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Creditreform
Rating Agentur

Debt Funds in Europe

Buoyant Growth in a Nascent Market

Management Summary

In this study, Creditreform Rating presents a comprehensive review of the European market for debt funds. We take an in-depth look at trends in the asset classes of real estate, infrastructure, and direct lending (corporate) and compare these to the trends in the US market. Furthermore, we examine the yields on debt funds. The calculations carried out by Creditreform Rating are based on data obtained from Preqin as well as on our own market data. Creditreform Rating continuously monitors the development of the market in this segment, as we carry out analyses with regard to existing, future and contingent risks at the various levels of debt fund structures and issue ratings on securities related to debt funds.

1. The buoyant growth of the debt fund segment has directly benefited from a financial environment characterized by low interest rates and a lack of investment opportunities. Institutional investors are able to satisfy their need for solidly collateralized debt instruments of good credit quality. At the same time, debt funds offer banks an opportunity to release regulatory capital.

2. While real estate debt funds began to establish themselves in the USA at the beginning of the 2000s, this asset class has seen significant growth in Europe since 2011. This momentum accelerated considerably between 2013 and 2014, as new peaks were recorded with 19 and 18 new real estate debt funds and a volume of 9.2bn and 13.9bn euros, respectively. By the middle of 2015 the cumulative volume had climbed to 41.1bn euros. The US market, which remains significantly larger in terms of volume (187.5bn euros), has also continued its upward trend.

3. In addition, the number and volume of newly-placed European infrastructure debt funds has risen continuously since 2011. By 2014 the number of newly established debt funds had tripled from three to ten funds per year; the annual volume grew from 0.3bn to 4.3bn euros. In contrast to the real estate debt fund segment, the US market for infrastructure debt funds is, with a current cumulative volume of 19.5bn euros in 2015, only marginally larger than its European counterpart (16.4bn euros).

4. In the light of increasing disintermediation and emergence of new market players, alternative sources of financing such as private debt funds, whose focus is the direct injection of capital into companies - so-called direct lending debt funds - are in particular taking on a larger significance. This is underpinned by the number of debt funds established as well as by the volume of the funds. Between 2007 and June 2015, the cumulative volume climbed from 0.6 to 43.1bn euros. Remarkable here is the very strong growth seen in 2013 and 2014, when 48 debt funds were launched with a volume of 28.1bn euros.

5. Accordingly, the trend in Europe largely reflects that of the direct lending funds in the USA; however, there are two significant differences. On the one hand, the USA has to some extent the role of a forerunner, as even before 2007 a notable albeit relatively small volume of debt funds was registered. On the other hand, the US market appears to be more mature; the cumulative volume was 87.0bn euros as of June 2015.

6. With regard to the various investment objects for debt funds, the recently launched infrastructure debt funds are particularly attractive. In 2007, newly launched funds in this asset class achieved a net IRR of *only 5.3%; for funds launched in 2012 it was 17.7%, making it significantly higher than debt funds in other asset classes. Returns in the area of real estate debt funds have also seen an improvement; the average net IRR in 2012 was, with 10.1%, significantly above that at the beginning of the century (2000-2006: 7.4%). The development of private debt funds in the same period underwent fewer fluctuations. Private debt funds following the direct lending strategy achieved returns of 11.4% in 2012.*

7. We expect the long-term capital for real assets and in particular for enterprises to be increasingly provided by means of alternative sources of finance. Hence the market for debt funds should continue along the dynamic path it has been on for the past three years. To be sure, demand-side factors will certainly continue to be important driving forces behind this trend. However, we believe that it will be especially legislative and regulatory impulses which will result in alternative sources of finance such as debt funds playing a far more significant role in the financial landscape than is presently the case.

