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Private debt fund survey 2024

Unlocking a new world of alternative investments for the retail market

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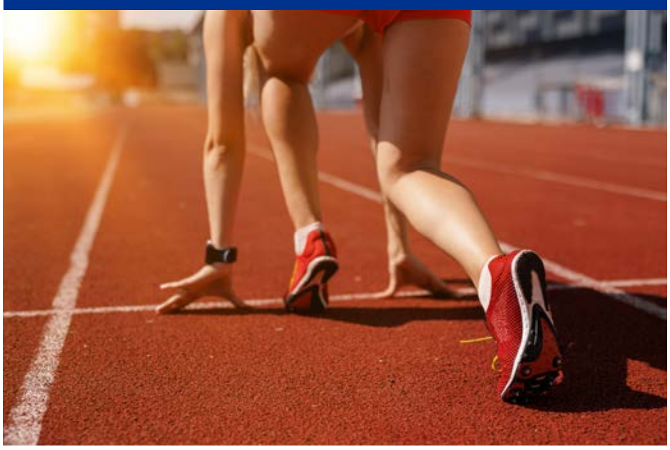


Introduction

Serge Weyland
ALFI CEO

The private debt market continues to demonstrate resilience and growth, despite the challenges faced by global markets in recent years. The 2024 edition of the KPMG Private Debt Fund Survey reveals that assets under management (AuM) in private debt have soared to an impressive EUR510 billion, reflecting an average growth of 21.5% in just six months, between June and December. This significant increase showcases the ongoing appetite for private debt as a key asset class, with Luxembourg maintaining its status as the leading domicile for these funds. Our country has in fact become a leading hub for private debt funds, offering a robust regulatory framework, political stability, and a skilled, multicultural workforce within a well-established financial services sector.

Introduced in 2013 and 2016 respectively, the SCSp and the RAIF have experienced tremendous growth and now represent the vast majority of debt fund vehicles. The market has also expanded geographically, with investors looking beyond the initial US focus. Europe and Asia-Pacific have emerged as key growth regions, and 35% of investments now target EU member states. While interest in Europe is increasing, there remains significant and growing attention on North America as well as other European countries. Furthermore, the rise of technology integration and AI tools is helping managers process larger portfolios more efficiently, while enhancing transparency and operational robustness. We also witness that Luxembourg domiciled structures are now increasingly used by GPs a single vehicle solution accommodating a global investor base.

However, the evolving regulatory landscape poses new challenges. While sustainability remains a vital aspect of investment strategies, there has been a notable shift, with 76% of funds classified under Article 6 of SFDR, compared to 21% under Article 8, reflecting a more cautious approach to ESG integration. As policymakers help to drive transparency and investor protection, private debt managers must adapt to new demands for clearer reporting, governance, and AI-driven processes.

Looking ahead, the private debt market is poised to expand, with retailization becoming an emerging trend. ELTIFs and other initiatives aimed at attracting retail investors are gaining traction, adding further complexity but also opportunity to the market. With interest rate cuts on the horizon and a stabilising economic outlook, private debt funds are well-positioned for sustained growth in the coming years.

On behalf of ALFI, we would like to thank KPMG for their ongoing support and express our gratitude to the many market participants who contributed to this year's survey.

Valeria Merkel

Partner Audit, Public and Private Asset Management & Co-Head of Private Debt

Julien Bieber

Partner Tax, Alternative Investments & Co-Head of Private Debt

The private debt market is experiencing a period of **unprecedented growth,** driven by a confluence of factors, including low interest rates, increased investor demand and a shift away from traditional bank lending. This dynamic and evolving landscape presents both opportunities and challenges for investors, making it crucial to understand the key trends and insights shaping this exciting asset class.

This survey delves into the heart of the private debt market, drawing upon expert perspectives from leading industry players. We explore the growth trajectory of this asset class, examining the factors driving its expansion and the key trends shaping its future. We also dissect the challenges and opportunities presented by the evolving regulatory landscape, the rise of retailization and the increasing focus on ESG considerations.

Throughout this ever-changing landscape, the Luxembourg private debt funds market has demonstrated strong resilience, realizing impressive 21.5% growth in Assets Under Management (AuM) in six months, pushing the market past **half a trillion dollars** to a staggering **EUR510 billion**[1] in AuM.

Other AIFs but indirectly supervised funds seem to have significantly surpassed the regulated funds market in Luxembourg, increasing their market share by 18% since June 2023. The **Luxembourg SCSp** continues to dominate as the preferred indirectly supervised private debt funds structure for 86% of the market. The **Luxembourg RAIF** has also increased its market share to an astounding 62% of indirectly supervised private debt funds, a 9% increase on last year.

The **EU remains the top geographical target** for investments, favored by 35% of our respondents, with other European countries (25%) and North America (16%) rounding out the list. Investors in Luxembourg private debt funds remain largely institutional (80%) and mainly come from the European Union (40.5%).

Direct lending continues to prevail as the principal strategy (62% in 2024 versus 64% in 2023), driven by record levels of buyout dry powder amassed by European private asset managers over recent years. The industry is further evolving beyond large-scale direct lending with a growing focus on **specialty credit** involving industry-specific expertise. As private credit replaces traditional banks, there is an inherent **interconnection between private debt and private equity,** and this trend is only expected to grow.

Through **in-depth interviews and insights from industry experts like Park Square Capital, AllianceBernstein, Permira, Waystone and FairOaks Capital,** we gain valuable insight into the current state and future trajectory of the private debt market. These experts have shared with us their perspectives on the evolving dynamics of the market, the opportunities for growth and the challenges that lie ahead.

The market is increasingly exploring ways to attract retail investors, recognizing the potential for significant growth and diversification. **Retailization** can help to diversify the private debt market, reducing its reliance on institutional investors and creating a more balanced ecosystem. With this shift, it will be even more important to have a robust regulatory framework.

The second Alternative Investment Fund Manager Directive **(AIFMD II)** introduces a more robust framework for loan origination and fund management, harmonizing regulations across Europe. This will enhance transparency and investor protection, creating a level playing field for market participants and promoting the growth of this asset class.

The European long-term investment fund **(ELTIF 2)** regulation has applied since the beginning of 2024, and although the fund industry has already expressed optimism about the product's evolution and the democratization of private markets, distribution networks and retail investors need to follow suit. The evolving regulatory landscape presents a key challenge for the private debt industry. **Increased regulatory scrutiny** demands adaptability, while pressure to deploy capital raises concerns about due diligence and inflated asset valuations.

With an increasing number of regulations and reporting obligations, developing the **right technology** will be a key element for Luxembourg-based private debt funds. **Digitalization and blockchain technology** are expected to revolutionize the private debt market in the coming years, potentially increasing the asset class's liquidity while reducing costs and barriers to entry for retail investors.

Private debt fund managers continue to integrate environmental, social and governance (ESG) factors into their decision-making processes, while focusing on maximizing investor returns.

This survey serves as a comprehensive guide for professionals seeking to navigate the complexities of the private debt market.

Before signing off, we would like to thank everyone who took part in the 2024 private debt fund survey. This publication would not have been possible without the valuable insight of the participating depositaries and market players.

Now, let's journey into the world of private debt, exploring its growth, resilience and the exciting opportunities it presents for investors in today's evolving market landscape.

[1]Average growth between June 2023 and December 2023 based on data provided by depositaries surveyed.

[1]Total assets under management based on data provided by depositaries surveyed. This does not cover all the market and only includes regulated funds and indirectly supervised investment vehicles, such as RAIF, SIF or SCSp AIF.

EUR510 billion

Total Private Debt AuM

*Based on data provided by depositaries surveyed. Accounts for only a portion of the market and includes regulated funds and indirectly supervised investment vehicles, such as RAIF, SIF or SCSp AIF

21.5%

Average growth of AuM

during last 6 months

*Average growth between 30 June and 31 December 2023 based on data provided by the depositaries surveyed

86% SCSp

Vehicle of choice for other AIFs debt vehicles

-6% SIF

compared to 2023

62% RAIF

+9% compared to 2023

Investment target

35%
EU member states

25%
Other European countries

15%
North America

Investment strategy

62%
Direct lending

16%
Mezzanine

ESG

76%
Article 6 SFDR

21%
Article 8 SFDR*

* 21% of the funds for which we received information possess environmental or social characteristics, or a combination of the two

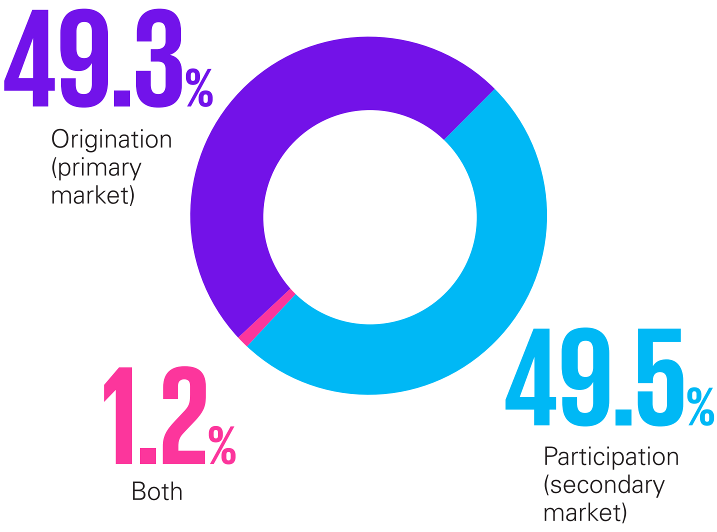
Debt Fund rundown

Debt fund categories

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

- A debt-originating fund is, according to its investment strategy, allowed to grant loans (so-called "loan origination or primary market") and restructure debts. In other words, it can amend debt conditions, such as prolongation or deferral.
- A debt-participating fund is allowed to partially or fully acquire and restructure existing debts from third parties (i.e. banks and other institutions), either directly from the lender or in secondary markets where these debts are traded. According to its investment strategy, a debt-participating fund is not allowed to grant loans.

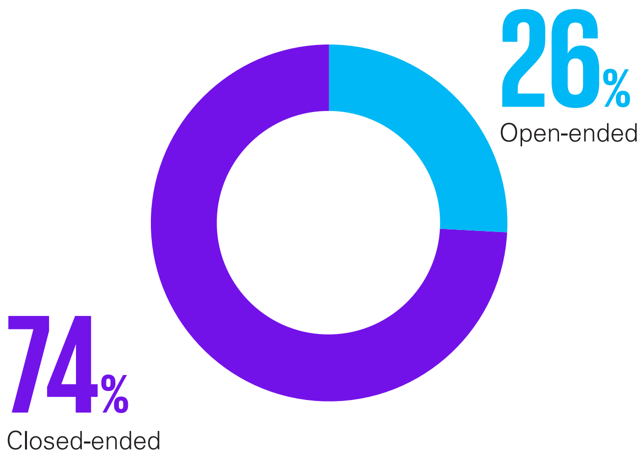
Figure 1:
Debt-originating vs. debt-participating funds



Source: KPMG/ALFI debt fund survey

Debt funds can be open- or closed-ended depending on the type of investors and the underlying asset category. Similar to last year, the vast majority (74%) of Luxembourg debt funds are closed-ended (Figure 2).

