Fund structures

Loan fund categories

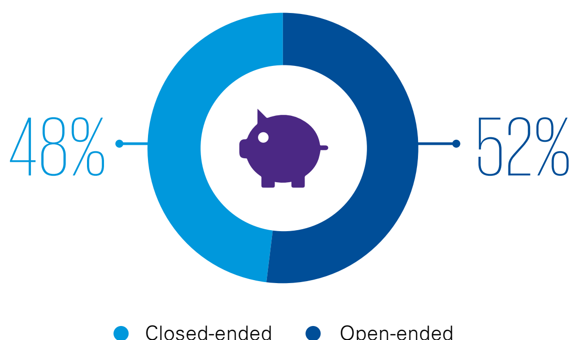
Based on their investment strategies, loan funds can be classified as either loan-originating funds or loan-participating funds:

— A loan-originating fund is any type of fund that is, according to its investment strategy, allowed to grant and restructure loans (i.e. to subsequently amend 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 its investment strategy, a loan-participating fund is not allowed to grant loans.

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. A slight majority (52%) 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 either as regulated or unregulated funds. The former are authorised and supervised by Luxembourg's supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF).

In order of the least regulated structure to the 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)

— Specialised 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)

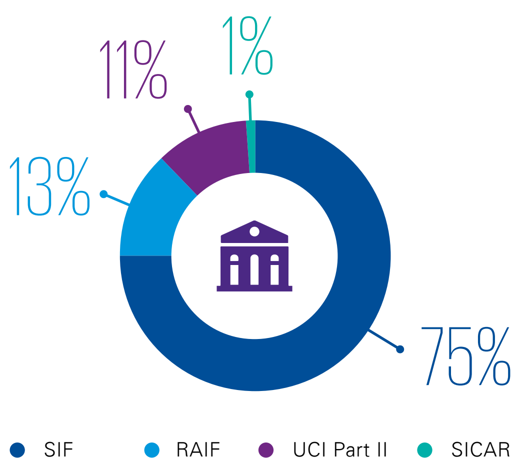
UCITS are open to retail investors while Part II funds are open to all types of investors. SIFs, SICARs and RAIFs are reserved for "well-informed investors" — that is, institutional investors, professional investors or other investors who confirm that they adhere to the status of "well-informed" investors and either (i) invest a minimum of €125,000 or (ii) have been assessed by a credit institution, an investment firm or a management company, resulting in a certification of their ability to understand the risks associated with investing in the fund.

Regarding assets, UCITS can only invest in transferable securities and other liquid assets (as detailed by article 41 of the law of 17 December 2010). No restrictions apply to the eligible assets for Part II funds, SIFs or RAIFs (although Part II funds must obtain prior approval of their investment objectives and strategy from the CSSF). SICARs can only invest in securities that represent risk capital (as detailed by CSSF circular 06/241).

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

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

Figure 2: Loan funds[1] by legal regime



Source: KPMG/ALFI loan fund survey

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

As can be seen in Figure 2[2], SIFs dominate Luxembourg's loan fund market — accounting for 75% of the market — followed by RAIFs (13%) and Part II funds (11%), while the use of SICARs is marginal (1%).

SIFs being loan fund managers' first choice of structure (excluding UCITS) can easily be explained by their flexibility regarding investment policy, as well as by their regulatory regime. Further, having now been available for a decade, this vehicle is well known.

Compared to last year, the percentage of loan funds set up using RAIFs has remained constant, at about 13%.

We expect RAIFs to gain greater market share in the future.

The RAIF — which was launched in 2016 — represents a strong alternative to the SIF. It possesses the features and flexibility of the SIF and the SICAR, but is less regulated: only the RAIF's AIFM is subject to direct supervision by and reporting to the CSSF, thus removing the double layer of regulation and enabling a quicker time to market.

