Fund structures

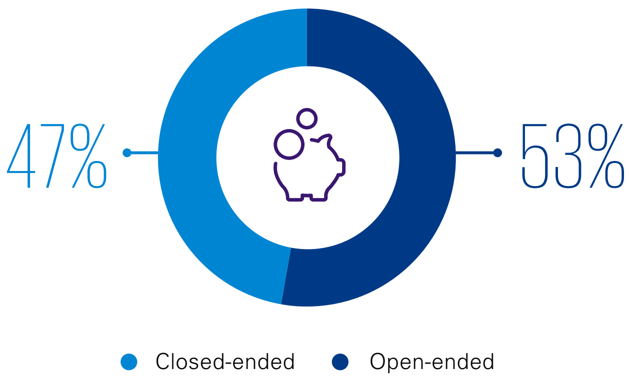
Loan fund categories

Depending on their investment strategy, loan funds can either be loan-originating funds or loan-participating funds:

- A loan-originating fund is, according to its investment strategy, allowed to grant and restructure loans. In other words, it can amend loan conditions such as prolongation or deferral.
- A loan-participating fund is allowed to partially or fully acquire and restructure existing loans from banks and other institutions, either directly from the lender or in secondary markets where these loans are traded. According to its investment strategy, a loan-participating fund is not allowed to grant loans.

Loan funds can be open- or closed-ended, depending on the type of investor and the underlying asset type. A slim majority (53%) of Luxembourg loan funds are open-ended (Figure 1).

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



Source: KPMG/ALFI loan fund survey

Regulatory framework (regulated investment vehicles)

Loan funds can be structured as regulated or unregulated. Regulated funds are authorized and supervised by Luxembourg's supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF).

Ordered from least regulated to most, regulated loan funds can be structured as:

- Reserved alternative investment funds (RAIFs): funds subject to the law of 23 July 2016.
- Investment companies in risk capital (SICARs): funds subject to the law of 15 June 2004, as amended.
- Specialized investment funds (SIFs): funds subject to the law of 13 February 2007, as amended.
- Part II funds: funds subject to part two of the law of 17 December 2010, as amended.
- UCITS funds: funds subject to part one of the law of 17 December 2010, as amended.

UCITS are available to retail investors, while Part II funds are available to all investor types. SIFs, SICARs and RAIFs are reserved for "well-informed investors". These are institutional investors, professional investors or others who can confirm they qualify for this status and either (i) invest a minimum of EUR€125,000 or (ii) were assessed by a credit institution, investment firm or management company and certified of their ability to understand the risks of investing in the fund.

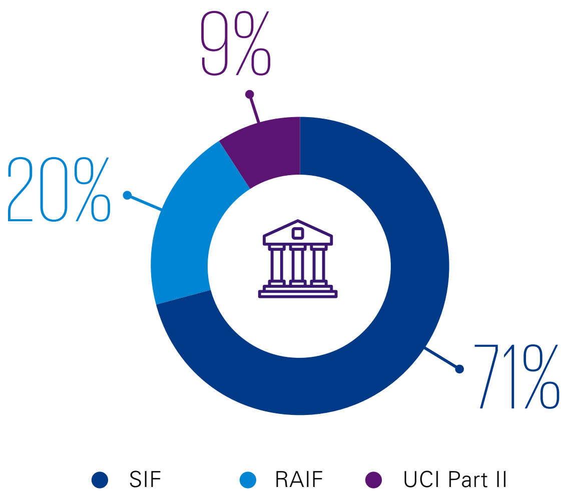
Regarding assets, UCITS can only invest in transferable securities and other liquid assets, as stated in article 41 of the law of 17 December 2010. Eligible assets for Part II funds, SIFs or RAIFs are unrestricted, although Part II funds must receive prior CSSF approval of their investment objectives and strategy.

SICARs can only invest in securities that represent risk capital, as stated in the CSSF circular 06/241.

