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# Collateral Thinking: Beyond Conventional Lending

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# LEGAL UPDATE

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As businesses in Asia-Pacific grow and adapt to enhance resilience amidst geopolitical volatility, accessing the right type of financing becomes a critical strategic decision. In the same vein, against the backdrop of the region's rapidly growing and evolving economies, an increasing portfolio of alternative credit is emerging to address funding demand, especially in areas where traditional lending is constrained. Beyond conventional bank loans and equity raises, there exists a sophisticated toolkit of debt financing structures designed to match particular business profiles and risk appetites.

This update provides a practical overview of three types of debt financing that have become increasingly prominent across the region: structured finance, leveraged finance and fund finance. While each serves distinct purposes and involves different legal and commercial mechanics, they share a common feature: they allow businesses and investors to access capital in ways that are tailored, flexible and highly efficient when properly structured.

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## **Structured Finance**

At one end of the financing spectrum sits structured finance, which is typically asset driven and cash flow focused, and often used by businesses seeking to optimise balance sheets rather than increase leverage.

### **What is it?**

Structured finance refers to a category of financing that involves the pooling of financial assets such as loans, trade receivables, lease payments or mortgages and repackaging them into securities or financing instruments that can be offered to investors. At its core, structured finance is about transforming illiquid assets into accessible, tradeable capital.

The most common structured finance technique is securitisation. In a typical securitisation, a company (called the "originator") sells a pool of its income-generating assets (such as receivables or loan portfolios) to a special purpose vehicle or "SPV". The SPV then issues notes or bonds to investors, who are repaid from the cash flows generated by those underlying assets. The originator receives upfront liquidity, while investors receive exposure to a ring-fenced pool of assets that is legally insulated from the originator's own financial health.

### **Key features of structured finance include:**

- (a) **Asset-backed financing:** The financing is secured by or dependent upon, the performance of a defined pool of assets rather than the creditworthiness of the originator.
- (b) **Bankruptcy remoteness:** The SPV is structured to be legally isolated from the originator, so that if the originator becomes insolvent, the assets in the SPV and the investors' rights to those cash flows are unaffected.
- (c) **Credit enhancement:** Structures often incorporate mechanisms such as over-collateralisation, reserve accounts or subordinated tranches to improve the credit quality of the senior notes issued to investors. Senior tranches are paid first and carry lower yields, while junior or mezzanine tranches absorb losses first but offer higher returns.

### **Why use it?**

Structured finance is particularly attractive to businesses that hold large portfolios of receivables, lease assets or loan books. It allows companies to monetise assets that would otherwise sit on the balance sheet, freeing up capital for deployment elsewhere. For originators with strong asset quality but limited access to unsecured credit markets, structured finance offers an alternative path to liquidity at competitive rates.

In Asia-Pacific, structured finance has grown significantly, with Singapore serving as a key regional hub for deal structuring and documentation.

Singapore's robust legal framework and mature capital markets infrastructure make it a desirable jurisdiction for SPV establishment and asset-backed transactions. Transactions commonly seen in the region include trade receivables securitisation and collateralised loan obligations and more recently, with a growing presence of infrastructure asset-backed securitisation.

### **Leveraged Finance**

Where structured finance focuses on asset pools, leveraged finance centres on the borrower's capital structure and acquisition strategy.

#### **What is it?**

Leveraged finance refers to debt financing provided to companies that already carry a significant level of debt relative to their earnings, such as companies undergoing a leveraged buyout, a major acquisition or a recapitalisation where the transaction is funded primarily by borrowed money.

The two principal instruments in leveraged finance are leveraged loans and high-yield bonds. Leveraged loans are typically arranged by banks and syndicated to a group of institutional lenders. High-yield bonds are debt securities issued in the capital markets and rated below investment grade, reflecting the higher credit risk associated with the borrower's elevated leverage, and in exchange offering a higher return to bondholders. These two instruments are sometimes used together in the same financing package, with leveraged loans occupying a senior secured position in the capital structure and high-yield bonds typically ranking junior or unsecured, subject to the specific security and intercreditor arrangements governing the transaction.