Figure 2:
Open-ended vs. closed-ended debt funds



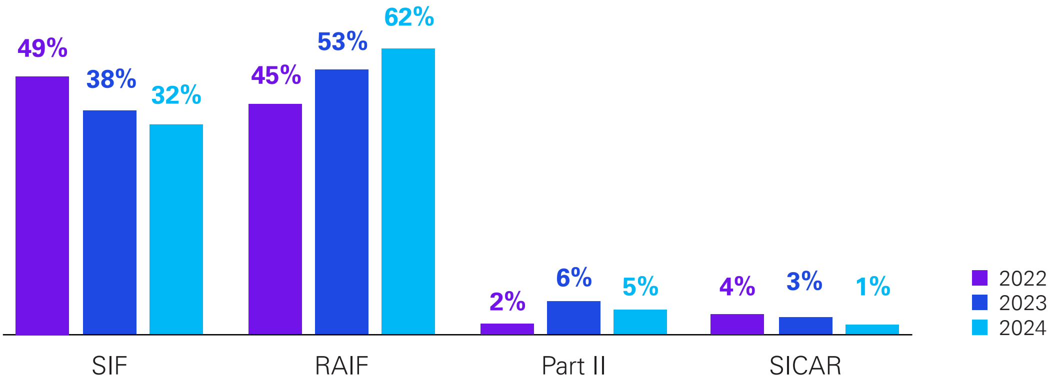
Source: KPMG/ALFI debt fund survey

Regulatory framework

Regulated fund vehicles are authorized and supervised by Luxembourg's supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), and also have an authorized AIFM. This excludes RAIFs, which are not overseen by the CSSF. They are, however, considered indirectly supervised because they must be managed by an authorized AIFM, which is subject to direct supervision and reporting requirements to its local regulator.

Other AIFs investment vehicles are also neither authorized nor supervised by the CSSF, and are either exempted from the AIFM requirement as per Article 3 of the AIFM law or have a registered AIFM as per Article 3 of the AIFM law.

Figure 3:
Regulated debt funds[3] by legal regime



Source: KPMG/ALFI debt fund survey

Regulated fund vehicles[1]

Ordered from least regulated to most, regulated debt fund vehicles (including RAIFs) exist in the following structures:

/ Reserved alternative investment funds (RAIFs): funds subject to the law of 16 July 2019[2], as amended.

/ 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.

While Part II funds are available to all investor types, SIFs, SICARs and RAIFs are reserved for "well-informed investors." This refers to institutional investors, professional investors or others who can prove they qualify for this status by meeting one of the below criteria:

(i) Invest a minimum of EUR125,000

(ii) Undergo an assessment by a credit institution, investment firm or management company that certifies their ability to understand the risks of investing in the fund.

Eligible assets for Part II funds, SIFs and RAIFs are unrestricted. However, Part II funds and SIFs, along with SICARs, are under direct CSSF supervision and subject to prior CSSF approval and authorization.

RAIFs, on the other hand, are not subject to CSSF approval but must be managed by an authorized external alternative investment fund manager (AIFM), who is required to regularly report on the RAIF to its local regulator.

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

As seen in Figure 3[4], RAIFs dominate Luxembourg's debt fund market at 62%, followed by SIFs (32%), Part II funds (5%) and SICARs (1%).

Similar to last year, the percentage of debt funds set up using RAIFs continues to grow (+9%), while the percentage of funds set up as SIFs continues to fall (-6%). We expect RAIFs to continue this level of growth.

Launched in 2016, the RAIF is an attractive alternative to the SIF. It has the same features and flexibility as the SIF but is less regulated. Only the RAIF's AIFM is subject to supervision and reporting requirements, removing the double regulation layer and allowing for shorter time to market.

SIFs remain popular with debt fund managers due to their flexible investment policy and regulatory regime. In addition, because they have been available for a decade, SIFs benefit from being well-known.

Debt fund promoters rarely use SICARs due to their restrictive investment policy: They can only be used to invest in risk-bearing securities, such as mezzanine bonds/notes.

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1. RAIFs have been included in the list of "regulated" investment vehicles for presentation purposes, although they are only indirectly supervised and neither authorized nor directly supervised by the CSSF.
2. RAIFs have been included for presentation purposes, although they are only indirectly supervised and not authorized or directly supervised by the CSSF.
3. Excluding UCITS and including RAIFs as indirectly regulated vehicles.
4. Ibidem.

Other AIFs, indirectly supervised investment vehicles

Other alternative investment vehicles that are not directly regulated (such as SIF) or indirectly regulated (such as RAIF) represent another important element of the debt fund market.

Absence of CSSF authorization and supervision

Contrary to regulated fund vehicles, these investment vehicles are not subject to any specific legal regime (e.g. UCITS, Part II, SIF and SICAR) or CSSF prior authorization requirements, reporting or direct supervision.

Alternative investment funds (AIFs)

Nonetheless, these Luxembourg investment vehicles qualifying as AIFs and thus falling within the scope of the AIFM Directive must be managed by an EU AIFM. In the case of a Luxembourg AIFM, its direct authorization and supervision of the AIF translates into indirect CSSF supervision.

Certain AIFMs falling within specific thresholds have lighter reporting requirements[5] and are only required to register with the CSSF.

Legal forms

These other AIFs vehicles can be set up as the following:

- Limited partnerships: sociétés en commandite simple (SCSs)
- Special limited partnerships: sociétés en commandite spéciale (SCSps)
- Partnerships limited by shares: sociétés en commandite par actions (SCA)
- Public limited companies: société anonyme (SA)
- Private limited companies: société à responsabilité limitée (S.à r.l.).

Securitization Vehicles (SVs)

These investment vehicles can also be structured as SVs, subject to the law of 22 March 2004 or EU Regulation 2017/2402 of 12 December 2017 (as amended).

Advantage of indirectly supervised investment vehicles

Compared to regulated fund vehicles, these are highly flexible and cost-effective since they do not require direct CSSF approval, reporting or supervision. In addition, they are not subject to registration fees, only limited minimum taxation if set up as SCS/SCSps or SVs.

Loan origination, to the extent debt is granted to a limited number of identified persons, can be done without any CSSF authorization and supervision (provided the fund does not qualify as an AIF, for example).[6] This makes the Luxembourg market extremely attractive to the debt industry, as AIF vehicles may be used within the framework of specific projects—for example, to acquire a single portfolio or several portfolios in the same industry.

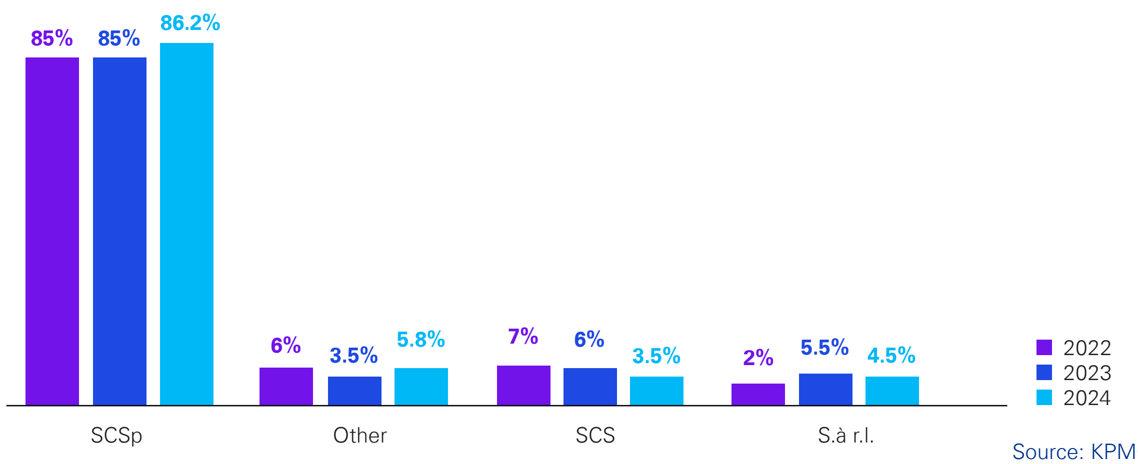
These AIFs set up as SCSs, SCSps or SOPARFIs can also invest in any type of asset. If they are managed by an EU AIFM, they can market their partnership interests to EU-wide professional investors with a specific passport.

Collecting data on the AIF segment of the debt fund market remains a challenge. These vehicles are neither authorized nor supervised by the CSSF, and no detailed information or listing currently exists on the market.

Like last year's survey, we extended the data collection within depositary banks to these AIFs investing in debts. Thanks to the participating depositaries, we garnered a broader view of the debt fund market's not directly regulated segment.

Based on the data collected, debt fund managers in this market[7] tend to favor the SCSp (86%) over the S.à r.l. (4.5%) and SCS (3.5%). SCSps are widely used for their accessibility, flexibility and visibility among investors and promoters.

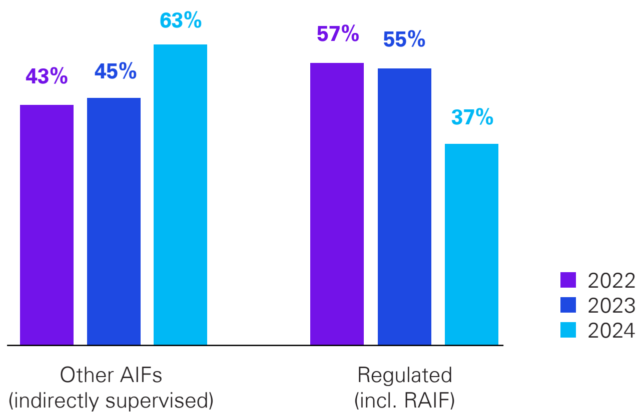
Figure 4:
Other AIFs debt fund by legal form



Source: KPMG/ALFI debt fund survey

5. Article 3, §2 and §3 of the law of 12 July 2013 on Alternative Investment Fund Managers.
6. Based on the definition of AIF: "any collective investment undertaking, including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which does not require authorization pursuant to the UCITS Directive."
7. The data for the other AIFs debt fund market only refers to indirectly supervised AIFs. No data has been collected for other non-AIF vehicles.

Figure 5:
Regulated (incl. RAIF) vs. other AIFs (indirectly supervised) debt funds



Source: KPMG/ALFI debt fund survey

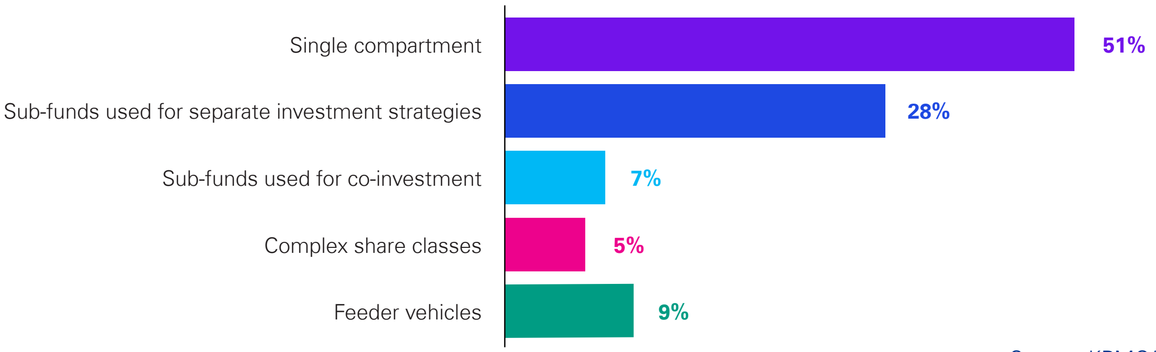
Figure 5 shows that, in contrast to recent years, most Luxembourg debt funds represented in the survey are other AIFs (63%) which have not applied for the RAIF regime, while 37% are regulated (or indirectly supervised) investment vehicles, such as RAIF or SIF. This represents a significant increase, aligning with our previously observed market trends.

Regarding debt fund structuring, promoters can choose between single or multiple compartments. Figure 6 illustrates this breakdown as of 31 December 2023. As in last year's survey, 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 utilized for different investors.

Usually, a single compartment focuses on one asset class, and sub-funds are used to build up different strategies. Due to other accounting and consolidation considerations, investors tend to opt for the simplest solution.