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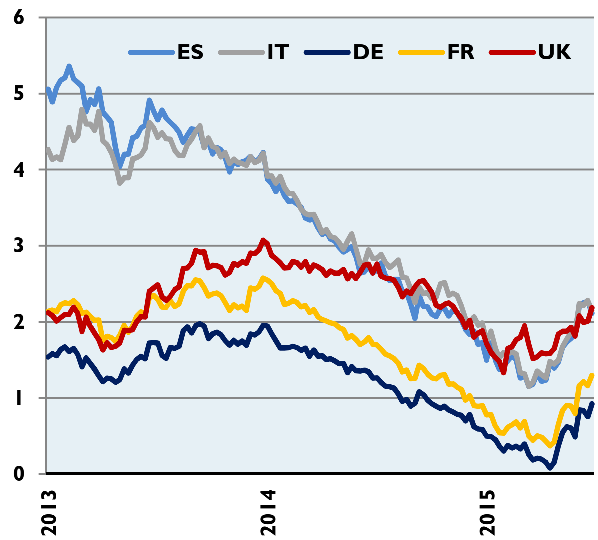
1. Debt fund segment benefiting from financial environment

The monetary policies of the most important central banks remain highly expansionary. Moreover, while central banks such as the Federal Reserve or the Bank of England has continued to adhere to their highly accommodating monetary policies, the vast majority of central banks has pursued an even more expansionary monetary strategy. Thus the European Central Bank (ECB) decided in January 2015 to launch a large-scale program for purchasing assets which includes government bonds in addition to asset-backed securities (ABS) and covered bonds. Since March 2015, the ECB has been carrying out monthly purchases in the amount of 60bn euros. This purchase program is to continue until at least September 2016 or until the ECB has observed a sustained adjustment in the path of inflation towards its inflation target of below, but close to 2%.

Fig. 1: Long-term bond yields

Yields of 10-year government bonds in %



Source: Creditreform Rating

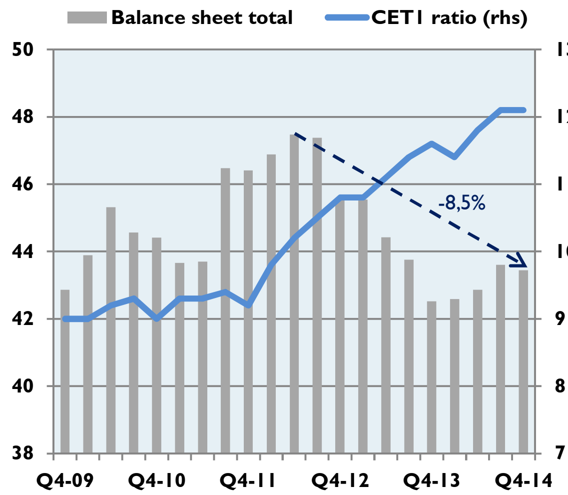
This decision by the ECB led to a further drop in market rates. In the course of the first half of 2015 yield levels for long-term government bonds fell to new lows (see fig. 1). Yields for 10-year government bonds in Germany decreased in 2014 from 1.929% to 0.541%, plummeting to a historic low of 0.075% in April 2015. Bonds with a maturity of up to five years posted negative returns. Bond yields of other eurozone countries such as France, Spain, and Italy also continued to plunge to record lows. Recently, yields for long-term government bonds returned to their previous level - which remains very low - of the beginning of the year, after investors were beset by doubts concerning their high valuation and by uncertainty with regard to developments in Greece.

In light of the extraordinarily expansionary monetary policy, the search for yield contributed to a surge in European corporate share prices during which European stock indices have registered record highs. Other asset classes have for the most part also followed a similar trend, in particular those acquired within the framework of the ECB purchase program (ABS, covered bonds). The long-term yield trend for corporate bonds is also in decline - for investment grade as well as high-yield corporate bonds, even though they have mirrored the development of sovereign bonds, trending slightly upwards in the second quarter of 2015.

At the same time, the financing market in Europe is subject to noticeable changes. Financing conditions remain tense in many European economies due to credit institutions finding themselves under pressure with their traditional business models, facing new regulatory conditions, and the low-interest environment. Hence banks see themselves exposed to declining profits while making the necessary adjustments to meet the requirements of banking regulations. European banks have significantly reduced their balance sheet totals in the past few years. In doing so, the decrease in the balance sheet total was accompanied by a reduction of risk-weighted assets, significantly strengthening the equity base (see fig.2). At the end of 2014, the percentage of risk-weighted assets covered by equity (common equity tier 1, CET1) was an average of 12.1% - nearly 3 percentage points above that of the fourth quarter of 2011, when the CET 1 ratio was at only 9.2%. Although this trend is to be seen as favorable from a financial stability-point of view, the deleveraging involved significant credit rationing in the banking sector.

