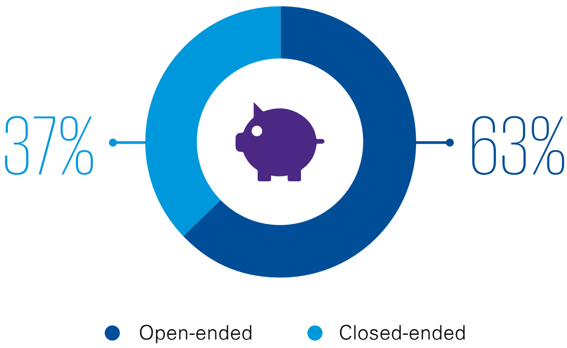
Fund structures

Loan funds may be open-ended or closed-ended. The choice between the two depends on the type of investor as well as the underlying asset type. Closed-ended funds are generally, for example, more suitable for private equity actors. The majority of Luxembourg loan funds are open-ended.

Figure 1: Proportion of open- and closed-ended loan funds



Source: KPMG/ALFI loan fund survey

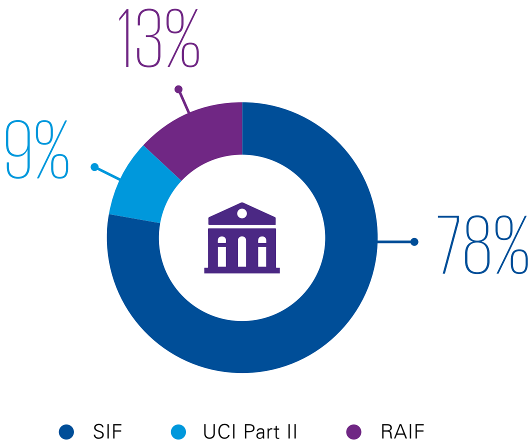
A distinction can be drawn between two types of loan funds[1]:

— A loan originating fund is any type of fund that is, according to its investment strategy, allowed to grant and restructure loans (i.e. subsequent amendment of loan conditions such as prolongation or deferral).

— A loan participating fund is a fund that is allowed to partially or entirely acquire and restructure existing loans originated by banks and other institutions, either directly from the lender or in secondary markets, where such loans are traded. According to their investment strategy they are not allowed to grant loans.

As can be seen below, the biggest part of the loan fund market in Luxembourg is driven by SIFs (78%), followed by RAIF and UCI Part II (13% and 9%). The use of SICARs is marginal.

Figure 2: Loan funds by legal regime



Source: KPMG/ALFI loan fund survey

1. The International Organization of Securities Commissions, findings of the survey on loan funds, February 2017, pp.2

The fact that SIFs are the first choice of loan fund managers (excluding UCITS) can be easily explained by their flexibility with regard to investment policy, as well as by the SIF regulatory regime. Furthermore, this vehicle is well-known by loan fund managers given that it is now a decade old.

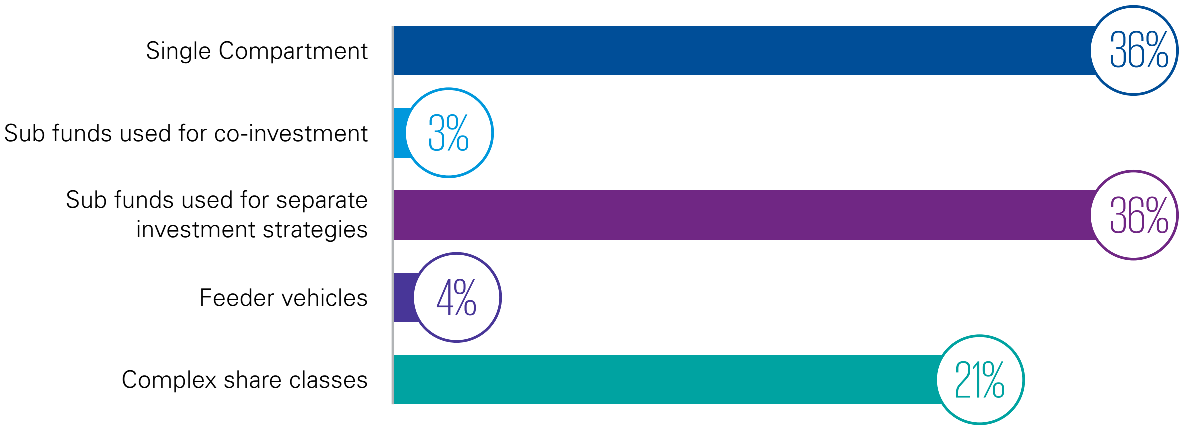
Last year, Luxembourg upgraded its funds toolbox with a new fund vehicle, the Reserved Alternative Investment Fund (RAIF), which better aligns with the shift in regulatory focus towards the managers of alternative funds. Many AIFMs and their sophisticated investors had been calling for the removal of the dual regulatory approach whereby both manager and fund are regulated and supervised. Luxembourg responded to this call by creating the RAIF structure which contains many of the same features as the popular SIF and SICAR structures. The novelty with the RAIF lies in the removal of this double layer of regulation of both the fund manager and the fund, which also promises a quicker time-to-market.

Only authorised external AIFMs are allowed to manage RAIFs and it is expected that the RAIF will have considerable appeal to many categories of sophisticated investors that seek to invest quickly in products with solid investor protection.

