Chapman and Cutler LLP

Action Item

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Insight and Opportunities for Clients

Rated-Debt Feeder Fund Structure: An Alternative Structure for an Insurance Company's Alternative Investments

Insurance companies continue to look to alternative investment funds as a means to increase returns in this low interest rate environment and to add diversification to their portfolios. One impediment to increasing a concentration in alternative investments may be the higher risk-based capital requirements associated with alternative investments. Recently, various participants in the insurance, alternative investment, and rating agency industries have considered addressing that risk-based capital impediment by utilizing a bespoke rated-debt feeder fund structure.

Rated-Debt Feeder Fund Explained

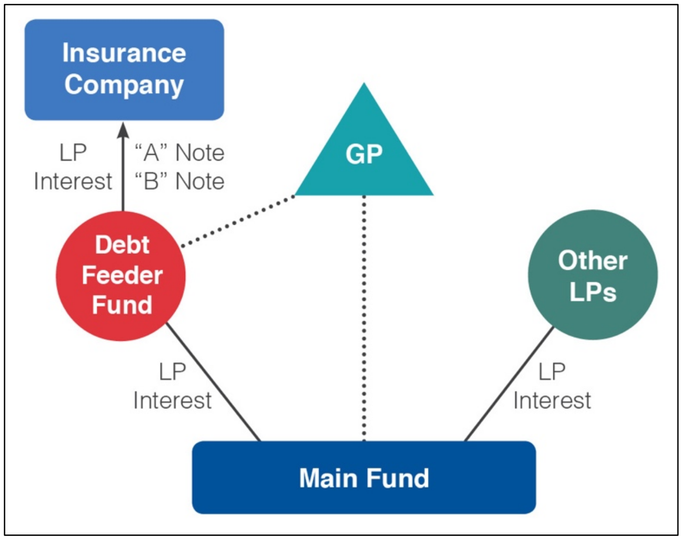
Private investment funds commonly utilize feeder funds to organize the equity capital raised from similarly advised or similarly situated investors. A rated-debt feeder fund structure might be deployed by a private investment fund seeking to incentivize one or more insurance companies to participate indirectly in the investment strategy of the private investment fund (the "main fund") at a reduced cost of capital.

To implement this structure, the main fund would first establish a feeder fund intended for investment by those insurance companies (the "debt feeder fund"). The debt feeder fund would be managed and controlled by the general partner of the main fund.

Unlike a typical feeder fund, which raises only equity capital, a debt feeder fund raises its capital by issuing debt and equity in a private offering to the insurance company participants and then utilizes the proceeds of the offering to purchase limited partnership interests in the main fund.

In the rated-debt feeder fund structure, in addition to receiving an equity interest in the debt feeder fund, an insurance company participant would receive one or more series of notes from the debt feeder fund. If multiple series of notes are issued, each series may differ in interest rate, duration, and priority of payment. The insurance company would then request that a rating agency rate the notes. The rating of the notes would typically result in the risk-based capital requirements associated with the notes being materially lower than the risk-based capital requirements that would have been associated with the insurance company directly holding equity interests in the main fund.

The economic terms of the notes issued by the debt feeder fund may depend upon the investment strategy, projected cash flows, and other terms of the underlying private investment fund and will likely be impacted by the requirements of the applicable rating agency. An insurance company contemplating participation in a rated-debt feeder structure can benefit from the advice of experienced counsel to negotiate the terms and conditions of the



note purchase agreement and to coordinate the intricate relationship between the debt feeder fund, with its debt-capital orientation, and the main fund, with its equity-capital orientation. Legal experience representing insurance companies in private debt offerings and in negotiating and structuring investments in private investments funds is essential to a successful deployment of the rated-debt feeder fund structure.

How We Can Help

Chapman attorneys have significant experience representing investors in all manner of private investment funds and we recently represented an insurance company in a rated-debt feeder fund investment transaction with a large-cap, private investment fund. That direct transactional experience, together with our firm's market-leading private placement and private funds experience, makes us highly suited to provide advice to insurance companies considering this unique investment structure.

We welcome the opportunity to discuss any questions that you may have or any fund investment transaction that you may be considering that utilizes a rated-debt feeder fund structure.

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