



association of the  
luxembourg fund industry

# **Debt Funds**

**An Alternative Source of Financing  
for the European Economy**

## Facts on non-banking credit intermediation

- Debt funds play an important role in addressing the imbalance in liquidity supply/demand and helping businesses raise capital and stimulate economic growth.
- Debt funds and banks are working together to finance the real economy by providing capital to SMEs and investments in infrastructure, real estate assets etc.
- In Europe, lending carried out by banks represents 80% of credit intermediation compared with 20% in the US<sup>1</sup>.

- Regulators and policy makers across Europe have shown eagerness to support non bank lending as a means to ensure flow of capital in the financial system<sup>2</sup>: A key building block in the European Commission's Capital Markets Union (CMU) initiative for unlocking funding for Europe's growth is to encourage "greater diversity in funding"<sup>3</sup>.
- In November 2014, the European Commission presented its "Investment Plan for Europe", in which short term measures were presented including the implementation of European Long-Term Investment Funds (ELTIF) regulation. In 2015, the ELTIF regulation entered into force.
- The Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the Securitisation Regulation) was

adopted in 2017. It consolidates the legal framework governing European securitisations and lays down the rules for issuing simple, transparent and standardised (STS) securitisation transactions – principally aiming at establishing a more risk-sensitive prudential framework for STSs.

- Regulators and policy makers in Europe recognise the benefits of non-bank intermediation and especially debt funds as they provide an alternative source of financing with little maturity transformation and limited leverage to the real economy.

Regulated funds or AIFs managed by a regulated AIFM provide an ideal tool and framework for the market to provide non-banking financing solutions. They also allow regulators to monitor maturity mismatch and leverage.

## Non-bank credit intermediation in Europe represents a sizeable opportunity for debt fund managers

Tighter banking regulations and higher capital ratios imposed on banks have significantly reduced bank lending in Europe since the financial crisis and the EU is only half way through the deleveraging process<sup>4</sup>.

Ample liquidity conditions have increased the demand for yield from institutional investors which are looking at direct lending either through funds or other vehicles as traditional fixed income strategies struggle to deliver yields as attractive as before the 2008 crisis.

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<sup>1</sup> European Banking Sector Facts & Figures 2014, European Banking Federation (December 2014)

<sup>2</sup> European Commission "Action plan on Building a Capital Markets Union", dated 30 September 2015

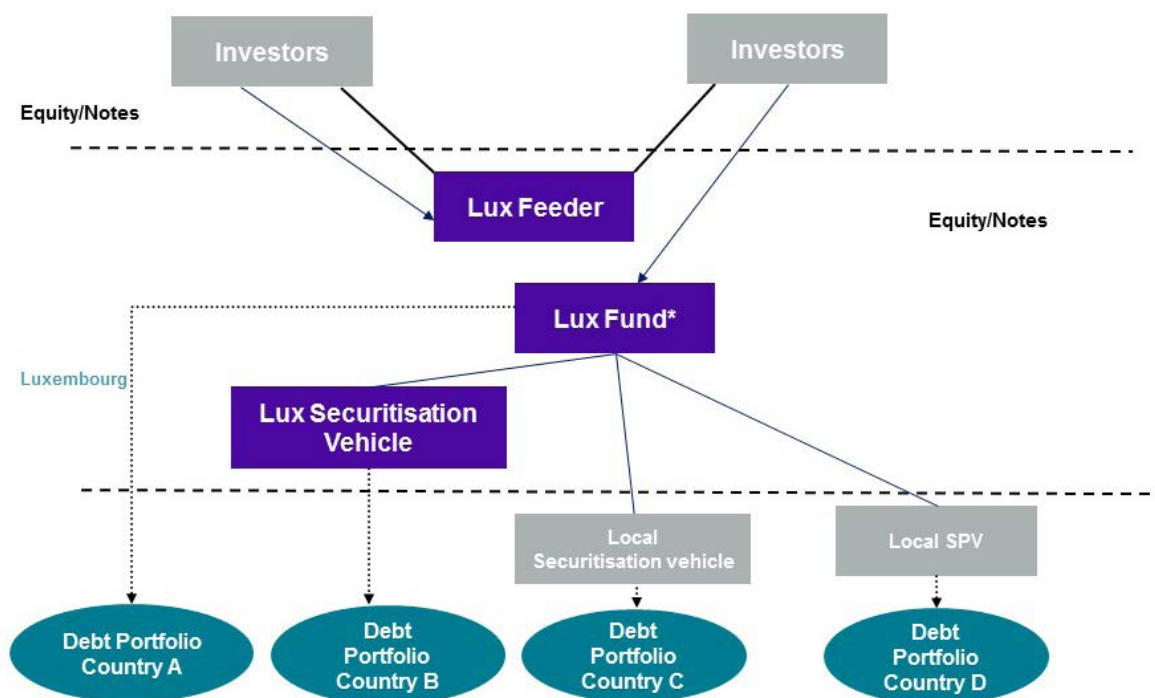
<sup>3</sup> Source: Steven Maijor, ESMA Chair, joint EU Commission/Italian Presidency Growth for Finance Conference in Brussels