Based on Figure 2, we can see that SICARs are marginally used by loan fund promoters. This can be explained by the investment policy that a SICAR must follow (i.e. investment in risk-bearing securities), which is typically not in line with loan investments (with some exceptions). Going forward, SIFs will continue to be used by loan fund managers, but RAIFs will constitute a very strong alternative.

In terms of structuring loan funds, promoters have a choice between single compartments or multiple compartments. As of 30 June 2017, the split between both types of fund structures may be summarised, as in the following Figure 3.

Figure 3: Loan funds structure

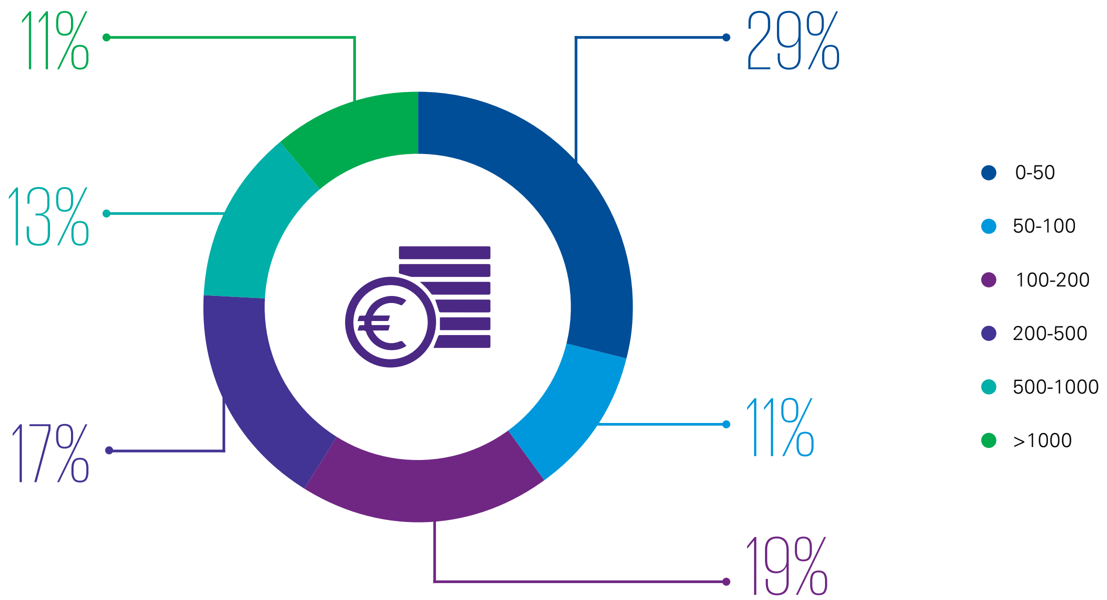


Source: KPMG/ALFI loan fund survey

We note that the percentage of sub-funds used for separate investment strategies is roughly equal to single compartment funds. Complex share classes means that different management and performance fee structures can be managed for different investors.

Most of the funds have a size ranging between €0-50 million. Notably, large funds (i.e. funds having a total commitment exceeding €1 billion) represent 11% of the total number of loan funds. As at 31 August 2017, the regulated market of loan funds represents approx. EUR 40b.

Figure 4: Loan funds by fund size (in million EUR)



Source: KPMG/ALFI loan fund survey

The above information is purely related to regulated funds (for the RAIF, the regulation takes place at the level of the AIFM). However, a big part of the market is not regulated, and is, as a result, difficult to catch.

Indeed, non-regulated investment vehicles can be set up as limited partnerships (*société en commandite simple* or SCS), special limited partnerships (*société en commandite spéciale* or SCSp), non-regulated securitisation vehicles (SV), or holding and financing companies (SOPARFI).

These vehicles are set up either by Luxembourg or foreign funds to acquire portfolios of loans or even to originate loans. Indeed, granting loans to a limited number of identified persons (and therefore not on a large scale) may be done without the CSSF's authorisation. This is a great advantage of the Luxembourg market, as unregulated vehicles may be used in the framework of specific projects to do such activities. This ability strengthens the attractiveness of Luxembourg for the loan fund industry.

As a result, many loan fund actors have used Luxembourg unregulated structures to originate or acquire loan portfolios. This means that the figures presented in this survey, which only provides statistics in relation to regulated funds, only capture a portion of the total size of the loan fund structures carried out from Luxembourg entities.

In compiling this survey we spoke to the top ten loan fund managers in the world, as well as other major actors in the debt-investment sector. All of them have a presence in Luxembourg and assets under management totalling more than EUR 45b. From these interviews we have collected data on the unregulated part of the market.

The main trend is that most of the actors use unregulated vehicles. The first vehicle of choice is the SOPARFI, which is preferred over the unregulated SV. Indeed, SOPARFIs are widely used amongst investors due notably to their accessibility, flexibility, and how well-known they are by investors and promoters alike.

Furthermore, several actors have confirmed that they have started (or are in the process of starting) to use a RAIF structure for future investments. These fund managers have been drawn to the RAIF's quick time-to-market as well as its flexibility on legal forms and rules.

In terms of investment regions, the European and the North American markets are still, unsurprisingly, seen as providing good opportunities of investment in the short to medium-term. More interestingly, we see an appetite for more investments in Asia and South America. As for the evolution of the market in the coming years, overall returns are expected to remain stable but good opportunities might become more difficult to find.