Figure 6:
Debt fund structures

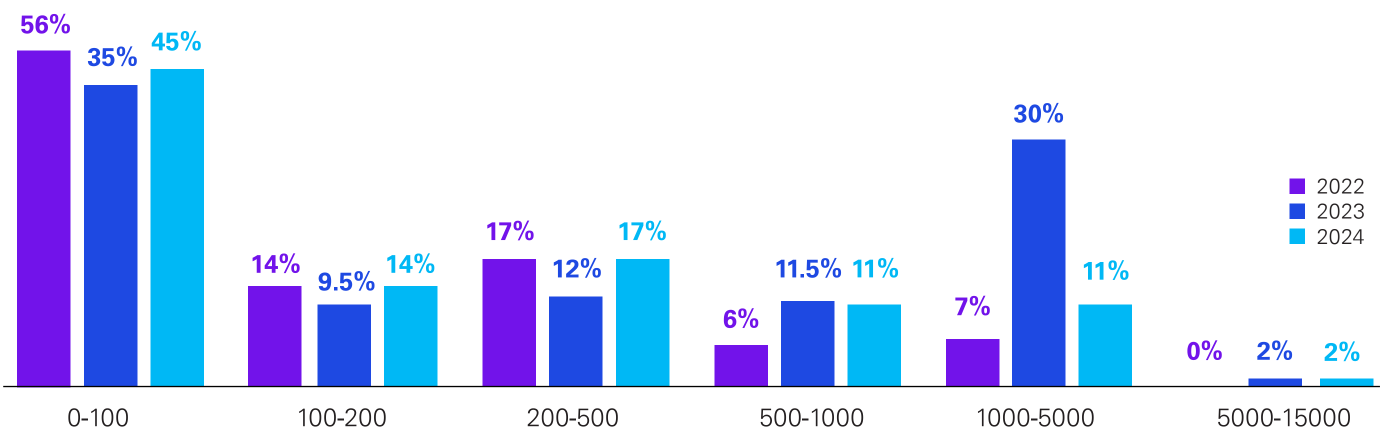


Source: KPMG/ALFI debt fund survey

Confirming the trends observed in recent years, 45% of debt funds have AuM up to EUR100 million. Thirty-one percent of debt funds are mid-size funds, i.e. those with a net asset value of EUR100 million to EUR500 million, a significant percentage increase over last year. Finally, large funds ranging from EUR1 billion to EUR5 billion represent 22%.

Based on the information received from depositary banks, total AuM as of 31 December 2023 for regulated funds and indirectly supervised investment vehicles is approximately EUR511 billion. Moreover, the depositaries surveyed reflected an average growth in AuM of 21.88%, compared to the survey in June 2023[8].

Figure 7:
Debt fund by fund size (in million EUR)



Source: KPMG/ALFI debt fund survey

8. Average growth between June 2023 and December 2023 based on data provided by the depositaries surveyed..

Industry voices: thoughts from private debt managers

Here's what frontline financial experts have to say about key trends and future outlook

Industry dynamics continue to show signs of positive momentum

Conversation with Matthew Maguire and Andrew Haywood from Park Square Capital

Matthew Maguire
CFO and Head of ESG
Park Square Capital

Andrew Haywood
COO
Park Square Capital

Many have talked about this being a golden moment for private credit. How long do you think it will last?

Matthew: There has been much hype in the media that private credit is experiencing a 'golden moment' driven by an environment of higher base rates and decreased competition from the banks. While it is true that private credit is flourishing, we do not believe this to be a momentary phenomenon. In fact, it may be more appropriate to describe it as a 'golden age' of private credit, which we expect will continue well into the future.

Andrew: I would agree with Matthew that this is not just a 'flash in the pan' moment. Private credit has matured as an asset class over the last decade, with USD1.6 trillion AUM today, and is expected to double over the next five years. With this phenomenal expected growth, it is important to note that private credit is not just an asset class to invest in during the good times. It really is an all-weather asset class that can deliver attractive risk-adjusted returns through the cycle, while exhibiting relatively low volatility.

What are the key challenges facing the private credit market at this time, given the tough macroeconomic backdrop?

Matthew: While higher interest rates are generally a positive for fund level returns given the floating rate nature of our loans, they do put pressure on free cash flow at the portfolio company level, which means that a number of pre-rate hike capital structures will need to be restructured. Park Square's investment philosophy centers around investing in high-quality companies with resilient business models, high margins of safety and positive cash flows. This selective approach really pays dividends in a difficult macro-environment and has protected us from the uptick in defaults that the broader market has experienced. Our portfolio is fortunately in excellent health, with a very healthy 2.4x interest coverage on a 'next 12 months' basis, but we cannot rest on our laurels. We must remain very disciplined on new deal activity and laser focused on our portfolio monitoring.

What investment opportunities are you currently seeing and how are you finding the competitive landscape?

Andrew: The syndicated markets reopened with a vengeance in 2024. While some private lenders might view this as a negative, given we are often in competition with the banks, we view this as a positive and a requisite for healthy M&A activity. A major beneficiary of the syndicated markets reopening has been junior debt, which was up 20% in Q1 2024, as sponsors look to reduce their cost of capital and cash interest burdens to solve the challenges Matthew mentioned earlier.

Core mid-market direct lending has remained solid, and we were pleased to see Park Square top Debtwire's 2024 European Direct Lender Rankings table, highlighting our strong market position in Europe. Competition is tough and while volumes are up, we have seen compression in margins and OID, which are now back to more normal levels after a peak in 2022 and 2023. It's really important that we remain disciplined and highly selective in our deployment of capital.

The recipe for Luxembourg's leading fund industry

Insights from Rebecca Collins of Park Square Capital

Rebecca Collins
Conducting Officer
and Finance Manager
Park Square Capital

What is the role of Luxembourg within your organization?

Rebecca: Our Luxembourg office was first established in 2004, right at the beginning of Park Square's journey. Originally set up to service local SPVs with one employee, it has become the backbone of Park Square's regulatory center, having secured its AIFM license in 2020. Now the office has eight experienced full-time employees focused on risk, compliance, portfolio management oversight, governance, valuation and accounting. Our Luxembourg team is well integrated within the group, with some employees serving group-wide roles. The team performs a crucial function in ensuring our funds' structures are set up and maintained in compliance with AIFMD and local regulations.

Would you agree that Luxembourg has proven to be a center of excellence for the establishment of private debt funds?

Rebecca: Luxembourg has indeed proved itself as a center of excellence for the establishment of, not just private debt funds, but private capital funds in general. In the post-Brexit era, it has played an essential role in ensuring our funds can be offered across the EEA via the AIFM's passporting rights, reaching one of our core investor markets. This, combined with the regulatory environment and robust oversight by the CSSF, provides a high level of investor protection in Luxembourg. This has been a key driver for choosing Luxembourg as the domicile of choice for our funds.

Luxembourg has firmly established itself as a hub for private debt funds, thanks to its attractive investment fund infrastructure, which combines a talented multicultural workforce with a robust regulatory framework, political stability, and a well-developed financial services sector. However, in an increasingly competitive global landscape Luxembourg must focus on maintaining its position as the domicile of choice for private debt fund initiators by addressing its current challenges and leveraging its know-how in the investment fund industry.

What else will it take to continue being successful?

For continued success, Luxembourg's regulatory environment must also stay innovative and flexible without losing its robustness. The country must continue to adapt to align with the evolving needs of private debt funds by streamlining set up and approval processes. An accelerated approval processes for fund registration and operational set up is a key advantage over other jurisdictions. The set up and authorization processes must be simple and transparent, including the processes for bank account opening, incorporation, authorization (where applicable) and operational onboarding.

Luxembourg's lawmakers have excelled in keeping the country ahead in terms of implementation of EU legislation. Luxembourg should continue to be a leader in this capacity, aided by the regulator in providing clear guidance to the industry to enable quick implementation and compliance.

One of Luxembourg's challenges is its ability to attract and retain talent. Now is a crucial time for the country to dig deep and focus on how to achieve this, either by implementing new employment policies and incentives, or strengthening the position of cross-border workers. The new draft bill presented in July 2024 by Finance Minister Gilles Roth is a welcome first step in the right direction. Ensuring that talented individuals with the right skillsets are attracted to Luxembourg and remain there, will go a long way to maintaining its competitive edge over other jurisdictions.

Evolution of credit funds and the 'shadow banking' framework

Views from Pauline Roux of AllianceBernstein

Pauline Roux
Vice President, Legal Counsel
AllianceBernstein Luxembourg

How have European lending activities outside of the traditional banking system evolved since 2008? What was Luxembourg's role?

Pauline: Credit activities have undergone a shift since the 2008 financial crisis. Traditionally, banks have been the primary institutions involved in lending activities. However, starting in 2008, there has been a growing desire to develop programs aimed at extending lending beyond the conventional banking system to maintain broad access to credit and stimulate economic growth. Investment funds, as well as the non-bank financial intermediation sector, have grown considerably since then.

Some European Union (EU) policymakers have recognized the crucial role of private debt and loan origination funds in providing alternative financing options to specific borrower categories. Specifically, Luxembourg has had extensive experience with the Alternative Investment Fund Managers Directive (AIFMD) since it came into effect. The Luxembourg regulator, the Commission de Surveillance du Secteur Financier (CSSF), has long established that

lending activities are permissible for alternative investment funds (AIFs), provided they exclude lending to the 'public'.

Has the industry or its regulators highlighted any areas for improvement given the growth of assets under management for investment funds with a lending strategy?

Pauline: One must acknowledge that there was a lack of harmonization in the European Union regarding the ability for Alternative Investment Funds (AIFs) to originate loans, which created uncertainty for market players. Moreover, some macroprudential institutions and members of other financial sectors viewed funds that originate loans as being subject to 'lighter' regulations than traditional banks and expressed concerns about the systemic risk surrounding these lending activities. However, these statements can be challenged, as Alternative Investment Fund Managers (AIFMs) have always been subject to specific, targeted regulatory requirements and macroprudential policies. In this regard, AIFs are indirectly (through their AIFMs) governed by numerous rules from the AIFMD, and sometimes additional (national) product laws which directly apply to some AIFs. Notably, AIFMs have always been required to ensure that the investment strategy, liquidity profile and redemption policy are consistent for each AIF they manage and to monitor these on a regular basis. Furthermore, as mentioned above, these AIFs were only offered to specific targeted borrowers, not to the general public.

Nonetheless, a revised version of the AIFMD, known as AIFMD II, was recently published in response to the aforementioned concerns. This proved to be a significant milestone for debt funds as the European text clearly confirms that AIFs can implement loan origination strategies. This new lending passport comes with a series of new regulations for AIFMs which manage AIFs with loan originating activities. These include additional reporting requirements, risk retention rules, and limitations on leverage. It's also worth noting a distinction between specific rules applicable to open-ended funds, while closed-ended funds remain subject to fewer constraints. This should not come as a surprise to Luxembourg market players, as the CSSF has always required liquidity management tools to be in place for open-ended funds, along with additional scrutiny.

In practical terms, and given the current CSSF expectations for existing funds, the impact should be minimal for Luxembourg debt AIFs. Meanwhile, AIFMD II should lead to improved investor transparency, further promoting the growth of this asset class.

What does the future hold for funds with a lending strategy? What will be the key next steps?

Pauline: All member states are to implement AIFMD II into national law. As per usual practice, it is anticipated that Luxembourg will not add further requirements beyond those stipulated by AIFMD II. However, there remains uncertainty regarding other countries, though one can hope that there will be no gold-plating in order to allow for a better harmonized European debt funds industry. Level 2 measures implementing AIFMD II should also provide awaited clarifications on practical requirements. As the distribution of private debt funds to retail investors is flourishing, it will be even more important to have a clear, consistent framework for the entire EU.

