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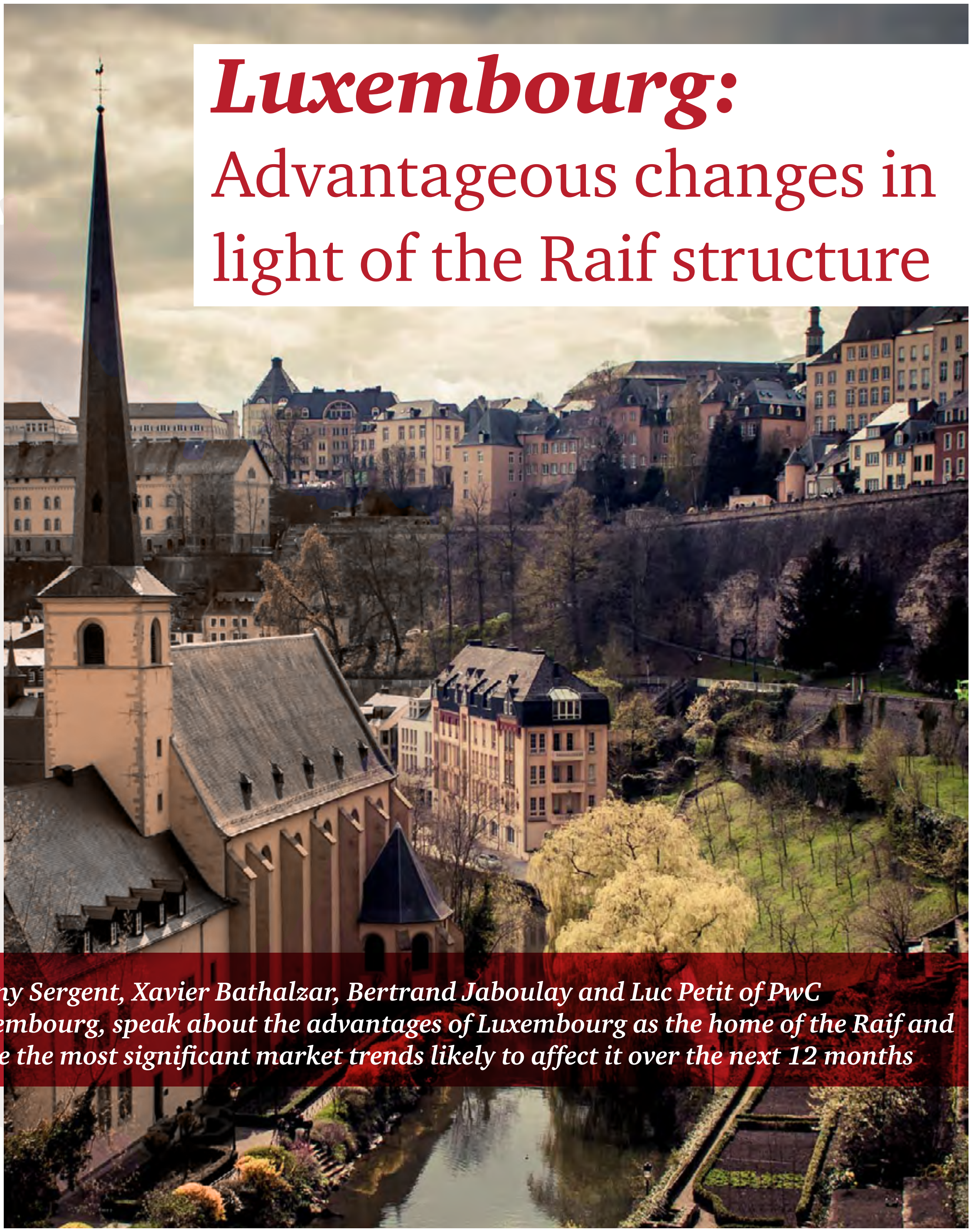
Luxembourg: Advantageous changes in light of the Raif structure



Fanny Sergent, Xavier Bathalzar, Bertrand Jaboulay and Luc Petit of PwC Luxembourg, speak about the advantages of Luxembourg as the home of the Raif and some the most significant market trends likely to affect it over the next 12 months

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FANNY SERGENT, XAVIER BALTHAZAR, BERTRAND JABOULAY AND LUC PETIT OF PWC LUXEMBOURG SPEAK WITH *HFMWEEK* ABOUT THE CURRENT POPULAR FUND LAUNCHING STRATEGIES, LUXEMBOURG'S ADVANTAGES AS THE HOME OF THE RAIF AND SOME OF THE MOST SIGNIFICANT MARKET TRENDS LIKELY TO AFFECT IT OVER THE NEXT 12 MONTHS

HFMWeek (HFM): What strategies are most popular to launch among managers and why?

Fanny Sergent (FS): Credit/loan funds are a very popular strategy today and encompass different strategies like the senior debt strategies (large syndicated loans), mid-market credit strategies (direct lending to mid-market companies) or credit opportunities strategies (distressed loans). We also see a lot of loans secured on real estate assets that are advanced or acquired by asset managers. We have never seen this many loan funds being created, and have never had so many requests from people looking to launch loan funds. Indeed, banks are not lending anymore or are cleaning their balance sheet. While banks apply tougher conditions when it comes to granting loans to companies, what loan funds actually do is disintermediating the banks. As a result, it leaves the floor open for other players to enter the market.