Fig. 2: Deleveraging in the European banking sector

Balance sheet total of the EU-28 MFI in EUR tn, average equity ratio (CET 1) in %



Source: EBA, ECB, Creditreform Rating

Meanwhile, the lack of financing opportunities as a result of the decline in bank lending has increasingly been compensated for by market-based forms of financing. In past studies we showed that increasing recourse is being taken in favor of sources of financing outside the banking sector, in particular corporate bonds (see e.g. "Corporate Bonds in Europe – 2005-14", June 2015).

A further recent and sustained trend is the increasingly important role taken on by debt funds, in particular direct-lending funds, as a market-based form of financing for enterprises. With this investment instrument, an investment vehicle is launched - the debt fund - which invests primarily in illiquid and non-tradeable loans or assets. The debt fund is financed either by means of equity in the form of shares or via the issuance of debt instruments. Debt funds differ from ABS in that a) the number of assets in which the debt fund invests tends to be significantly smaller than with an ABS pool and b) there is no slicing into tranches in a debt fund structure.

The buoyant growth of the debt fund segment has directly benefited from a financial environment characterized by low interest rates and a lack of investment opportunities. While institutional investors in a low interest environment are able to satisfy their demand for solidly collateralized debt instruments of good credit quality, debt funds offer banks the opportunity to refinance their financial assets and release regulatory capital.

In this regard, this study offers a broad review of the European market for debt funds. We take an in-depth look at trends in the asset classes of real estate, infrastructure, and direct lending (corporate), comparing these to the trends in the US market. Furthermore, we examine the yields on debt funds.

We have pursued an inductive and explorative approach, taking together all available data on the European market for debt funds in order to carry out a series of structural analyses and identify trends. The calculations carried out by Creditreform Rating are based on data obtained from Preqin as well as on our own market data.

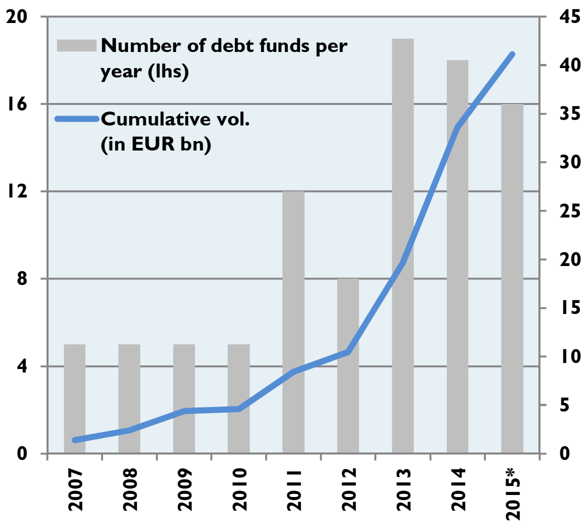
Creditreform Rating continuously monitors the development of the market in this segment, as we carry out analyses with regard to existing, future and contingent risks at the various levels of debt fund structures and issue ratings on securities related to debt funds.

2. Real asset debt funds – an international comparison

After the number of European real estate debt funds launched annually between 2007 and 2010 amounted to only five, the following year saw a noticeable boost in the market (see fig. 3). In 2011 the number of new funds was twelve, and with a volume of 3.9bn euros nearly twice as high as in 2009 (2.0bn euros). After development slowed in 2012, the market for debt funds gained momentum in the following years. In 2013 and 2014 new peaks were recorded with 19 and 18 new real estate debt funds and a placed volume of 9.2bn and 13.9bn euros, respectively.

Fig. 3: Real estate debt funds in Europe

Includes placed debt funds and funds in the placement stage
*) = January to June 2015