Understanding key market challenges

Sitting down with Julie Schleich of Permira Credit

Julie Schleich
Senior Director, Fund Finance
Permira Credit

PERMIRA

How do you expect the private debt funds market to evolve in the coming months?

Julie: Following a challenging year in 2023, the outlook for private credit in 2024 is brighter, as a more stable economic environment brings renewed optimism for a pick-up in activity. While interest rate cuts are on the horizon (projected decrease to 3% by the end of the year), the pace of the economic recovery across Europe will be muted as some headwinds persist. Against this macro backdrop, there is ample opportunity for private credit markets to thrive. With uncertainty diminishing, record levels of dry powder are ready to be deployed, and M&A activity is resuming, particularly in the mid-market.

There has already been a flurry of activity at the start of 2024, with private equity managing to sell high-quality businesses and strong activity in the secondary market as well. A stronger pipeline should see more transactions in the second half of the year for direct lenders. Improving market conditions are also helping to foster a return of true mid-market deals. If the story of 2023 was one of direct lending groups moving up the size spectrum to finance larger companies, it is expected that 2024 will see a return to the mid-market as activity starts to normalize at all size levels. Again, the leading indicator of this is what we see in the market, with many companies with EBITDA of EUR20 million to EUR50 million seeking financing.

We've noticed an interconnection between private debt and private equity lately, with leveraged buyouts relying increasingly on private debt funds. What are your views on this trend? Will the success of private equity drive the growth of the private debt fund market?

Julie: What we are seeing in the market is that demand for direct lending remains strong, principally driven by record levels of buyout dry powder amassed by European private equity groups over recent years, reflecting the combined effect of several years of strong fundraising growth and a slowdown in M&A activity in 2023. In the near-term, we think that private equity sponsors will be under pressure to both deploy capital into new investments and to exit or monetize investments that have been in their portfolios for some time in order to return capital to investors. That's why we think direct lenders should be able to benefit from both of these dynamics.

In the current political and economic environment with high interest rates, access to capital is becoming more challenging and corporates are likely to experience refinancing challenges as their debt approaches maturity. Private credit is becoming a critical source of capital for European companies requiring structuring solutions in the form of strategic capital.

What do you consider to be today's main trends in the private debt fund market?

Julie: Senior debt strategies already represent around two-third of the capital raised for European private debt and we believe this trend will persist as the yield generated for senior secured loans will still represent attractive risk-return ratios. In those strategies, we see in the market a growing prevalence of SMAs and evergreen structures.

This seems to be the golden age of private credit. How long do you think this will last, and what will be the key challenges?

Julie: Since 2008, private credit lenders have continued to gain market share from banks, which were previously considered the lender of choice for European mid-market businesses seeking to raise debt capital. The transition to alternative financing was fueled by heightened regulatory requirements for financial institutions in the aftermath of the Global Financial Crisis. We believe that the growing prevalence of alternative lenders in Europe is a structural trend that will continue to gain traction in the coming years, as the requirement for flexible and supportive capital intensifies in a more challenging environment.

Private credit has already weathered several highly challenging periods over the last decades: Global financial Crisis, Euro sovereign debt crisis, Brexit, Covid and, more recently, an environment of high inflation with high interest rates. Private credit has, however, shown resilience through those periods and is therefore, despite the challenges ahead, we think well-placed to continue its growth.

What is the role of Luxembourg within your organization?

Julie: Since the implementation of the Alternative Investment Fund Managers Directive (AIFMD) and the subsequent increase in demand for regulated products from institutional investors, Permira Credit has chosen to launch most of its funds in Luxembourg (Alternative Investment Funds).

Permira obtained a license as an Alternative Investment Fund Manager in 2021 and significantly expanded its team in Luxembourg from 11 to 19 people.

Today, Luxembourg is the primary location for all private equity and credit European newer fund structures. The Lux office is therefore considered a central hub for various workflows and facilitates integration with all other departments and locations within the firm.

Luxembourg has proven itself to be the center of excellence for the establishment of private debt funds. What will it take to continue being successful?

Julie: With the increasing number of regulations and related reporting obligations, developing the right technology will be one of the key elements for Lux service providers to remain competitive serving private debt funds. Indeed, having integrated technology able to manage large volumes of data is key, in particular for private debt funds, which usually have a large number of investments in their portfolios, and many related loan administration and reporting tasks to be performed.

What is your opinion on the AIFMD II update on Loan Origination Funds (i.e. LOAF)?

Julie: I think the proposed content of the AIFMD II regarding Loan Origination Alternative Funds (LOAF) is highly reasonable. These rules aim to formalize practices that I believe most private debt asset managers are already adhering to in order to mitigate risks, safeguard investor interests (particularly in terms of liquidity risk management) and ensure transparency.

However, it is important to note that while AIFMD II aims to protect investor interests, it may also create barriers to entry for new market participants due to the increased regulatory and compliance burden. This burden primarily relates to the implementation of effective policies, procedures, and processes for loan origination (including credit risk assessment, portfolio administration and monitoring); as well as investor reporting requirements.

The current international tax landscape has been facing many challenges for several years (e.g., ATAD 1, 2 and 3), with the upcoming ATAD 3 directive focused on the substance of the investment structures. How would you see these additional regulations/substance considerations align with the private debt fund business model (e.g., cost pressure/low margins)?

Julie: While there remains considerable uncertainty regarding the implementation timeline and specifics of the ATAD 3 directive, we are confident that the current level of substance we have in Luxembourg already meets the requirements for central management and control.

What is your view on the current implementation of ESG and SFDR within the market? Have you faced any challenges in implementing ESG-related KPIs?

Julie: Analysis of ESG risks and considerations is not something new in the alternative investment space, particularly during the investment and due diligence processes. However, ESG has gained momentum in recent years and the implementation of SFDR has introduced additional complexity in terms of ESG data collection and reporting obligations towards limited partners (LPs). As a result, there has been a heightened focus on ESG, leading to the appointment of dedicated personnel at various levels (LPs, asset managers (both sponsors and lenders) and portfolio companies). This trend is driving improved ESG data monitoring and reporting for investee companies, albeit accurate and consistent data across the private debt market remains a challenge. Currently, most newly launched direct lending funds do have "binding commitments to align with environmental and social characteristics," categorizing them as Article 8 funds, which remain a key requirement for many European direct lending investors.

Unlocking Value and Managing Risk in a Changing Landscape

In conversation with Oisin Kilgallen and Austin Brady from Waystone...

Oisin Kilgallen
Executive Director,
Global Client Solutions
Waystone

Austin Brady
Product Lead,
Credit and Research
Waystone

How do you think the industry has been shaping up recently?

The private debt funds industry has demonstrated phenomenal growth in the past few years, as per Preqin's 2024 report private credit AUM is expected to hit USD2.8 trillion by 2028, almost double the 2022 figure of USD1.5 trillion. This growth is driven by several factors, but a key one is the increasing allocation of new investors to the asset class as it matures. We have noticed investors looking beyond the initial US market, with Europe and Asia-Pacific emerging as key growth regions. Partnerships with major players in these regions are fueling this expansion. The market is also evolving beyond large-scale direct lending and private credit, with a growing focus on niche areas and industry-specific expertise. While initially, the big players focused on a 'grab all' approach with direct lending, specialty credit is now rapidly growing within the broader private credit market. Unlike traditional private credit strategies, which often target large, established companies, specialty credit focuses on smaller, more specialized businesses with unique needs. Traditional lending solutions are evolving from pure financing solutions to dynamic specialty credit which adds additional value through deep industry expertise and tailored approaches. Many credit managers are implementing new programs to synergize the companies across portfolios. The growth of the overall market is a key driver in this, as managers try to differentiate from one another.

What are in your opinion the main challenges for the private debt funds industry?

The evolving regulatory landscape, particularly around private credit and equity, presents a key challenge for the industry. Concerns regarding valuation opaqueness, transparency, and AIFM inefficiencies are under regulators scrutiny. Current policies and procedures may not be sufficient to meet the increasing regulatory changes, the key focus area being transparency of operating and reporting procedures. This increased regulatory scrutiny is leading to a more complex and demanding regulatory environment, requiring industry participants to adapt their strategies and operations accordingly.

The pressure to deploy capital also causes concerns around due diligence and risk assessment. In a highly competitive market, some managers may be tempted to prioritize speed over thoroughness, potentially leading to a broadening of risk appetite, which if not managed correctly could cause the industry challenges as we've seen in the past. Additionally, as deal flow demand continues to grow, there is the potential for inflated asset valuations, which poses a significant risk in creating unrealistic return expectations and could lead to potential losses down the line. The ever-increasing onus and responsibility towards all industry parties to manage these risks has never been more important.

How are your clients looking at retailization this year?

The industry is actively exploring ways to attract retail investors through initiatives like ELTIF products, private equity and private debt being the main initial asset classes where this is expected to be implemented. Most asset managers see retail as the 'unturned stone' when it comes to distribution so are keen on bringing their strategies to this market segment. Large and mid-sized asset managers tend to be more advanced in their process, and while smaller asset managers will likely follow their path they may need a broader external network to reach a retail audience. Ensuring data transparency and robust regulatory frameworks remains crucial to the success of retailization. Retail investors require a higher level of protection and education, and the industry must ensure that the necessary safeguards are in place before opening the doors to this segment of the market.

Retailization as such also requires a strong distribution network which takes a somewhat different approach to how traditional funds have been distributed. Even the larger global asset managers are looking at different solutions on how to address the distribution of alternative funds to the masses. Collaborations will probably become more common amongst asset managers. We've already seen a major traditional mutual fund house partner with a global private equity and private credit firm to offer retail clients the best of both public and private market strategies.

As part of this push to retail, a lot of effort is going into working with our clients to tweak their alternative strategies into a semi-liquid form, ensuring the right liquidity features are baked into their products to meet this new wave of investors. Managers understand that individual investors want the flexibility to access their investments if needed. Understanding the nuances of more complex liquidity features and management solutions has been an important step for the asset managers traditionally more focused on institutional closed-ended products.

How will artificial intelligence impact the industry in particular?

AI will have a huge impact on making what we do more efficient and thorough, although expectations need to be tempered in the short term as we learn more about AI and how we can implement its capabilities. In the immediate term, we see AI as a crucial tool to revolutionize valuation processes, enabling more frequent and accurate assessments for both enterprise and asset valuations. This will be particularly important for retail investors in ELTIF structures, as it will provide them with the enhanced transparency to make informed investment decisions. From a regulatory perspective we still have some work to do to ensure we can place reliability on AI before its tools are fully implemented into day-to-day operations.

Could you share your views on the recent regulatory changes impacting the Luxembourgish market?

We have noticed a higher level of scrutiny from regulators such as the CSSF. Last year, we noted an increased focus on AML related frameworks, while this year, the focus is moving towards governance matters, such as policies and procedures, the ideal operating model and framework especially for ELTIFs, retailization etc. Waystone has and will react positively to all regulatory changes and our standards for reporting are still as high as ever Increasing regulatory changes tend to lead to greater standardization across the industry, which ultimately benefits everyone. Luxembourg has always been proactive at the industry level, aligning as one when implementing new aspects of regulation. AIFMD II introduces a more robust framework for fund management, harmonizing regulations across Europe. This will enhance transparency and investor protection, creating a more level playing field for market participants. There will be some challenges as we implement new frameworks and align jurisdictions on topics such as loan origination, However, like with all other regulatory changes, the industry will adapt quickly.

Enhancing portfolio resilience: the strategic integration of private credit and CLO mezzanine debt

Miguel Ramos Fuentenebro
Partner and co-founder
FairOaks Capital

In recent years, investors have recognized the benefits of incorporating senior secured, floating rate assets, which minimize duration risk and offer downside protection due to their security by company assets. Fundraising for private credit strategies has been robust, driven by potentially attractive risk-adjusted returns resulting from market inefficiencies and illiquidity premiums.

