

Continuation Vehicles and SRTs on Private Credit: When Due Diligence Remains Paramount

Over the last few quarters, continuation vehicles (CVs) have become one of the most discussed developments in private credit. Originally developed in private equity, where they gained significant traction as a response to the increasingly “challenging exit environment” and the difficulty of monetising investments, CVs are now being structured in private credit as a strategic capital management tool. They allow managers to extend the life of a seasoned portfolio beyond the original maturity of a fund while offering limited partners (LPs) the option either to roll their investment into the new vehicle or to cash out. In doing so, continuation vehicles have reshaped the liquidity options available to LPs, who previously relied primarily on the growing secondary market for private credit.

Many market participants have drawn comparisons between private credit continuation vehicles and CLO resets or refinancings. The analogy is both appropriate and compelling, and many of the criticisms levelled against it are not well founded. In both cases, investors are given the opportunity either to get back their investment or to maintain the exposure under a new structure, with updated documentation, revised terms and limits, and potentially a different return profile. At the same time, managers are able to continue managing a portfolio they know well while retaining an existing investor base. Where existing LPs decide not to roll their positions, dedicated private credit secondary funds, many of which have raised capital specifically for these opportunities, provide the liquidity necessary to support the new transaction. Continuation vehicles have therefore become much more than a “liquidity solution”; they are increasingly a strategic tool for capital management.

I first became involved in due diligence for European private equity continuation vehicles in 2022 and, more recently, have participated in due diligence processes on behalf of LPs evaluating private credit continuation transactions. While analysing a seasoned portfolio may initially appear easier than underwriting a new investment with often unknown collateral, the reality is quite the opposite. Existing portfolio performance and data certainly provides valuable insight, but they also demand a more detailed assessment of how the asset pool is likely to perform over the next investment period rather than simply reviewing historical results.

In an uncertain global credit environment, it is entirely legitimate for LP investors to raise new questions about risk, liquidity and portfolio construction. One interesting

observation from my side is that investors often express similar concerns regarding continuation vehicles, yet interpret those concerns differently and, consequently, reach different investment conclusions.

The investment decision, from what I saw, is driven by a number of factors. Investors naturally focus on the quality of the existing portfolio, its granularity and sector concentrations, the sustainability of the expected return profile and the transparency of asset valuations. They also carefully evaluate the timing of the launch of the continuation vehicle, the economics associated with rolling versus cashing out, and whether retaining exposure to the risk credit portfolio represents the most efficient use of capital, particularly during periods when alternative investment opportunities become more attractive or market volatility increases scrutiny of private credit valuations. Equally important are the expected participation of existing LPs and the composition of the incoming investor base, as both can influence the long-term alignment and stability of the new vehicle. This last point has been raised to my attention from insurers (in Europe) always debating how private markets fit within portfolios and target allocations.

Many commentators argue that the increasing use of continuation vehicles is evidence that private credit has reached a new stage of maturity, and I share that view. A market capable of offering flexible solutions to one of its long-standing challenges—liquidity—while attracting dedicated secondary capital is clearly transforming private credit into a more sophisticated and mature asset class. Yet the market's continued development must be accompanied in my opinion by higher standards of transparency and disclosure. In my direct experience (I try to teach investors how to challenge portfolio managers), the information provided to LPs is not always sufficient to support a fully informed investment decision. Investors would benefit from much greater transparency, including portfolio stress testing (PDs and LGDs, recoveries—here the provided analysis is very light) under different macroeconomic scenarios (which models are used and how they work—here the provided analysis is incomplete or simplistic), detailed assumptions supporting projected returns (the provided analysis is sketchy), comprehensive analysis of performing, watch-list and stressed assets, updated financial projections and clearer explanations of asset valuation methodologies and mark-to-market prices (the provided information is surface-level). Last but not least, investors assess whether the proposed structure and governance models are robust, transparent, and appropriately aligned with the interests of both existing and incoming investors. Although LPs are evaluating known portfolios with an established performance history, this does not reduce the need for rigorous due diligence. If anything, the level of analysis is comparable to underwriting a new investment. Continuation vehicles today are a permanent feature of the private credit landscape but we should always keep in mind that a mature market is defined not simply by the liquidity solutions it offers, but by the robustness of the due diligence that supports every investment decision. GPs should recognize that LPs are no longer racing simply to allocate capital and establish positions in private credit; LPs are becoming increasingly selective, refining the existing exposures in their

portfolios. The illiquidity traditionally associated with private credit is no longer merely accepted as an inherent characteristic of the asset class; today, it is increasingly managed, monetised and aligned with LP investors' medium- and long-term objectives.

In this respect, continuation vehicles share important similarities with the growing market for significant risk transfer (SRT) transactions backed by private credit assets. In both cases, investors are assessing portfolios of existing assets with different vintages rather than committing capital to a “blind or statistical pool”. The presence of a seasoned portfolio does not reduce the complexity of the investment decision. On the contrary, it calls for a rigorous, asset-by-asset due diligence process, with a heightened focus on the risk-return profile of each individual exposure. In previous articles, I have discussed SRTs on consumer loans, auto loans and mortgage portfolios, where investors typically rely on aggregate portfolio statistics such as loan-to-value ratios, borrower concentrations, credit scores, recovery curves data, weighted average seasoning, weighted average remaining maturity, credit enhancement levels and liquidity reserves. While these metrics remain relevant, they become less informative in private credit where bank's portfolios are generally less granular and composed of a limited number of bespoke corporate exposures. Investors undoubtedly benefit from gaining exposure to assets originated by banks that have already passed rigorous underwriting standards, credit committee approval and established risk management processes. Nevertheless, this should not create a false sense of comfort on these SRTs. Independent credit analysis remains essential and forward-looking assessment of credit quality, downside risks and expected returns evaluated with due diligence. Ultimately, investors must develop their own conviction on every material risk within the portfolio and should preserve the ability to shape the credit exposure toward asset pool that better reflect the risk/return appetite and objectives. SRTs are fundamentally a tool for banks to manage and optimise the regulatory capital associated with their core lending activities (I like to define them the new return engine and programmatic tool for financial institutions). They redistribute risk but not all SRT structures are created equal. Their structural features, collateral pools, risk-transfer mechanisms and alignment of interests vary significantly, creating very different investment opportunities.

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