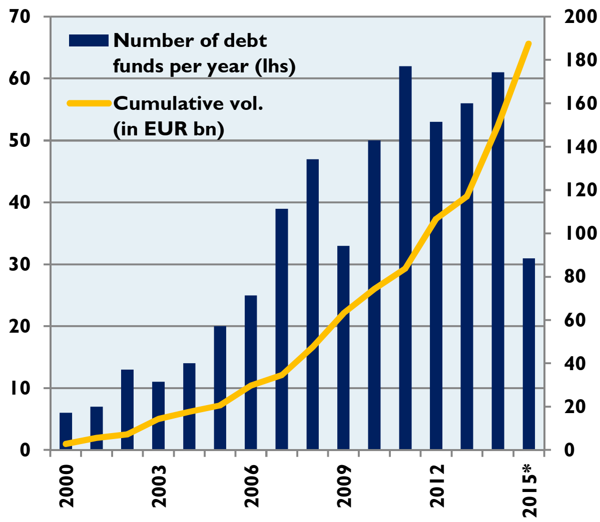
Source: Creditreform Rating

Meanwhile the trend in the first half of 2015 indicates a continuing robust growth. Thus the cumulative volume of all European real estate debt funds increased to 41.1bn euros (2014: 33.6bn euros). In addition, 16 new real estate debt funds were registered between January and June 2015 alone: nearly the same number as in the whole of 2014 (18). It is, however, notable that the fund volume of 7.5bn euros lies significantly below the previous year's level (2014: 13.9bn euros). Hence the volume of newly established funds in 2015 is lower on average than in the prior year.

In contrast to Europe, where real estate debt funds only began to establish themselves from 2007 onward as an alternative form of financing, this asset class had already taken on significant importance in the United States (USA) at the beginning of the century (see fig. 4). Hence the cumulative volume of all US real estate debt funds in 2000 was already at 2.8bn euros. By comparison, seven years later the entire European market for real estate debt funds was just half that size with 1.4bn euros.

Fig. 4: Real estate debt funds in the USA

Includes placed debt funds and funds in the placement stage
*) = January to June 2015



Source: Creditreform Rating

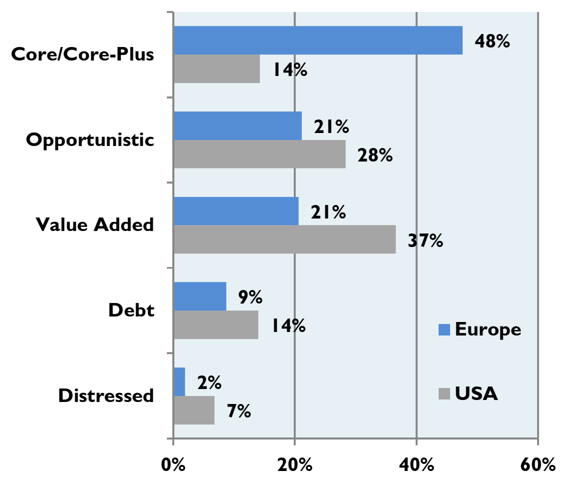
The continuous growth in the US real estate debt funds segment since the beginning of the century is reflected in the number of new funds launched annually as well as in its overall volume. Hence the number of newly established funds increased tenfold, from 6 funds in 2000 to 61 in 2014. Over the same period the volume of the funds grew by nearly a factor of 14 from 2.8 to 37.9bn euros; the cumulative volume amounted to 149.6bn euros at the end of 2014. With the exception of 2009 - the year of the crisis - when 33 new funds were counted (2008: 47), there was not any notable decline in the number of fund placements.

The latest data remains consistent with a continuation of the favorable development of real estate debt funds. Thus in 2014 a growing number of new funds (61) was registered for the third consecutive year accompanied by an increase in volume (37.9bn euros). Since the beginning of the year, 31 funds have been launched with a volume of 17.1bn euros; hence there is a good probability that the level reached at the end of 2014 will be attained.

Although the market for real estate debt funds gained significant momentum in the last few years, this segment has to date remained somewhat of a niche within the entire spectrum of European real estate funds. Thus the proportion of debt funds launched by European fund managers (⇔ debt strategy) of all real estate funds launched in Europe between 2007 and June 2015 was 9% (see fig. 5). By comparison, in the somewhat more mature US market this proportion is 14%.