BBB and BB-rated collateralized loan obligations ("CLOs") backed by first-lien, senior secured loans share some common features (attractive yield due to market inefficiencies, seniority, etc.) while focusing on broadly syndicated loans, characterized by large EBITDA and/or facility sizes and benefitting from additional protection given by subordinated equity, which minimizes exposure to single defaults.

CLOs are liquid and tradeable securities, backed by actively managed portfolios of senior secured loans, consisting of 100 to 300 large corporate issuers. The combination of active management, diverse underlying senior secured loans and structural subordination within the CLO structure has resulted in much lower default rates than those of similarly rated corporate bonds and loans.

We believe that CLO mezzanine debt is a diversifying and complementary asset class for private credit investors, offering similar returns, lower risk of defaults and higher liquidity.

Lower idiosyncratic risk

Unlike a loan fund, in which investors take a pro-rata share of credit losses, CLO debt holders mitigate against such idiosyncratic risk through structural subordination. This provides protection to debt notes as credit losses flow up through the capital structure, resulting in low historical default rates throughout multiple market cycles. For example, no European CLO AAA note has defaulted and the annualized 10-year default rate for BB notes is only 0.22%[2].

Lower refinancing risk

The grey area between large loans and private credit has almost disappeared. In 2023, for example, private credit loans were used to opportunistically refinance weaker credits at higher rates. In 2024, however, many higher quality private credit loans have been refinanced in the broadly syndicated market, given lower rates. This has increased the refinancing risk and potential negative selection risk for both broadly syndicated lenders and private credit. One of the advantages of CLO notes is that they benefit from a fixed spread over a reference rate (SOFR/EURIBOR) and a typically longer non-call period, reducing both risks.

Higher liquidity

While private credit strategies are typically accessed through draw-down and lock-up funds with five to seven-year maturities, CLO notes are actively traded by all major banks and through secondary auctions. A combination of private credit and CLO debt investments offers investors additional tools to manage liquidity and match liabilities.

Figure 1:
Return, volatility and liquidity across several fixed income asset classes[1]

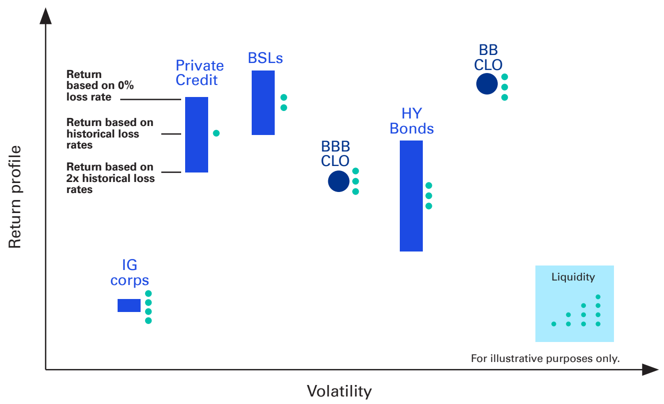
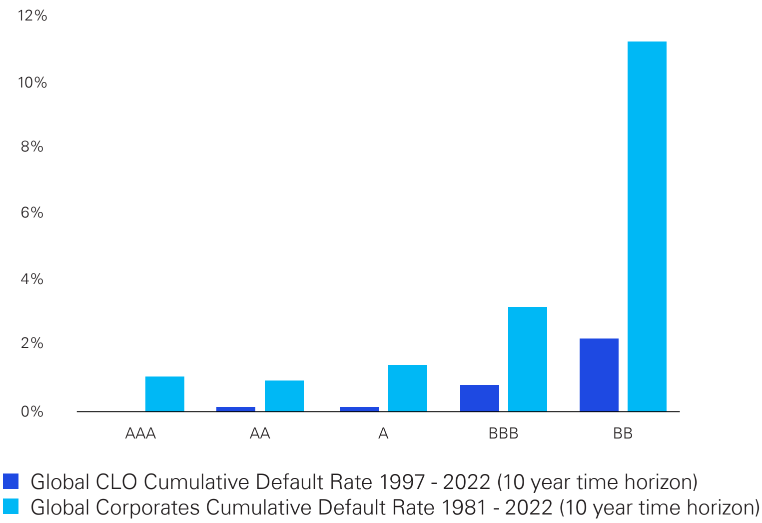


Figure 2:
Comparison between CLO and corporates cumulative defaults[2,3]



The integration of CLO mezzanine debt and private credit assets enables effective diversification within investor portfolios. Managers, such as Blackstone, Apollo and Ares, i.e. well-known players in the private credit space, are also some of the largest CLO managers and investors, leveraging their corporate credit platforms. This, combined with a market capitalization of USD1.2 trillion, highlights the benefits of considering CLOs as a complementary asset to private credit.

We believe private credit and CLO mezzanine debt represent compelling investment opportunities in today's market environment, each with unique risk-return and liquidity profiles. Despite CLO fundraising lagging behind that of private credit funds, we are confident that a strategic allocation to CLO mezzanine debt can enhance portfolio resilience and capitalize on the strengths of floating rate, secured investments in a 'higher for longer' landscape.

1. LECPTREU Index, Cliffwater Direct Lending Index swapped to EUR, EUR CLOIE BBB and BB, LP01TREU Index. Liquidity and volatility relatively ranked based on Fair Oaks Capital's market observations. Data as at 31-May-24.
2. S&P's, "Default, Transition, and Recovery: 2022 Annual Global Leveraged Loan CLO Default And Rating Transition Study", 10-year time horizon, 13-May-23.
3. S&P, "2022 Annual Global Corporate Default And Rating Transition Study", 10-year time horizon, 25-Apr-23.

Prioritizing ESG while maximizing returns...

Since 1 January 2023, asset managers have had to comply with the Sustainable Finance Disclosure Regulation's (SFDR) Level 2 reporting obligations, while facing more regulatory scrutiny on their sustainability risk and reporting processes.

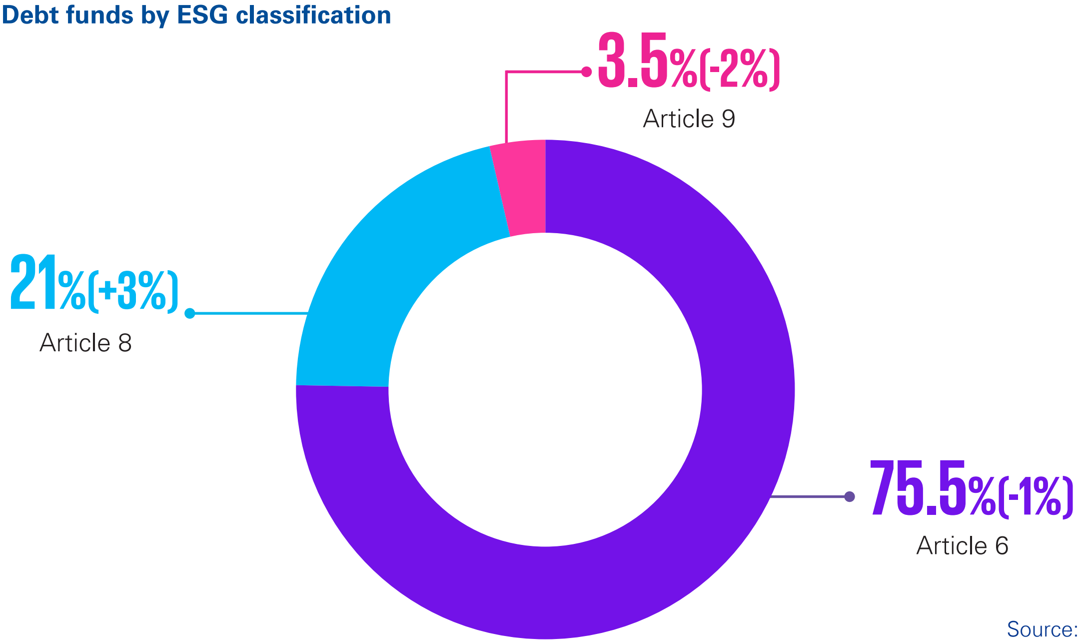
Alongside completing SFDR annexes for each Article 8 and 9 product, financial market participants have also received additional information requests from the CSSF through a dedicated eDesk process.

While sustainable finance is already business as usual for some financial professionals, the market still struggles to collect accurate and exhaustive data, define clear strategies and adapt its operations to ESG, including portfolio creation and reporting. Incorporating ESG factors into corporate debt transactions can provide borrowers with access to larger pools of capital and tangible debt pricing benefits, if they can demonstrate a positive ESG impact.

In this year's survey, we specifically ask about the ESG classification of funds under the SFDR (Figure 8). Through these responses, we learned that most of the funds are classified under Article 6 (75.5%), followed by Article 8 (21%) and Article 9 (3.5%%). Compared to last year, we noted a gradual shift from Article 9 (-2%) and Article 6 (-1%) to Article 8 (+3%).

Based on discussions with private debt players, we recognized that ESG, while a significant selling point a couple of years ago, is less of a priority for current investors. Funds prefer launching with Article 6 due to its less restrictive nature, enabling the potential for maximized returns, which is the key focus of investors as opposed to ESG.

Figure 8:
Debt funds by ESG classification



Source: KPMG/ALFI debt fund survey

AIFMD II

A level playing field for private debt origination

AIFMD II entered into force on 15 April 2024 with multiple aims:

1. Harmonize rules on loan-originating AIFs
2. Clarify AIFM delegation to third parties
3. Ensure equal regulatory treatment of custodians
4. Improve cross-border access to depositary services
5. Optimize supervisory data collection
6. Facilitate the use of liquidity management tools

For private debt, the directive stresses that this asset class can provide important funding for companies struggling to access traditional lending sources. By harmonizing rules on debt origination, the directive aims for a level playing field across EU Member States, replacing the existing patchwork of rules that vary from country to country. Important aspects that have been taken into account address micro- and macro-prudential risks as well as investor protection.

To this end, the directive introduces these main points:

- Definition of origination as the granting of a loan directly by AIFs or indirectly through third parties or special purpose vehicles.
- Definition of a loan-originating AIF as an AIF whose investment policy is mainly to originate loans or whose originated loans have a notional value that represents at least 50% of its net asset value.
- Requirement of AIFMs managing loan-originating AIFs to implement effective policies, procedures and processes for assessing credit risk and for administering and monitoring their credit portfolio, as well as making sure that these are kept up-to-date and are reviewed on at least a yearly basis.
- Limitation on loans to one single borrower total 20% of the capital of the AIF (where the borrower is another AIF, a UCITS or financial undertaking) applicable by the date specified in its legal documents but can be temporarily suspended due to capital increases or reductions.
- Limitation on leverage to 175% for open-ended AIFs and 300% for closed-ended AIFs.
- Prohibition on granting loans to connected parties, such as the AIFM, the AIF's depository, relevant delegates or to an AIFM group entity.
- 5% retention requirement on originated loans.
- Particular rules for open-ended loan-originating AIFs. ESMA will furthermore develop regulatory technical standards to determine requirements of such funds, including separate standards regarding liquidity management tools.

Grandfathering rules apply to existing funds and loans (from before 15 April 2024) until 16 April 2029, subject to certain conditions.

These points set a basis framework to which the Directive recognizes that each Member State can opt for stricter rules.

The Directive is to be transposed into national laws across the European Union by 16 April 2026.

ELTIF 2 is here. Now what?

The revised regulation concerning European Long-Term Investment Funds (ELTIFs) is applicable as of the beginning of 2024. The previous framework was updated to, among other things, expand eligible investments, make the products more accessible to a broader retail investor segment and allow for improved liquidity. At the time of writing this article, final technical details regarding compatibility of fund/asset life cycles, redemption policy, liquidity risk management and cost disclosure were not yet agreed between the European Commission and the European Securities and Markets Authority (ESMA). Although the fund industry has already expressed optimism about the product's evolution and the democratization of private markets, distribution networks and retail investors need to follow suit.