#### **Distinguished features of leveraged finance include:**

- (a) **Covenant structures:** Leveraged loans often include financial maintenance covenants which are regular tests of the borrower's financial ratios. It is also common to include incurrence covenants that restrict the borrower's ability to take on additional debt, make disposals or pay dividends. High-yield bonds tend to rely more heavily on incurrence covenants.
- (b) **Security packages:** Leveraged transactions typically involve a comprehensive security package over the borrower's assets, shares, and intercompany receivables, which may span across multiple jurisdictions given the cross-border nature of many Asia-Pacific acquisitions.
- (c) **Intercreditor arrangements:** Where multiple layers of debt exist (e.g. senior secured loans alongside high-yield bonds or mezzanine debt), an intercreditor agreement governs the priority of payments and the exercise of enforcement rights among different classes of lenders.

### **Why use it?**

For private equity sponsors and financial acquirers, leveraged finance is the engine that powers buyouts. By financing a significant portion of an acquisition price with debt, sponsors can amplify returns on invested equity. For strategic acquirers, leveraged finance structures offer a way to fund transformative deals without immediately diluting existing shareholders.

The Asia-Pacific leveraged finance market has matured considerably in recent years, driven by an increasingly active private equity ecosystem across markets such as Australia, India, Japan, South Korea, and Southeast Asia. While the market remains more relationship-driven and less liquid than comparable US or European markets, cross-border transactions involving Asia-Pacific targets frequently draw on the full suite of leveraged finance instruments.

### **Fund Finance**

Fund finance shifts the focus again, with financing structured at the fund level rather than the operating company.

### **What is it?**

Fund finance refers to credit facilities and financing arrangements entered into by investment funds, most commonly private equity, private credit or infrastructure funds rather than by the funds' portfolio companies directly. The borrower is the fund itself and the security for the facility is typically either the fund's uncalled investor commitments or the net asset value of the fund's investment portfolio.

### **Two principal types of fund finance are:**

- (a) **Subscription line facilities (also known as capital call facilities):** These are revolving credit facilities secured against the uncalled capital commitments of a fund's limited partners ("LPs"). Rather than calling capital from investors each time it needs to make an investment, the fund draws on the subscription line and repays it when capital is eventually called. This bridges the timing gap between investment decisions and formal capital calls, improving operational efficiency.
- (b) **NAV facilities (net asset value facilities):** These facilities are secured against the net asset value of a fund's investment portfolio (its "NAV") rather than against uncalled commitments. NAV facilities are typically used by funds in the later stages of their lifecycle, when most capital has already been deployed and uncalled commitments are limited. They can provide liquidity for follow-on investments, distributions to LPs or portfolio management purposes.

### **Why use it?**

For fund managers, subscription lines are a powerful liquidity management tool. They allow a fund to move quickly when investment opportunities arise without triggering administrative capital calls to dozens of investors simultaneously. They also allow fund performance metrics to be presented more favourably, since the timing of capital deployment is optimised.

NAV facilities have grown rapidly as a product across global private markets and Asia-Pacific is no exception. As the private equity and private credit ecosystems in the region have deepened, fund managers increasingly look to NAV facilities to manage portfolio liquidity, particularly in slower exit environments.

Singapore has been particularly proactive in positioning itself as a fund financing hub. The introduction of the Variable Capital Company (“VCC”) framework in 2020 created a bespoke corporate structure for investment funds in Singapore, offering flexibility in capital management and enhanced attractiveness to international fund managers. The VCC framework, combined with Singapore's extensive tax treaty network, transparent regulatory environment overseen by the Monetary Authority of Singapore and sophisticated banking infrastructure, has made Singapore a desirable domicile for funds seeking regional fund finance arrangements.

### **Conclusion**

As Asia-Pacific's financial markets continue to develop and evolve, and with more businesses in the region requiring easier access to flexible capital not typically available through traditional lending, these financing structures are becoming increasingly relevant across the region.

Navigating these products effectively requires not only an understanding of their mechanics, but also careful attention to regulatory requirements, cross-border considerations and most importantly, bespoke legal documentation that accurately reflects the commercial arrangements between parties.

Drew & Napier advises clients across a wide range of financing transactions across Asia-Pacific, combining deep regional experience with a practical understanding of both legal frameworks and prevailing market practice.

### **How Drew & Napier LLC can assist**

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