. Strong performance and deleveraging of an NAV loan may lead to positive rating actions.

Changes to Fitch's assessment of the various attributes described in this report for the QA factors, including Asset Quality, Additional Sources of Repayment and Liquidity, Fund and Manager, or Structure, which are material and are expected to be sustained, could lead to a rating change on the NAV loan. In addition, Fitch will consider how proactive the manager is in taking actions ahead of the loan's maturity date to refinance or repay the loan.

Fitch's opinions are forward looking and include the agency's views of future performance. Fitch's rating committees will consider the stability of the NAV loan rating under these sensitivities in assigning the NAV loan rating. In particular, Fitch may adjust the QRI if it shows a high sensitivity to expected scenarios, including based on transaction features like payment holidays or mild declines in NAV. Fitch may also perform sensitivity analysis to reflect specific considerations of a transaction.

Fitch relies in its analysis on the documentation and external legal opinions issued in connection with the transaction. If any relevant party to the transaction does not comply with its obligations or follow its responsibilities and procedures as described in the documentation, the ratings may be affected.

## Surveillance

Once Fitch rates an NAV loan, and if the ratings are not point in time, the transaction will be subject to ongoing surveillance, and ratings will be reviewed at least annually or on an ad-hoc basis if there is a material change to the transaction or economic conditions. Fitch expects to receive at least quarterly reporting on the NAV loan, fund, and assets and be notified about material changes in a timely manner.

## Criteria Disclosures and Variations

### Criteria Disclosures

In its rating action commentary, Fitch will disclose the QRI and QA, application of rating caps, rating sensitivities, any material additional analytical considerations considered as part of the analysis and any variations to criteria.

### Criteria Variations

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on a transaction-by-transaction or an issuer-by-issuer basis and full disclosure via rating action commentary strengthens Fitch's rating process, while assisting market participants in understanding the analysis behind the ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature or other factor relevant to the assignment of a rating and the methodology applied to it are included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

## Limitations

Ratings, including Rating Watches and Outlooks, assigned by Fitch are subject to the limitations specified on Fitch's [Ratings Definitions page at www.fitchratings.com](http://www.fitchratings.com).

## Appendix 1: NAV Loan Rating Example

Below is a simplified example of the application of the rating framework for an NAV loan.

### **QRI ('bbb-')**

Cash flow modelling is conducted using the PE CFO model based on the portfolio and structure of the NAV loan. The modelling generates residual LTVs at the NAV loan's five-year maturity of between 5% and 33% under different 'launch year' scenarios at the 'A' rating stress. The highest residual LTV of 33% maps to a 'A' stress QRI of 'bbb-'. Modelling at the 'BBB' rating stress level generates a maximum residual LTV of 8%, which maps to a 'BBB' stress QRI of 'bbb-'. Modelling at the 'BB' rating stress level generates a maximum residual LTV of 0%, which maps to a 'BB' stress QRI of 'bb'. Based on these results at the various stress levels, the transaction-level QRI is 'bbb-'.

### **Additional Sources of Repayment and Liquidity (Very Positive)**

The secondaries fund that owns the collateral pool has a high level of UCC, a subscription facility and additional assets outside of the collateral pool. The collateral pool also generates sufficient excess cash. These significant additional resources are very positive and imply an uplift at the upper end of the notching range of 0 to +2.

### **Asset Quality (Neutral/Positive)**

The portfolio consists of 35 underlying funds diversified by fund, GP and vintage. However, the GPs managing the underlying funds are fairly small, with average AUM of USD8 billion, some with good records and others newly established. The majority of the underlying funds are North American buyout funds focused on lower middle-market companies. The funds invest in a range of sectors, with the largest being healthcare and software. Overall, the positive portfolio diversification is counter-balanced by relatively small and some less experienced fund managers, implying neutral or slightly positive notching within the possible range of -2 to +2 notches.

### **Fund and Manager (Positive)**

The secondaries fund manager is experienced and large, with 175 staff members, AUM of USD35 billion and 19 years' experience in managing secondaries funds, with its latest fund in the strategy raising USD5 billion. The manager's funds have performed consistently in line with market expectations. Also, the manager has utilised NAV loans for other funds over the past three years. The assessment is positive and implies notching at the middle/upper end of the -2 to +2 possible notching range.

### **Structure (Neutral)**

LPA terms are standard, including allowing the fund to incur debt, provide the manager with sufficient remedies to cure LP defaults and include other typical provisions. Credit agreement terms for the NAV loan include security interest in the equity of a holding vehicle that owns the underlying funds, as well as security interest over the distribution accounts. The terms also include typical positive and negative covenants and events of default. The initial LTV of the NAV loan is set at 30% and the maximum LTV is set at 40%, and the credit agreement allows the manager to cure LTV breaches by calling capital or presenting lenders with a plan of remediation. There are no guarantees from the secondaries fund for the benefit of the NAV loan. The assessment for this factor is therefore zero notching, within the possible range of -3 to +1 notches.

### **QA**

The assessments of the four QA factors above results in an overall QA adjustment of +3 notches.

### **Assigned Rating**

The QRI of 'bbb-' and overall QA of +3 notches of adjustment lead to a rating on the NAV loan of 'A+'. The 'A+' rating cap has no impact since it is higher than the assigned rating.

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