<sup>4</sup> S&P LCD Europe 4Q13

## Why Luxembourg

- Over 85% of the top 30 debt fund managers worldwide are present in Luxembourg. Luxembourg offers an unparalleled breadth of solutions for debt funds including for debt origination and direct lending funds.
  - Placed at the heart of Europe, Luxembourg is ideally positioned to help global debt funds deal with the complexity of European financial market rules and regulations (incl. distribution, banking regulations, etc.).
  - Luxembourg is the ideal platform for pan-European and global marketing, with a proven track record in cross-border distribution.
  - Luxembourg debt funds can originate, participate, syndicate loans and accomo-
- date all types of debt strategies including investments in: secondaries, mezzanine, distressed loans, etc.
  - Confirmation by the Luxembourg regulator that AIFs may engage in loan origination and loan participation/loan acquisition has been provided<sup>5</sup>.
  - Open-ended, semi open-ended and closed-ended debt funds may all be structured, using a variety of Luxembourg legal forms and regulatory regimes.
  - IFRS and Lux GAAP are commonly used<sup>6</sup>. Valuation of the loans whether at fair value or amortised cost are both possible under certain circumstances.

### Exemple of a typical debt funds structure



\* SIF, RAIF or unregulated AIF, in corporate or partnership form different options and combinations exist to structure a debt fund in Luxembourg:

- use of a regulated vehicle (SIF), in corporate or partnership form;
- use of a supervised fund (RAIF), in corporate or partnership form;
- use of an unregulated AIF;
- use of a securitisation vehicle;
- use of a standard Luxembourg company.

A Luxembourg fund may also be invested through a Feeder vehicle, depending on the investors' profiles.

<sup>5</sup> See CSSF FAQ on the AIFM Law (available on the regulator's website)

<sup>6</sup> US GAAP is only available for special limited partnerships (société en commandite spéciale)

## Legal considerations

		AIF set up in the form of SCS/SCPS <sup>12</sup>	SIF	SICAR
Distribution	EU Passport <sup>7</sup>	Yes	Yes	Yes
	Private Placement <sup>8</sup>	Yes	Yes	Yes
	Reverse Solicitation <sup>10</sup>	Yes	Yes	Yes
Structuring	Types of companies	With (SCS) or without (SCSp) legal personality	Limited companies Limited partnerships <sup>10</sup>	Limited companies Limited partnerships <sup>10</sup>
	Contractual vehicles	No	Mutual funds	No
	Umbrella structures	No	Available	Available
	Open-ended and Closed-ended nature	Available	Available	Available
	Listing	Available	Available	Available
	Service providers	Depository (if managed by a fully authorised AIFM)	Central administration Depository	Central administration Depository
Issue of Securities	Equity (E) / debt (D) type securities	E/D	E/D	E/D
Diversification requirements		Not applicable	30% maximum in securities of the same type (e.g. of the same bonds issuer)	No requirements
Techniques & Strategies	Secondary market	Yes	Yes	Yes
	Origination	Yes	Yes	Yes
Eligible Assets	Senior and junior loans	Yes	Yes	Yes (provided that the beneficiaries/ underlying constitute risk capital)
	Partly drawn credit			
	Receivables			
	Revolving credit			
	Securitised debt			
	Whole loans			
	Unitranche debt			
Mezzanine debt				
Supervision and auditor	Supervision of the vehicle	No	Yes	Yes
	AIFM supervision	AIFM registration regime of fully authorised AIFM regime (passports)	AIFM registration regime or Fully authorised AIFM regime (passports)	AIFM registration regime or Fully authorised AIFM regime (passports)
	Auditor	Only if managed by a fully authorised AIFM	Yes	Yes
Financial Reporting	Accounting standards	IFRS of Lux GAAP, US GAAP <sup>11</sup>	IFRS or Lux GAAP or US GAAP <sup>11</sup>	IFRS or Lux GAAP or US GAAP <sup>11</sup>
	Valuation of the loans: fair value or amortised cost?	Both are possible under certain circumstances	Fair value unless different method provided for in the constitutive documents	Fair value