UCITS, Part II funds, SIFs and SICARs are all subject to prior CSSF approval and authorization.

RAIFs are not subject to CSSF approval but must be managed by an authorized external alternative investment fund manager (AIFM), which must regularly report on the RAIF to the CSSF. In comparison, UCITS, Part II funds, SIFs and SICARs are all subject to direct CSSF supervision.

Figure 2: Loan funds[1] by legal regime



Source: KPMG/ALFI loan fund survey

Alternative investment funds set up as Luxembourg limited partnerships (SCS/SCSp) can also invest in any type of asset. If they are managed by an EU AIFM, they can market their partnership interests to EU-wide professional investors with a specific passport.

As seen in Figure 2[2], SIFs dominate Luxembourg's loan fund market at 71% — followed by RAIFs (20%) and Part II funds (9%).

SIFs' popularity with loan fund managers (excluding UCITS) is due to their flexible investment policy and their regulatory regime. In addition, this vehicle is well known, having been available for a decade.

Compared to last year, the percentage of loan funds set up using RAIFs has surged from 13% to 20%.

We expect RAIFs to continue this growth in the future.

Launched in 2016, the RAIF is an attractive alternative to the SIF. It has the same features and flexibility of the SIF, but is less regulated: only the RAIF's AIFM is subject to direct CSSF supervision and reporting requirements, removing the double regulation layer and allowing a quicker time to market.

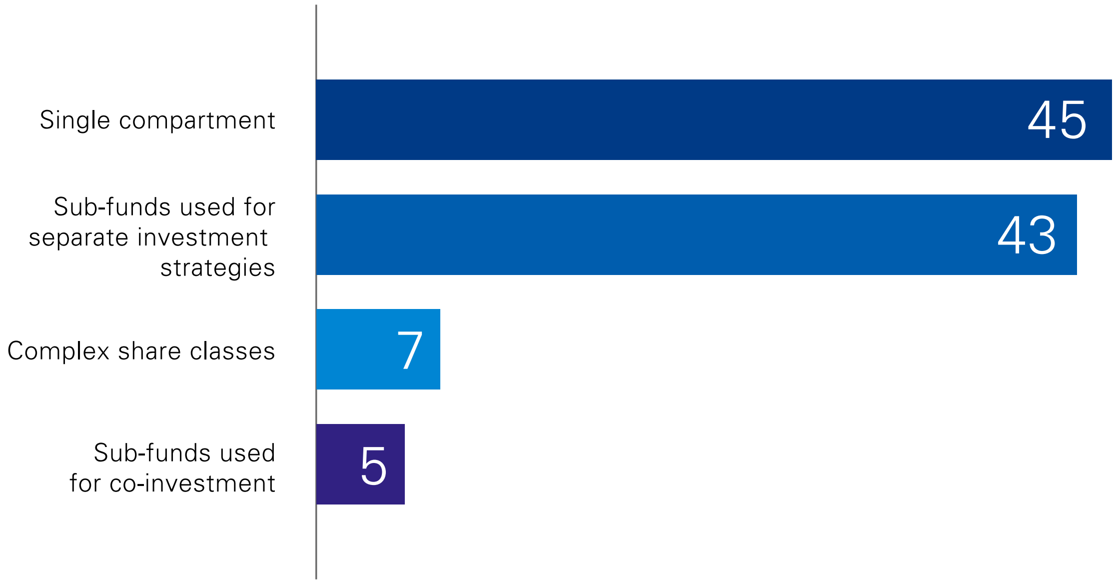
Loan fund promoters rarely use SICARs, due to their restricted investment policy — they can only be used to invest in risk-bearing securities.

Loan funds can be set up under the UCITS framework by using tailored indices and derivatives, but this is unpopular — mainly due to its strict liquidity requirements regarding assets. However, we still list the option here for the sake of completeness.