The ELTIF product was designed to channel private savings toward the European economy and long-term assets, but its first rendition set a barrier for retail investors with a minimum subscription amount of EUR10,000 and a maximum 10% portfolio allocation to ELTIFs. With this limitation gone, it remains to be seen if a broader scope of retail investors will be comfortable with the long-term investment horizon and generally illiquid nature of ELTIFs, which on the other hand unlock investment opportunities that were largely inaccessible.

The Federation of German Consumer Organizations has for its part issued a warning to retail investors stating that ELTIFs are unsuited for the inexperienced, particularly because of higher risks, long-term commitment and lack of diversification e.g. vis-à-vis ETFs. In some markets, such as Italy and France, retail investors will be able to enjoy unique ELTIF tax benefits not available in other countries. It is worth noting that the non-binding final report of the High Level Forum on the Capital Markets Union has recommended that ELTIFs generally receive simplified or preferential tax treatments in all Member States, so developments might ensue on this topic.

While potential retail investors need to familiarize themselves with the products, the underlying assets—particularly risks and redemption mechanics—distributors and managers must adapt to the needs and expectations of this new segment of potential investors. As per the regulation, suitability tests must be carried out by distributors or managers and particular warnings or alerts are to be provided to investors on the implications of redemption matching mechanisms and illiquid and long-term commitments, as applicable. Time will tell if the new changes brought with the ELTIF 2 regulation are enough to make the product a long-term success.

Viewpoints:

straight from the depositaries

Laurent Fudvoye
Director, Debt & Capital Markets
Alter Domus

"While a certain level of uncertainty remains present on macroeconomic topics like interest rates and geopolitical situation, we see a continuous trend of increased allocation of LPs money to private debt even if fundraising remains challenging, and this for all underlying debt strategies. The need for refinancing remains critical and, while competition is increasing on certain deals, risk-return remains attractive in many cases. We see a bright future for the asset class, which proved to be extremely resilient during market bumps over the last decade."

Shane Hurley
Executive Director, Head of J.P. Morgan Depositary Bank Services, J.P. Morgan Bank Luxembourg S.A

"The private debt fund market demonstrated resilience despite external macro conditions and higher interest rates, maintaining moderately low default rates overall. Within this context, the Luxembourg Reserved Alternative Fund (RAIF) experienced incremental growth primarily in closed-ended structures.

Looking ahead, two important pillars—investor protection and liquidity—will continue to shape the sustainable allocation of private capital within the EU's internal market and real economy. Specifically, for loan-originating AIF funds, forthcoming requirements under AIFMD II around concentration, leverage and retention will help fortify the regulatory framework and establish uniform European standards.

Given Luxembourg's status as the largest fund domicile in the EU, coupled with its proven track record and expertise in servicing debt funds, it remains exceptionally well positioned to support the expanding and maturing private debt fund market."

Charly Guyot
Global Head of Loan Solutions, Alternative Investors
BNP Paribas S.A., Luxembourg Branch, Securities Services business

"Private Credit remains a sought-after asset classes, with its global footprint expanding and growing steadily. The Luxembourg market has been a unique success in Europe thanks to its responsive and adaptable financial ecosystem. Despite the long-term macro trend towards private markets, all market participants will have to remain agile in response to an ever-evolving environment. Luxembourg will maintain its leading position through regulatory flexibility, access to a highly skilled and diverse workforce, and strategic use of data and technology."

Fabrice Buchheit
Head of Depositary Services, Continental Europe
IQ-EQ

"Following a challenging 2023, private markets are showing promise so far this year with expectations of central banks implementing rate cuts and inflation stabilizing. Some findings highlight that private debt is at a crossroads, fueled by regulatory changes and macroeconomic conditions, making it an exciting time for private credit with opportunities for strategic expansion in a shifting financial landscape. Nevertheless, a broader sense of uncertainty is still expected to linger, driven in part by geopolitical tensions, the prospect of a significant shift in the global political order amid the numerous elections slated for 2024, and persistent macroeconomic challenges."

The Bank of New York Mellon SA/NV
Luxembourg Branch

"The trajectory for private credit over the remainder of this decade seems all but assured. As the market continues to draw in more investors — both institutional and retail — and expands its borrower base from the middle market to very largest corporate entities, there seems to be little on the horizon, absent regulatory intervention, that will slow its further expansion. While that explosive growth will only continue to draw concerns regarding the minimal indirect regulation of this activity, it appears at present that private credit is set to become even more entrenched as an established alternative to loans, bonds and other public debt."

Banque de Luxembourg

"For the private debt fund market in Luxembourg for 2023 we see continued growth in assets under custody as investors continue to seek alternative sources of yield and the focus on sustainability and ESG considerations gains prominence. The evolution of microfinance funds was positive from our perspective, driven by the increasing demand for financial inclusion and support for entrepreneurs in underserved communities."

Lata Vyas
Managing Director
Brown Brothers Harriman

"Private debt continues to gain popularity as a resilient asset class, offering flexibility and a strong control environment. The economic environment and the higher cost of capital has had an impact on the sector. However, investors are increasingly attracted to accessing income opportunities presented by managers funding larger lending deals. Technology and digitization will be the big drivers impacting this market with the entry of retail investors who require more liquidity and data transparency."

Guglielmo Manzoni
Head of Depositary and Fiduciary Services, HSBC Continental Europe, Luxembourg

"We keep on seeing continuous growth and competition in private debt as an asset class. The recent modernization in the laws on SICARs, SIFs, RAIFs, UCIs and AIFM introduced by the Luxembourg legislator in 2023 are adding to the attractiveness of the marketplace. From a regulatory standpoint, the developments brought up by AIFMD II and ELTIF 2 will require additional scrutiny and monitoring from a depositary standpoint. This makes it even more important for depositaries to be part of a servicing model where fund administration, loan agency/administration and banking solutions are part of an integrated end-to-end model. The close interaction and exchange of information/documents through automated solutions therefore continues to be a key factor for depositaries to perform their oversight duties efficiently and effectively."

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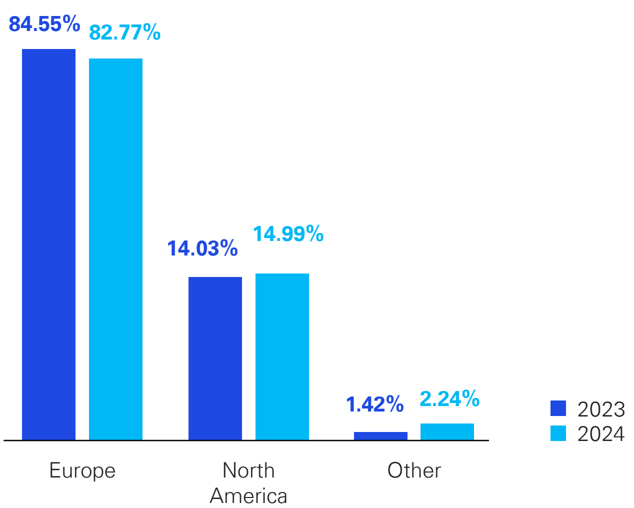
Overview of key data

Initiator origin

Similar to last year, the vast majority of debt fund initiators (promoters) in Luxembourg are from the EU, distantly followed by those from North America (Figure 11). Most of the initiators come from the UK (44% versus 42% last survey), followed by the US (18%) and Germany (15%), with fewer than 5% from Luxembourg.

Figure 11:
Initiators origin by region



Source: KPMG/ALFI debt fund survey

Investments per fund and holding period

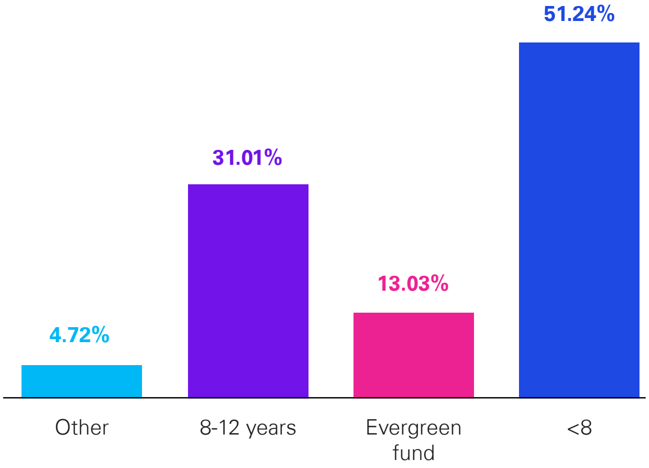
The number of investments per debt fund is highly variable and depends on several factors, including the fund's size and investment strategy.

Based on the information gathered, the average number of investments per fund is 36, which is in line with last year's survey (38).

31% of the funds have holding periods of between 8 and 12 years, and 51% below 8 years, compared to 29% in 2022 (Figure 12). Regarding maturity strategy, similar to last year, most investments are held to maturity (98%), and only a small percentage are held for trading (2%).

Evergreen funds also represent 13% of the funds surveyed, revealing a slight decrease compared to last year's findings (20%).

Figure 12:
Debt funds by maturity

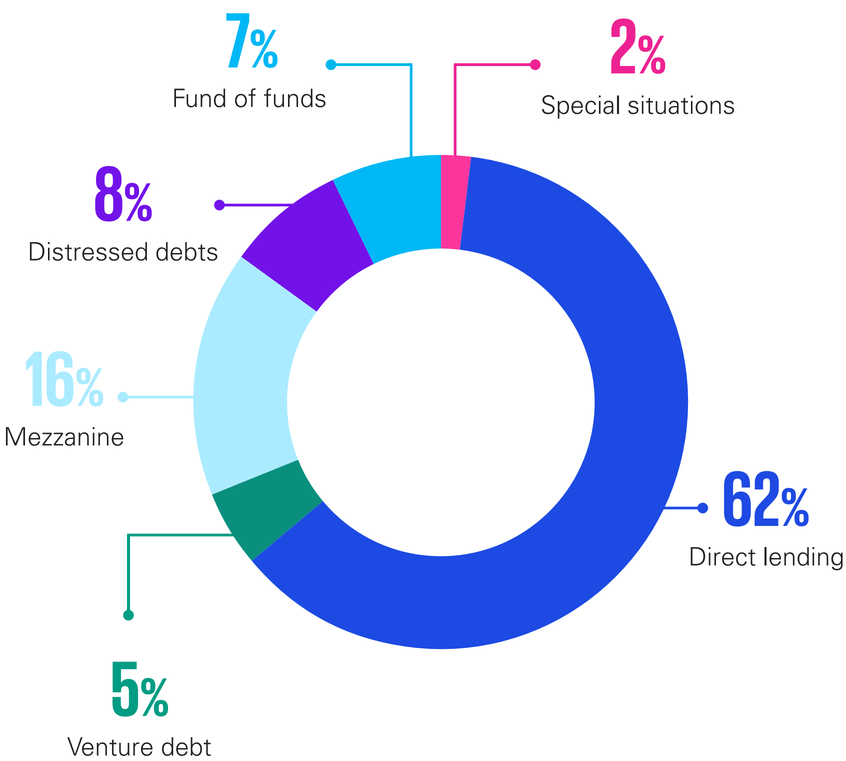


Source: KPMG/ALFI debt fund survey

Investment strategy

Luxembourg debt funds use three main debt strategies (Figure 13): direct lending (62%), distressed debt (8%), and mezzanine (16%). These proportions match prior years' surveys, although the numbers of each fund have surged.