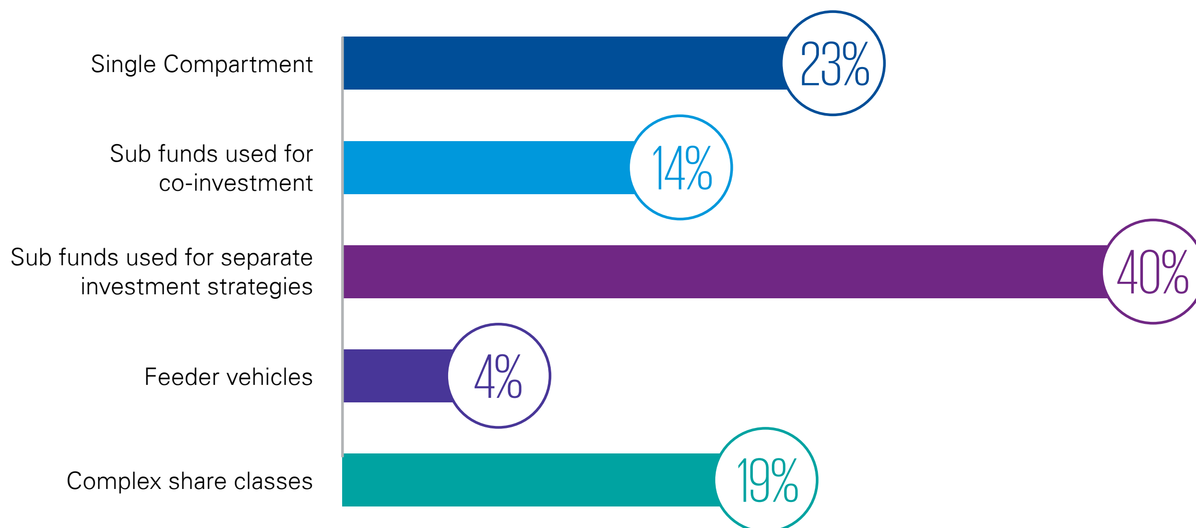
Figure 2 shows that SICARs are barely used by loan fund promoters. This can be explained by their restricted investment policy — meaning they can only be used to invest in risk-bearing securities.

Loan funds can be set up under the UCITS framework through the use of tailored indices and derivatives, but this option is not used to any significant degree — mainly because of the strict liquidity requirements in terms of assets. Nevertheless, for the sake of completeness, we mention this option in the survey.

1. excluding UCITS
2. ibidem

In terms of structuring loan funds, promoters have a choice between single compartments or multiple compartments. Figure 3 shows the split between these types as at 30 June 2018 — it can be seen that the percentage of sub-funds used for separate investment strategies is higher than that of single compartment funds. Complex share classes mean that different management and performance fee structures can be managed for different investors.

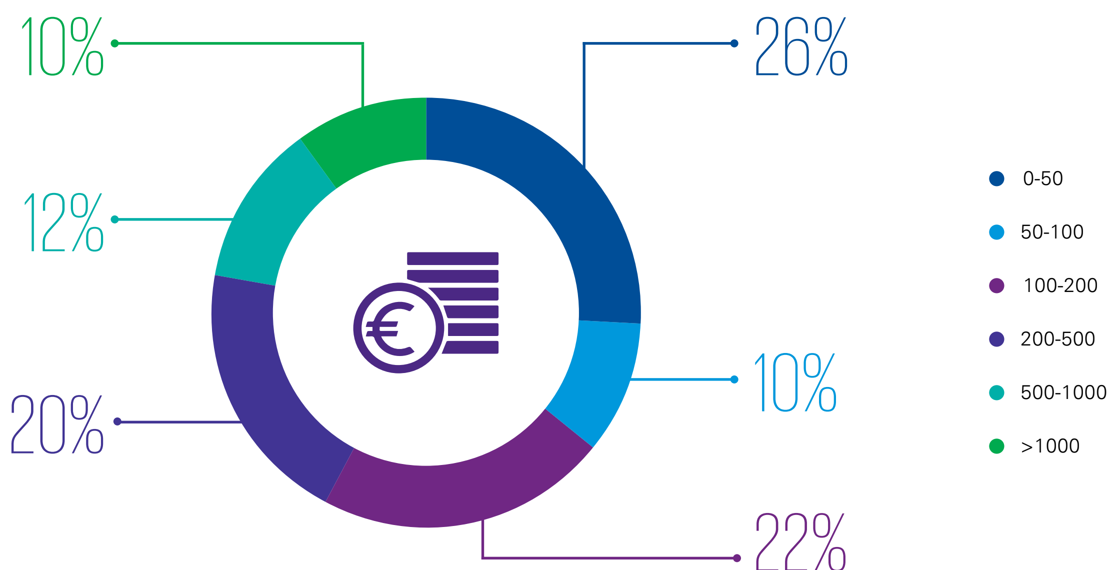
Figure 3: Loan fund structures



Source: KPMG/ALFI loan fund survey

As last year, the majority of funds range up to €50 million in size (Figure 4). Notably, large funds — i.e. those with a total commitment exceeding €1 billion — represent 10% of the total number of loan funds (versus 11% in 2017). As at 31 July 2018, the regulated market of loan funds represented about €49 billion (compared to €40 billion as at mid-2017).

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



Source: KPMG/ALFI loan fund survey

Unregulated investment vehicles

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

Compared to regulated vehicles, these unregulated vehicles are highly flexible — and cost less to set up and operate since they require no CSSF approval, reporting or supervision.

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

For those loan fund managers in the unregulated market, the first vehicle of choice is the SOPARFI, which tends to be preferred over the unregulated SV. Indeed, SOPARFIs are widely used amongst investors due principally to their accessibility and flexibility, and the fact that they are well-known to investors and promoters alike.