Optimising the Private Credit Operating Model

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1. Specialist systems are required to deal with the complexities of private credit loan processing

2. Loan servicing units – teams of loan experts – should be in place to model loan cashflows and returns

3. Private credit is booming and expected to grow further – optimising your PC operating model is key to your funds' future success

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With demand for loans sourced from private credit funds growing fast, there's an increasing need for fit-for-purpose systems to process and report on them. Ryan O'Neill and Steven Calderon explain the rapidly evolving technology leading the charge.

Private credit has grown rapidly over the past decade. Shifts within the market, a volatile interest rate environment and tighter regulation has contributed to the reduced availability and attractiveness of bank lending. The trend for seeking alternative funding arrangements is expected to continue and for fund managers this means they need future-fit automated systems to meet their growing regulatory, procedural, and reporting requirements.

According to PitchBook, the global private credit market grew from $280 billion in assets under management (AUM) in 2007 to $1.2 trillion in 2022. It is expected to grow further as investors seek the higher yields, stability of returns and diversification benefits which private credit brings, while borrowers demand more flexible and customised financing solutions. According to BlackRock's 2023 report, *Private debt: a primer – unpacking the growth drivers,* the private credit market could be worth $3.5 trillion by 2028.

There are a number of factors private credit fund managers need to consider to ensure their proposition is best-in-class for investors and borrowers. One of them is that they have fit-for-purpose technology in place to ensure loans are processed, reported and accounted for in the most efficient and accurate way possible.

Real-time service delivery

To build a future-fit service that can manage the incoming volumes the market is predicting, managers need to focus on two key areas. Firstly, they need a dedicated Loan Servicing Unit (LSU) team to deliver client service and, secondly, the technological investment to support it. For example, Aztec's private credit offering has gone through significant changes and improvements over the last 18 months to put both these aspects in place.

Implementing these factors presents the following advantages:

1. Real-time processing and reporting on current positions, cash flows and loan performance, replacing historic accounting in arrears – which was common – meaning decisions were based on aged data.
2. Fully automated, integrated and system-generated reports, producing quicker and more accurate reporting whilst reducing risk and human error.
3. Loan assets serviced by a specialised central team, knowledgeable about the investment, that do not have the burden of NAV cyclical peaks and troughs and are familiar with the loan capabilities of the system.
4. Instant loan modelling and future cash projection reporting of what expected flows should be.
5. A dedicated and skilled team of loan experts to manage on-demand requirements.

What does a Loan Service Unit (LSU) do?

An LSU is a dedicated and centralised team with the sole purpose of processing and reporting on the loan assets contained in the portfolio daily. The team are loan and system experts and are agnostic to NAV cycles, resulting in speedier and more efficient processing and the ability to provide position reporting in real-time to clients. They focus predominantly on the Investment Book of Record (IBOR) feeding data seamlessly to the Accounting Book of Record (ABOR).

At Aztec, the LSU uses both their loan expertise and specific knowledge of our eFront Debt loan processing system to model loan cashflows and returns from start date all the way to maturity, providing clients with an immediate forecast of how the loan may perform.

Additionally, by profiling out the loan from day one, the expected cashflows and timings are recorded in the system as draft, meaning the LSU has the ability to monitor cash receipts and shadow Agents' notifications based on what is expected.

Our LSU has built a core suite of loan reports which can be provided to clients as frequently as daily if required, which is a unique differentiator in the private credit market. The LSU works alongside the administration and accounting teams to achieve quicker, more accurate flash and final NAVs. Clients, both existing and new, are finding this a new and more efficient way to keep on top of their portfolio. It offers a real-time review of administrators' workings rather than receiving quarterly, in arrears reports, several weeks after a quarter end.

At Aztec we have a loan system (FrontDebt) which immediately integrates into our core General Ledger and Investor Allocation system (eFront FIA) providing real time updates of the NAV records. So, there are no delays or loss of data porting information from one system to another and no reconciliations cobbling together reports from a separate loan system, GL system and investor allocation system, that can sometimes occur.

Why private credit loans need a bespoke system

Loans have unique characteristics and requirements that other asset classes don't, especially those in private markets. For example, these loans need to reflect original commitments and drawdowns of positions, fees on drawn and undrawn components, to calculate interest on variable interest rates and spreads, reflect cash but also PIK interest, amortise discounts and other fees over the life of the loans and calculate these on a varying basis, mindful of certain countries' holiday calendars. This is simply not possible on spreadsheets – and certainly not in volume.

Managers should not accept the risk inherent in managing a book in that manner and an automated STP solution is demanded and expected by the industry. Simply put, if the system cannot handle private credit loans it's the wrong system to operate a private credit mandate.

There is also a high volume of administrative duties and paperwork associated with loan servicing and there are growing requirements around it. There's also a growing burden of regulation in loan servicing which technology can assist with greatly, in reducing compliance costs across the process.

The next technological evolution in Private Credit

Since loan records are processed daily and accurately and are therefore up to date, these records act as the book of truth to how the loans are performing. Increasingly, as the capability is available, managers want their service provider to automate daily data feeds directly to them, and they can then use this real-time, reliable data to present to their front office.

We also see plenty of scope for machine readable technology in receiving, extracting, and reconciling data provided from agents' notices and expect this will be an ever-increasing capability within private credit as the asset class grows and servicing scale demands.

Finally, we are exploring opportunities in the Covenant Monitoring area where we can utilise additional system functionality to collect and present underlying investment information to investment managers. It's the collection of data and the presentation of it to those skilled in interpreting it, the investment manager, where we believe we can add value.

Daily processing 101

Within our Private Credit team, we've created a centralised Bank Reconciliation team, providing daily bank reconciliations to the LSU, the client facing team (CFT) and to share externally with the client. Without this team in place, we would have no right to distribute daily reports. The clean bank reconciliation proves we are processing daily and are up to date every morning.

This daily cadence also means that immediately after a quarter-end we can provide core reports, for example, loan interest schedules, debt investment schedules and cash flow analysis. Similarly, when valuations are received from the client or loan agent, the LSU can process the valuation run and reconcile all the components such as market value, positions, interest accruals and loan performance sanity checks swiftly, allowing the CFT to progress with the NAV and reducing the quarter end workload 'hump' and speeding up the process.

Aztec Group has invested heavily in redesigning our private credit offering into a product that we feel truly differentiates us in the private credit servicing environment. If you'd like to discuss how our Private Credit team can deliver for you or your clients, please contact **Ryan** or **Steven**.