Figure 13:
Debt funds by strategy

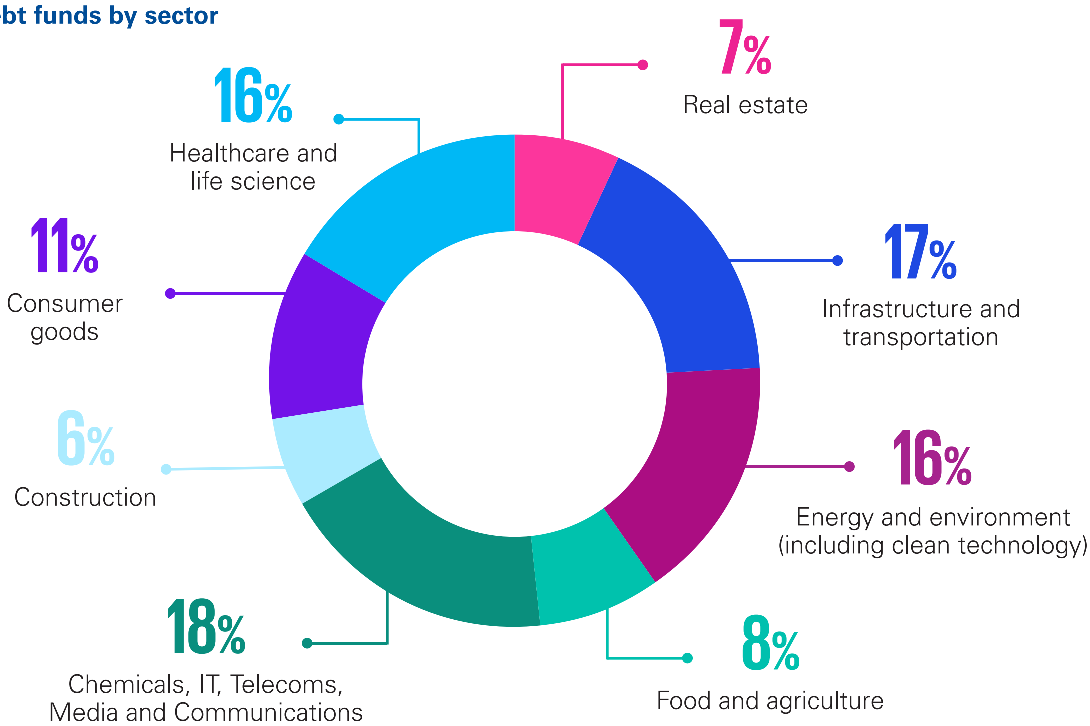


Source: KPMG/ALFI debt fund survey

Sectors financed

Recent surveys have specifically asked which sector is financed. The results show that private debt continuously spans a large range of sectors. As illustrated in Figure 14, there's a balance between infrastructure and transportation (17%), energy and environment (16%), chemicals, IT, telecoms, media and communications (18%) and healthcare and life science (16%). All sectors remain stable compared to last year's survey.

Figure 14:
Debt funds by sector

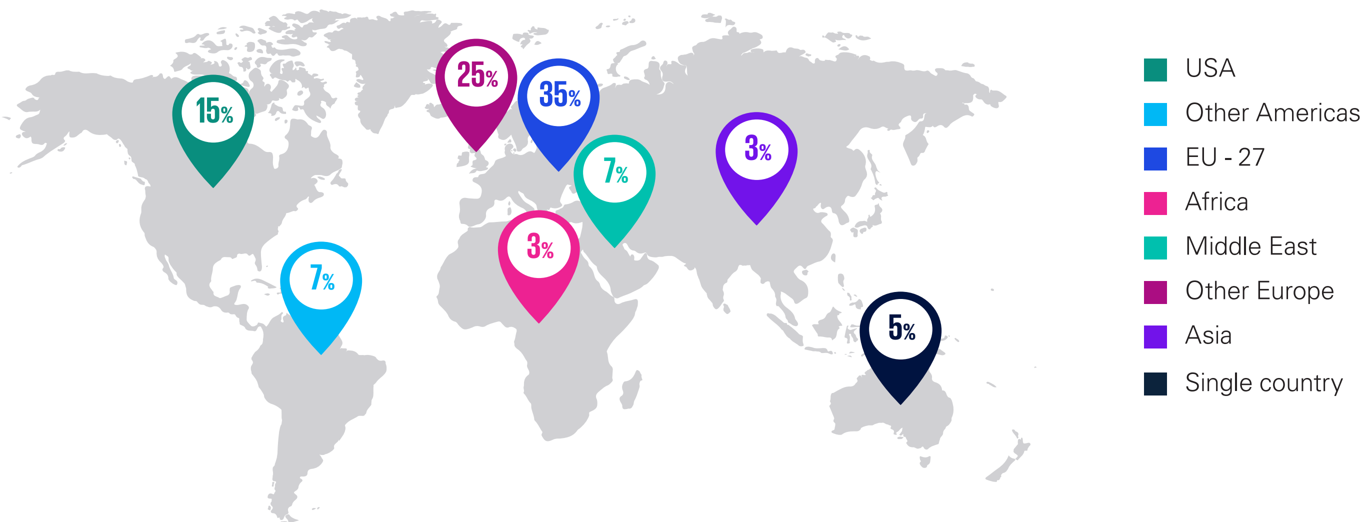


Source: KPMG/ALFI debt fund survey

Geographical investment targets

The vast majority of debt funds have a multi-country investment approach. Similar to last year, preferred investment targets (Figure 15) are in the EU (35%), other European countries (totaling 25%) and North America (15%). Middle East has, however, increased compared to last survey (+5% compared to June 2023).

Figure 15:
Debt funds by geographical investment targets



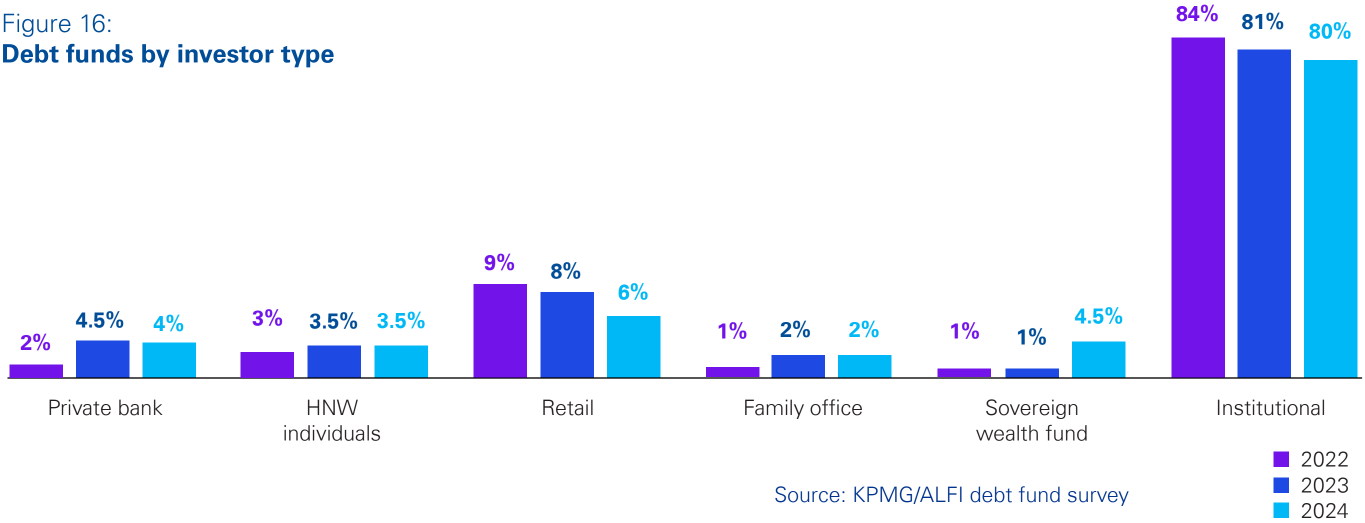
Source: KPMG/ALFI debt fund survey

Investor type and origin

Similar to last year, the main investor type is institutional investors (80%), followed by retail investors (6%), sovereign wealth funds (5%) and private banks (4%) (Figure 16). Most institutional investors are pension funds or insurance companies (61%).

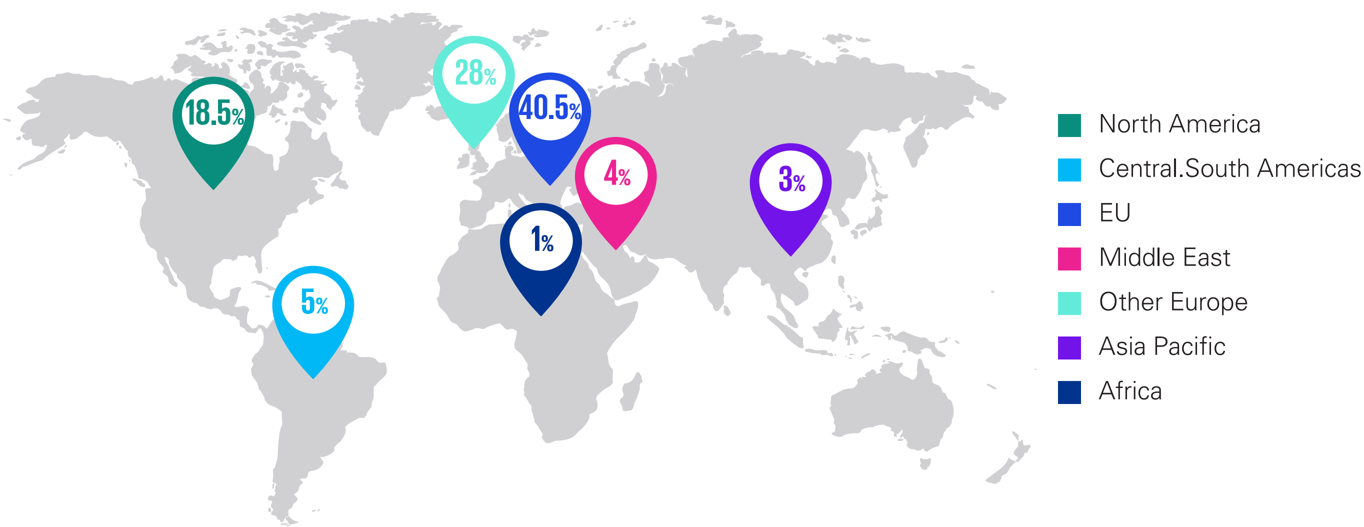
Similar to last year, these investors are mainly from EU countries (68%) (Figure 17). Seventy-eight percent of funds have between 1 and 25 investors per fund (Figure 18).