Many alternative firms moved into the private credit and direct lending space and provide an additional source of funding in the economy (real estate development, infrastructure programmes, housing/commercial projects, trade financing, businesses, etc.). We also see funds buying portfolios of securitised loans from banks, which allow the latter to significantly reduce the amount of regulatory prudential capital that they are required to set aside.

There is, however, a legitimacy dilemma, as lending to the public is largely perceived as a banking activity. So loan origination needs to be considered with care. Shadow banking can be seen as an unorthodox practice, as one takes over operations that have traditionally been executed by banks without complying with the capital or regulatory requirements they have. And regulators seem to be on guard when it comes to fund lending to retail investors. Most funds would originate loans to a company or professional entity, rather than the retail market.

HFM: Why do you think they're enjoying such popularity among investors?

Xavier Balthazar (XB): With private lending, you can have a higher interest rate on those loans, which turns out to be an interesting asset class for some investors, given the low interest rate environment. When you lend to a corporate entity, you will probably charge between 5%, and 7% interest, making a net revenue, after expenses, of around 4% or 4.5%. For investors, this is significantly better than placing their money in a bank account with a negative interest rate. Credit strategies can be wrapped in unregulated or regulated vehicles. And in a Sif/Raif vehicle, you can have different types of strategy in terms of debt structuring, depending on the risk appetite. As a matter of principle, pension funds and insurance companies have an objective to increase their share of alternative assets compared to listed or traditional investments in their overall portfolio. Private equity firms listing private debt strategies have also had a lot of success because very large institutional investors are increasingly investing in these types of assets.

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HFM: Why is the new Raif being created in Luxembourg?

Bertrand Jaboulay (BJ): The rationale for creating the Raif regime can be found in the AIFM directive (AIFMD).

If you have an AIFM licence, and a licenced depository for your fund, the fund benefits from a passport for distribution to professional investors in Europe. What is more, the regulation does not say a fund has to be under the prudential supervision of a local regulator. In Luxembourg, our fund regime requires prudential supervision over the fund. We basically had an over-regulating framework before the implementation of the AIFMD, which placed regulated funds under the supervision of the local regulator.

The AIFMD specifies that if you have a supervised depository, the fund managed by the AIFM can be distributed to professional investors and can benefit from the passport without being supervised. We then realised we were missing a tool. The Raif is an addition to the toolbox; Raifs are funds that are not directly supervised by the Luxembourg regulator. They must, however, appoint an authorised AIFM, complying with the AIFMD, to ensure adequate market protection and benefit from the distribution passport to professional investors in Europe.

The fund is not directly supervised, but it is still regulated, since the AIFM is supervised by the regulator. Unlike the Cayman fund, the Luxembourg Raif

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Bertrand Jaboulay is an audit partner operating in the asset management industry. Bertrand has over 15 years of experience in auditing funds in Luxembourg. He has specialised in Ucits funds and hedge funds. His clients' portfolio includes investments funds from large and mid-sized international asset managers.

Luc Petit's specialty is in tax for the alternative investment fund industry (private equity, hedge funds, real estate and infrastructure). He advises alternative asset managers on fund and acquisition structuring.

is not a fully non-supervised, non-regulated structure.

HFM: What do you think are the main attractions of the Raif, and how does it differentiate from other regimes?

XB: The Raif is quick to market. The depository and the AIFM have to pass a number of due diligence requirements and then the requisite agreements need to be signed with the relevant counterparties. Agreeing the fee schedule can take some time but if there are delays to setting up the structure, they are unlikely to come from the regulator.

As the Raif is a Luxembourg fund, there is some brand value associated with it. Luxembourg is a jurisdiction recognised as a high-quality, comprehensive location with strong expertise in administrating and domiciling funds.

The Raif provides AIFMD compliance. You benefit from the protection of the AIFMD requirements, and from the passport to professional investors in Europe.

> "THE RAIF PROVIDES AIFMD COMPLIANCE. YOU BENEFIT FROM THE PROTECTION OF THE AIFMD REQUIREMENTS, AND FROM THE PASSPORT TO PROFESSIONAL INVESTORS IN EUROPE"

Luxembourg has always attributed certain specifics to a fund, such as having one investment according to a specific investment policy defined in a prospectus. An additional benefit of the Raif is the exemption from corporate tax while only subscription tax of 1 bps of the NAV is due annually.

HFM: What market trends do you feel will be significant for the Raif over the next 12 months?

Luc Petit (LP): We anticipate a significant growing trend for wealth management. The wealth management industry like investing in different strategies, i.e. private equity, real estate, hedge fund and traditional assets using the Raif. They also enjoy using sub-funds for different family members. This is also driven by an interest in avoiding offshore structures, with a clear preference for regulated products. We also see some re-domiciliation from offshore jurisdictions (Cayman, BVI, and Curaçao). Lastly, we're currently observing the transformation of Sifs (funds supervised by the local regulator) to Raifs. ■

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