Fig. 5: Real estate investment strategy according to location of fund managers

Funds launched between 2007 and June 2015



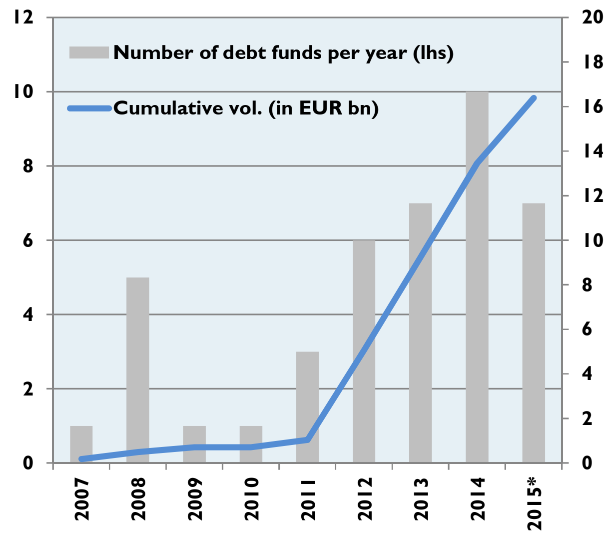
Source: Creditreform Rating

By comparison, European fund managers appear to be inclined towards a more conservative investment strategy: nearly one in two real estate funds (48%) invests in high quality, leased property with a leverage of up to 30 (core) or 55% (core plus). 21% of the funds, respectively, pursued opportunity-oriented strategies involving higher risk. Such funds invest primarily in property requiring higher leverage of 50% to 70% (value added), or more than 60% (opportunistic) due to e.g. necessary renovations, repositioning, or vacancy.

When one compares the markets for debt funds in the real estate and infrastructure segments, differences become apparent. The discrepancy which can be seen with regard to the size of the market for real estate debt funds between here and on the other side of the Atlantic is hardly present (see fig. 6 and 7). Up to 2014, the market for European infrastructure debt funds, with a cumulative volume of 13.5bn euros, was only slightly smaller than its American counterpart (15.1bn euros).

Fig. 6: Infrastructure debt funds in Europe

Includes placed debt funds and funds in the placement stage
*) = January to June 2015

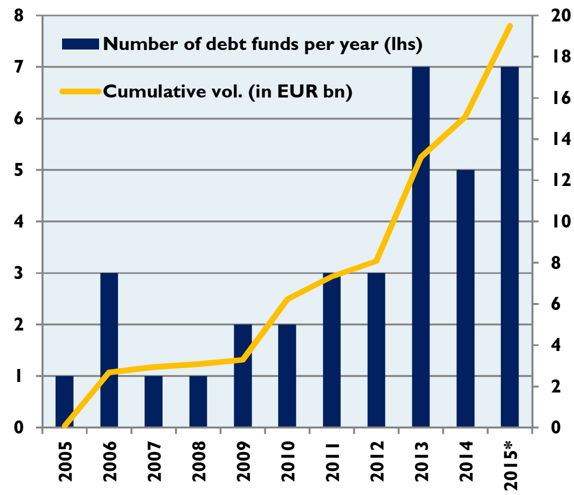


Source: Creditreform Rating

At the same time, the figures show the infrastructure debt fund market to be significantly smaller on the whole. One reason for this may be the smaller number of investment-ready infrastructure projects and the lesser degree of market transparency. In addition, infrastructure assets possess a series of specific characteristics which may hamper investment; e.g. roads, bridges and harbors cannot usually be liquidated at short notice and are therefore suitable only for investors with a very long investment horizon. Moreover, the amount of capital necessary for purchase and state regulatory requirements pose obstacles for potential investors which should not be underestimated.

Fig. 7: Infrastructure debt funds in the USA

Includes placed debt funds and funds in the placement stage
*) = January to June 2015