Figure 16:
Debt funds by investor type



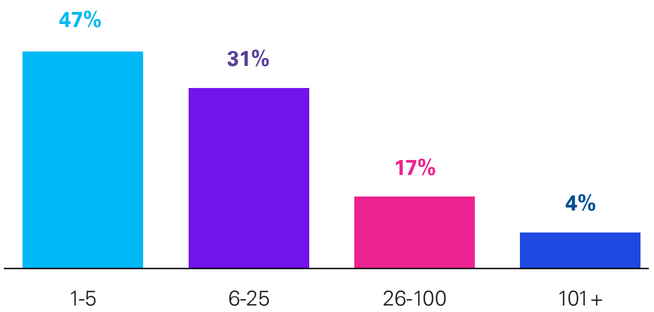
Source: KPMG/ALFI debt fund survey

Figure 17:
Debt funds by investor origin



Source: KPMG/ALFI debt fund survey

Figure 18:
Debt funds by number of investors

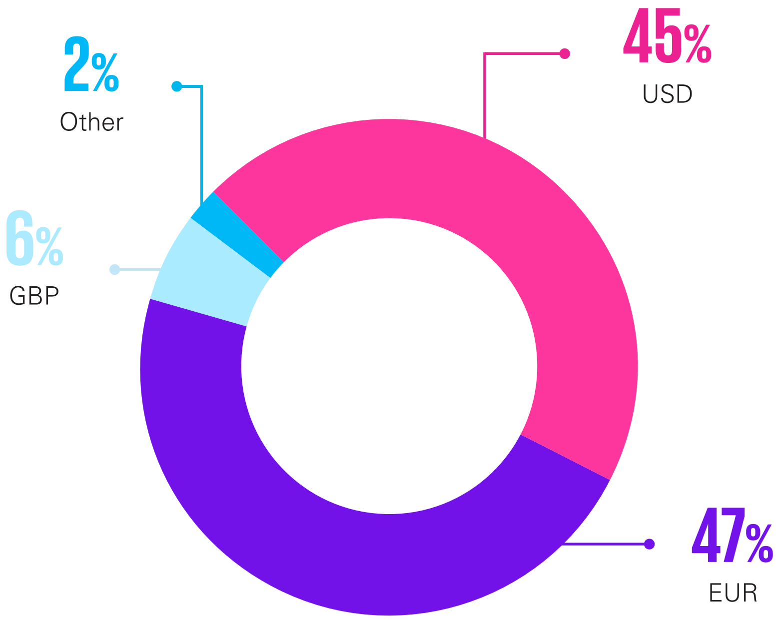


Source: KPMG/ALFI debt fund survey

Financial statements

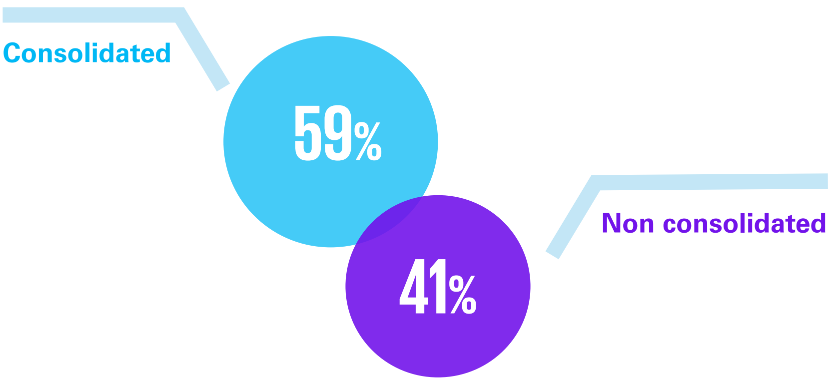
Like last year, the financial statements of Luxembourg debt funds are mostly prepared in euros (47%), closely followed by US dollars (45%) (Figure 19). Just over half consolidate their assets (Figure 20).

Figure 19:
Debt funds by currency



Source: KPMG/ALFI debt fund survey

Figure 20:
Debt funds consolidation

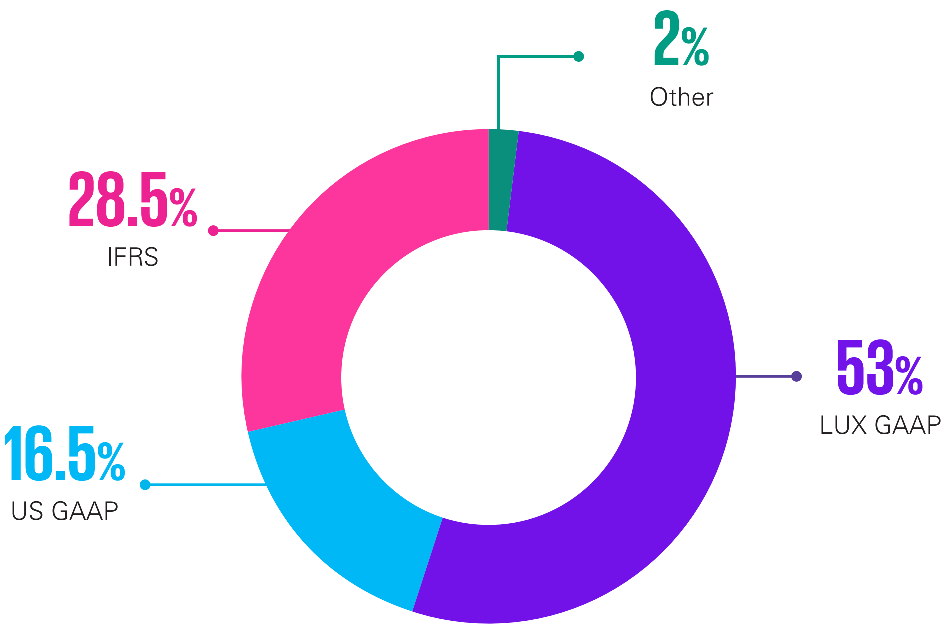


Source: KPMG/ALFI debt fund survey

Valuation methodology

The most popular valuation method used is fair value (64%), followed by cost less impairments (18%) and amortized cost (17.5%). Lux GAAP remains the main accounting standard (53%), followed by IFRS (28.5%) (Figure 21).

Figure 21:
Accounting standard

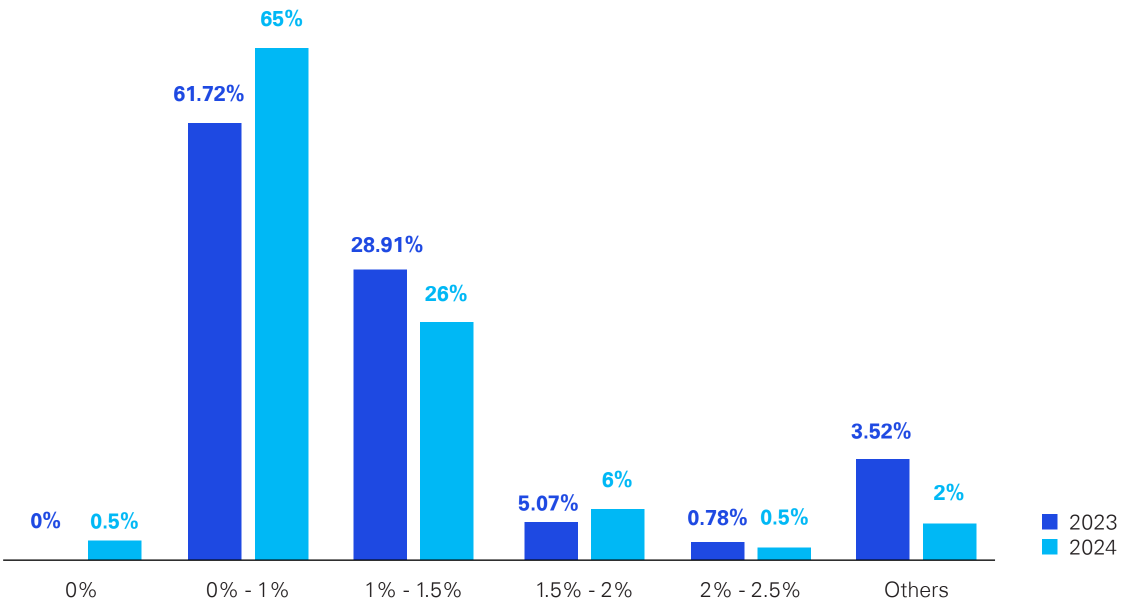


Source: KPMG/ALFI debt fund survey

Management fees

Like last year, management fees typically lie between 0% and 1.5%, with a small proportion above 1.5% (Figure 22).

Figure 22:
Debt funds by management fee

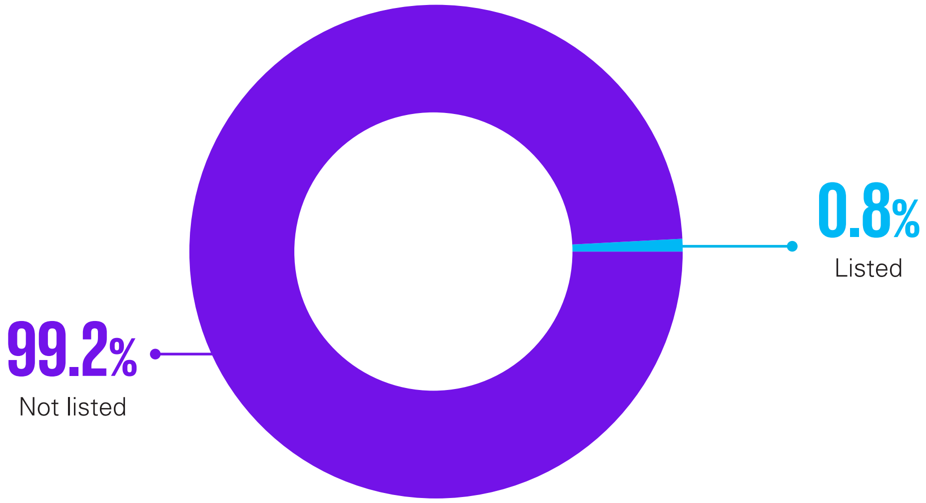


Source: KPMG/ALFI debt fund survey

Other information

Only a small percentage of funds (0.8% compared to 1.3% last year) are listed on a stock exchange (Figure 23). Furthermore, 76% of the funds do not use separately managed accounts (SMA).

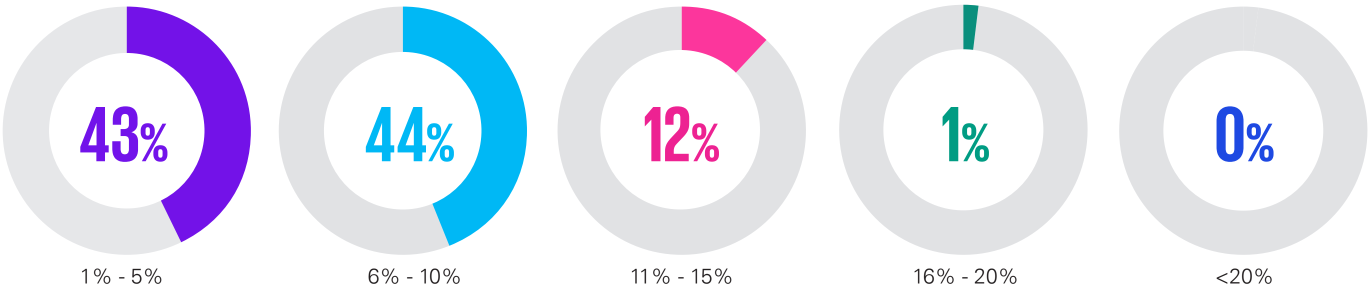
Figure 23:
Proportion of debt funds listed on a stock exchange



Source: KPMG/ALFI debt fund survey

Most funds (43%) have an expected return of between 1%–5%, followed by 44% with an expected return between 6%–10% (Figure 24).

Figure 24:
Expected return



Source: KPMG/ALFI debt fund survey

About this research

Objectives

This study has two main objectives:

- interpret current behaviors and structuring trends related to private debt funds in Luxembourg and predict their trajectory
- provide qualitative insights based on numerical data.

Methodology

We received data from 13 active depositaries representing 1,300+ funds (or sub-funds) investing in private debt. We sent a predefined questionnaire to each depositary surveyed to gather data on the various debt funds that they oversee.

This questionnaire of 38 closed-ended questions covered a range of topics, such as fund category, regulatory regimes, legal forms, geographical investment targets, investor origin and financial statement data.

The following depositaries/depositary banks were surveyed:

- Alter Domus
- Brown Brothers Harriman Luxembourg
- BNP Paribas, Succursale de Luxembourg
- The Bank of New York Mellon
- Citco Fund Services
- Citibank Europe
- Edmond De Rothschild Asset Management
- J.P. Morgan Bank
- HSBC Continental Europe
- UBS Europe
- Banque de Luxembourg
- IQ-EQ
- Aztec Group

Content

The survey's key findings are disclosed in this report on a no-name basis.

Research for this survey began in December 2023.

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