<sup>7</sup> Upon appointment of an EU authorised AIFM

<sup>8</sup> National rules apply

<sup>9</sup> Reverse solicitation: is not a mean of distribution per se since it is assumed that the potential investor approaches the fund/asset manager without any solicitation made by the fund/asset manager

<sup>10</sup> For limited partnerships (*société en commandite simple*) or special limited partnerships (*société en commandite spéciale*)

<sup>11</sup> US GAAP is only available for special limited partnerships (*sociétés en commandite spéciale*)

<sup>12</sup> SCS and SCSp (limited partnerships) are the preferred legal forms for unregulated AIFs, but other legal forms may also possibly be opted for (such as limited companies like the *société en commandite par actions* (SCA), the *société anonyme* (SA), or the *société à responsabilité limitée* (S.à r.l.))

RAIF	Securitisation vehicles (subject to the law of 22 March 2004)
Yes	Subject to conditions of the Prospectus Regulation
Yes	Yes
Yes	Not applicable <sup>13</sup>
Limited companies Limited partnerships <sup>9</sup>	Limited companies
Mutual funds	Securitisation funds
Available	Available
Available	Available
Available	Available
Central administration Depositary	Depositary (regulated securitisation vehicle)
E/D	E/D
30% maximum in securities of the same type (e.g. of the same bonds issuer) (a SIF like RAIF) unless the RAIF decides to invest in qualifying risk capital investments (a SICAR like RAIF)	Not applicable
Yes	Yes
Yes	Yes (restricted)
Yes for the SIF like RAIF  Yes for the SICAR like RAIF (provided that the beneficiaries/underlying constitute risk capital)	Yes
No	No - unless issuance of securities to the public on a continuous basis
Fully authorised external AIFM regime (passports)	No
Yes	Yes
IFRS or Lux GAAP or US GAAP <sup>11</sup>	IFRS or Lux GAAP
Fair value unless different method provided for in the constitutive documents	Both are possible under certain circumstances

<sup>13</sup> Not applicable for securitisation vehicles falling outside of the scope of the AIFMD



The Association of the Luxembourg Fund Industry (ALFI), the representative body for the Luxembourg investment fund community, was founded in 1988. Today it represents more than 1,500 Luxembourg-domiciled investment funds, asset management companies and a wide variety of service providers including depositary banks, fund administrators, transfer agents, distributors, law firms, consultants, tax advisers, auditors and accountants, specialist IT providers and communications agencies.

Luxembourg is the largest fund domicile in Europe and its investment fund industry is a worldwide leader in cross-border fund distribution. Luxembourg-domiciled investment structures are distributed in more than 70 countries around the globe, with a particular focus on Europe, Asia, Latin America and the Middle East.

ALFI defines its mission as to “Lead industry efforts to make Luxembourg the most attractive international investment fund centre”.

Its main objectives are to:

### Help members capitalise on industry trends

ALFI’s many technical committees and working groups constantly review and analyse developments worldwide, as well as legal and regulatory changes in Luxembourg, the EU and beyond to identify threats and opportunities for the Luxembourg fund industry.

### Shape regulation

An up-to-date, innovative legal and fiscal environment is critical to defend and improve Luxembourg’s competitive position as a centre for the domiciliation, administration and distribution of investment funds. Strong relationships with regulatory authorities, the government and the legislative body enable ALFI to make an effective contribution to decision-making through relevant input for changes to the regulatory framework, the implementation of European directives and the regulation of new products or services.

### Foster dedication to professional standards, integrity and quality

Investor trust is essential for success in collective investment services and ALFI thus does all it can to promote high professional standards, quality products and services, and integrity. Action in this area includes organizing training at all levels, defining codes of conduct, transparency and good corporate governance and supporting initiatives to combat money laundering.

### Promote the Luxembourg investment fund industry

ALFI actively promotes the Luxembourg investment fund industry, its products and services. It represents the sector in financial and economic missions organised by the Luxembourg government around the world and takes an active part in meetings of the global fund industry.

ALFI is an active member of the European Fund and Asset Management Association, of the International Investment Funds Association, of Pensions Europe, of the International Association of Pension Funds Administrators and of the Global Impact Investing Network.

For more information, visit our website at [www.alfi.lu](http://www.alfi.lu) and follow ALFI on









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