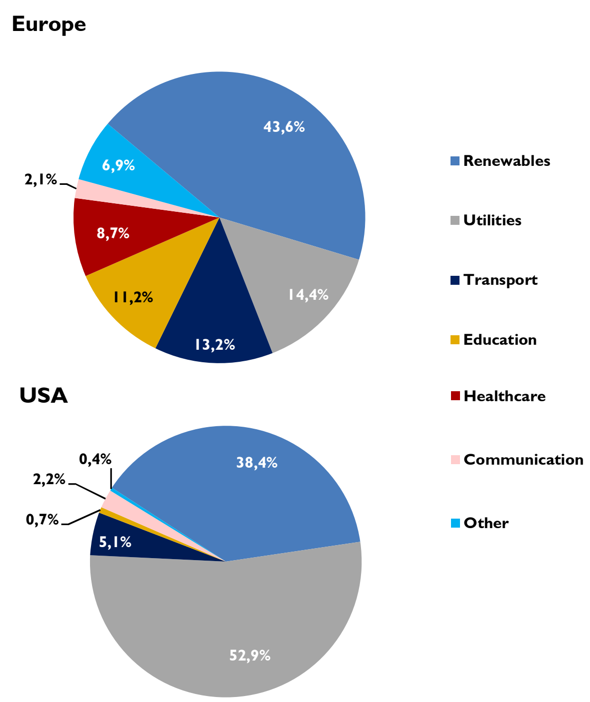
Source: Creditreform Rating

Nevertheless, the European market for infrastructure debt funds has seen a steady upward trend since 2011. The volume of new funds launched per year rose until 2014 from 0.3bn to 4.2bn euros; the number of new funds tripled during the same period from three to ten per year. The trend in the USA is likewise positive; within ten years, the cumulative volume of infrastructure debt funds grew steadily from 0.1bn euros (2005) to 15.1bn euros (2014). Parallel to this, the number of new funds launched also saw an increase which further accelerated from 2013. The market trend between January and June 2015 indicates continuing expansion of European as well as American infrastructure debt funds; the number of new fund placements in the US (7) as well as the funds raised (4.4bn euros) were already significantly higher than at the end of 2014 (5; 2.0bn euros). The trend for European funds also remains positive: seven funds were placed, with a volume of 2.9bn euros (2014: 10; 4.2bn euros).

Analysis at the level of infrastructure deals reveals a clear distinction between the investment behavior of European and American infrastructure fund managers. Here it is evident that European investors are predominant in the area of infrastructure. Three quarters of the funds investing in infrastructure assets in the USA and Europe (74%) are based in Europe, while only 24% are headquartered in the USA.

Fig. 8: Distribution of infrastructure deals by asset class

Underlying deals for infrastructure funds closed between 2007 and June 2015



Source: Creditreform Rating

Collectively, both European and American infrastructure funds in Europe invest preferentially in renewable energy (43.6%), followed by a large margin by the segments utilities (14.4%), transport (13.2%), and education (11.2%) at an equal level. By contrast, in the USA a much higher concentration of investors can be seen on few infrastructure areas (see fig . 8). Nine out of ten deals are accounted for by the utilities sector (52.9%) and renewable energy (38.4%). The third highest concentration is in the transport sector with only 5.1%. Hence investments in toll roads, bridges, and harbors are significantly more infrequent than in Europe. In contrast to Europe, there have been no deals of noteworthy size in the areas of healthcare or education in the USA.

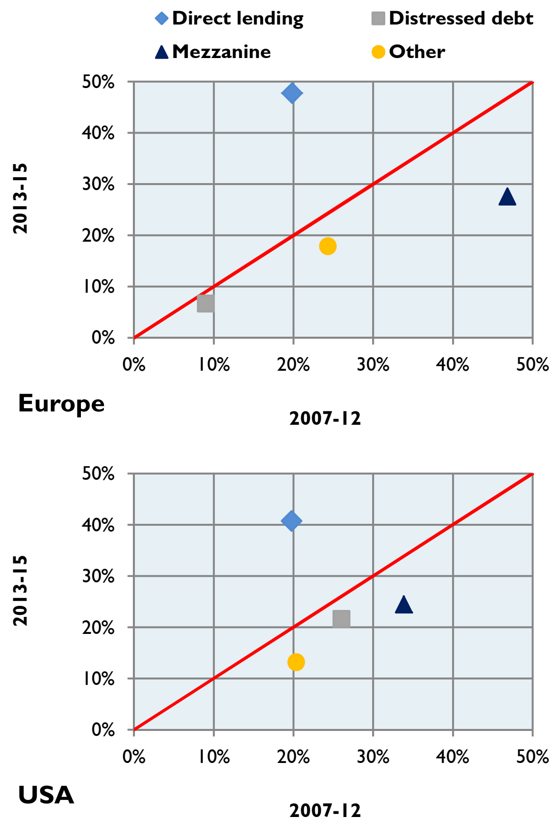
3. A burgeoning direct lending market in Europe

Traditionally, European enterprises finance their investments and growth by means of bank loans; this historic pattern of finance is, however, undergoing a transition. In light of increasing disintermediation and emergence of new market players, alternative sources of financing such as private debt funds, whereby predominantly institutional investors provide capital to enterprises, are rapidly gaining significance.