1. Excluding UCITS
2. Ibidem

Regarding loan fund structuring, promoters can choose between single or multiple compartments. Figure 3 shows how these types are split as of 30 June 2019 — the percentage of single compartment funds is higher than sub-funds used for separate investment strategies. Complex share classes mean that different management and performance fee structures can be managed for different investors.

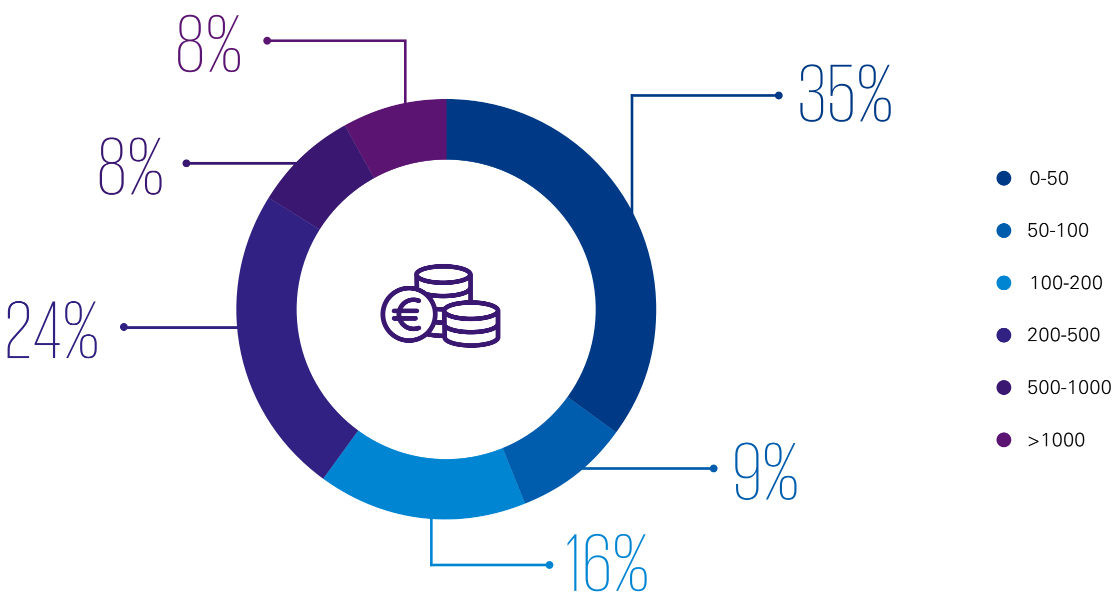
Figure 3: Loan fund structures



| Source: KPMG/ALFI loan fund survey

Like last year, most funds range up to EUR€50 million in size (Figure 4). Notably, mid-size funds — i.e. those with a net asset value of between EUR€200 million and EUR€500 million — represent 24% of the total number of loan funds (versus 20% in 2018). As of 31 July 2019, the regulated market of loan funds represented around EUR€56 billion (compared to EUR€49 billion as of mid-2018).

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



| Source: KPMG/ALFI loan fund survey

Unregulated investment vehicles

Another important element of the loan fund market is unregulated investment vehicles. These vehicles can be set up as limited partnerships (sociétés en commandite simple or SCSs), special limited partnerships (sociétés en commandite spéciale or SCSps), unregulated securitization vehicles (SVs) or holding and financing companies (sociétés de participations financières or SOPARFIs).

Compared to regulated vehicles, they are highly flexible and cost less to set up and operate since they do not require CSSF approval, reporting or supervision.

In fact, granting loans to a limited number of identified persons — i.e. on a small scale — can be done without CSSF authorization. This makes the Luxembourg market extremely attractive to the loan fund industry, as unregulated vehicles may be used in the framework of specific projects — for example, to acquire a single portfolio or several portfolios in the same industry.

The favored vehicle of loan fund managers in the unregulated market is the SOPARFI, who tend to prefer it to the unregulated SV. SOPARFIs are widely used mainly due to their accessibility and flexibility — and also because they are well-known to investors and promoters.