The value of knowing your client

A growing community of private debt managers brings with it greater demand for specialist third-party fund administrators. **Anja Grenner** and **Renaud Oury** of SGG Group offer insight into their clients' evolving needs

Q Private debt returns seem less attractive to investors, yet the asset class continues to flourish. Why?

Renaud Oury: Investment is about having a long-term perspective. Even if private debt fund returns currently seem less attractive to investors, private debt has nearly always outperformed the major fixed income indices, frequently with double digit IRR. In today's volatile and politically unstable environment, their returns have proved to be consistent throughout market cycles relative to equity indices.

In fact, according to Preqin Investor Interviews 2015, 76 percent of institutional investors reported that this asset class exceeded expectations, while 10 percent reported that it met expectations, and only 14 percent said it fell short of expectations. As returns remain at an historical low globally, private debt has gained traction among investors with long-term horizons who want to take advantage of the illiquidity premium.

However, institutional investors do not only look at private debt as dedicated investment vehicles. In fact, private debt is now an established component of any institutional portfolio. In addition to offering good long-term returns, private debt is perceived by investors as a diversification asset class, bringing additional structural protection to their portfolio thanks to the extended due diligence process underlying any issuing.

The opportunity to invest based on a detailed and exhaustive analysis makes private debt an ideal asset class, balancing the risk for the investor, despite its lower liquidity; such characteristics make it an asset class of choice for insurance groups and public pension funds in particular.

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Anja Grenner

Q Why do your clients choose to set up their private debt funds in Luxembourg?

Anja Grenner: There are various elements, firstly regulation factors: in some countries, debt can only be issued by banks, as was the case in Germany until 2016. While this has since changed, the conditions under which funds can issue debt are still limited. Luxembourg offers a less restrictive environment.

Additionally there are infrastructure-related factors: on one hand, Luxembourg hosts many sophisticated service providers, some with a particular focus on private debt, including law firms, directors and administrators. For funds targeting institutional investors across many countries, the ability to provide services through an international hub and to service clients in their own language is an asset. On the other hand, the need for higher returns than listed bonds is particularly urgent for insurance companies and pension funds.

While pension funds can be more flexible, insurance companies are often less so. For example, the potential increase of the allocation to private debt can be linked to the requirement to invest in AIFMD-compliant funds only. More than three years have passed since the


Renaud Oury

introduction of the AIFMD in Luxembourg and the country now has probably the largest number of third party AIFMs that have been nominated to act as a fund manager. For those that want to set up their own AIFM, the licence can be obtained via a smooth and efficient process through the local regulator.

Q What is the most commonly used investment vehicle?

AG: There are various structures that can be used, Luxembourg has a large range of available vehicles. Nowadays, the most frequently used is the (RAIF) Reserved Alternative Investment Fund, which is only indirectly regulated through the appointment of a regulated AIFM, but which itself is not subject to direct supervision through the local regulator.

Q What are the perceived advantages of using RAIF?

AG: Compared to the well-established and well–known regulated SIF and SICAR, the RAIF has quicker time-to-market and avoids double regulation of both the AIFM and fund; but it displays the same operational characteristics and tax features as a SIF or SICAR. Alternatively, directly regulated SIF and SICAR fund structures continue to exist – as well as unregulated entities that can voluntarily opt for the submission to the AIFMD regime – if preferred by investors. Into the latter category falls unregulated limited partnerships that are highly flexible and do not need to respect certain aspects contained in SIF or SICAR law, such as the need for diversification (as in the case of SIFs) or the need to hold only risk capital (as with SICARs).

Q Are private debt clients more demanding?

AG: Private debt clients are not necessarily more demanding than others, they simply have different needs. The servicing teams need to understand the debt markets and the available instruments to structure debt funds.

Q What expectations do clients have towards a specialist supplier such as SGG?

AG: Debt clients expect a team that is specialised in debt fund servicing, that not only understands the different strategies and financial instruments, the tax and regulatory framework but also valuations, impairments and impairment testing or loan administration, just to name a few. New debt managers are facing different challenges in terms of resourcing and operations knowledge. The key expectation they have is a dedicated debt management team with relevant fund and SPV administration experience, providing full and vertically integrated fund and SPV services for the entire structure, including loan and portfolio administration, third party AIFM and depositary services. Technology is another key expectation in servicing private debt clients. Today, debt fund administration providers have to deliver detailed portfolio reports for asset managers or investors from an automated platform, tailored to the needs of debt clients. ■

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__SGG Group__ is a global investor services firm offering fund administration to investment manager clients across all types of illiquid asset strategies including debt, infrastructure, real estate and private equity.