In particular private debt funds with a focus on the direct injection of capital into companies - so-called direct lending funds - are playing an increasingly significant role. The comparison over time of investment strategies pursued by fund managers shows the direct lending strategy gaining considerably more importance in the last two to three years than was the case in the preceding years (see fig. 9). It seems that the market has adapted to the increased demand for market-based financing on the part of enterprises faced with a limited supply of bank loans. While direct lending funds comprised only 20% of the private debt funds in Europe between 2007 and 2012, in the years 2013 to 2015 nearly one in two funds (48%) pursued this investment strategy. By comparison, the proportion of mezzanine funds and distressed debt funds investing in non-performing loans fell from 47% and 9% respectively to 28% and 7% respectively.

Fig. 9: Investment strategies of US and European fund managers

Proportion of respective strategies in all private debt funds launched in the respective period



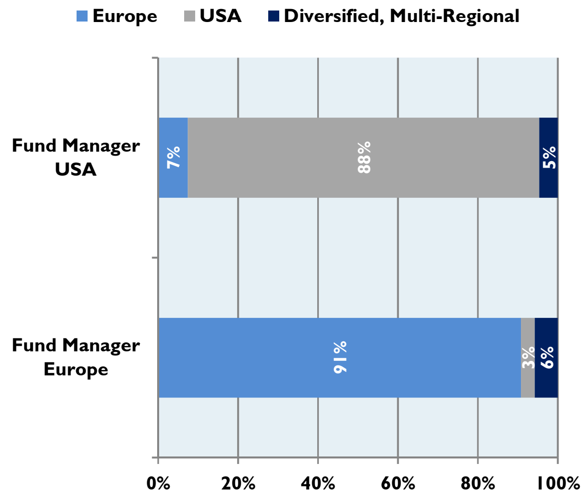
Source: Creditreform Rating

In general, we can differentiate between loan origination and loan participation. While participation in an already existing loan is an established form of participation for investment funds, direct lending on the part of the fund is a recent phenomenon. In these cases the fund acts as the original lender; the loan is part of the investment strategy of the debt fund. At times, however, the distinction is somewhat blurred; particularly where the loan has been granted with the aim for it to be sold directly to a fund, i.e. the bank loan is primarily part of a broader arrangement (see also the ESMA report on Trends, Risks and Vulnerabilities No. 1, 2015).

Closer examination of the investment strategy here indicates a home bias on the part of the fund manager, i.e. a clear preference on the part of the fund manager for granting loans in its domestic market (see fig. 10). Nine of ten debt funds (91%) launched by a European fund manager have borrowers based in Europe. This applies also to the USA: the debt funds managed by American fund managers grant loans primarily (88%) to US corporations.

Fig. 10: Geographic focus of direct lending funds

Debt funds launched since 1995



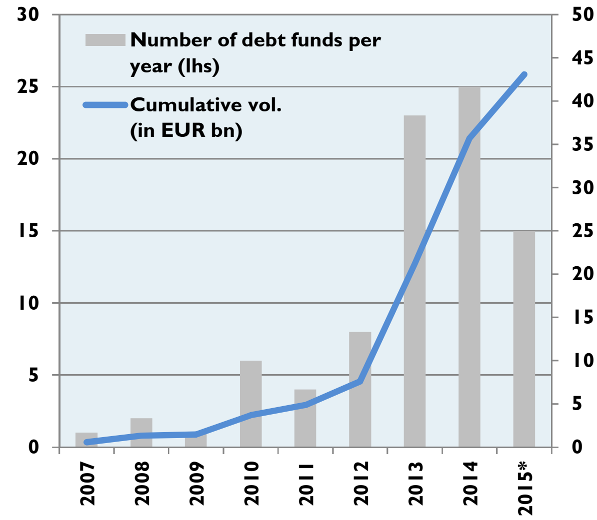
Source: Creditreform Rating

The fact that direct lending funds are taking on an increasingly significant role in corporate finance is strikingly underpinned by the trend in the number of debt funds launched and by their volume (see fig. 11). This form of financing, however, was hardly taken advantage of in Europe before 2011; the cumulative volume of debt funds amounted to just under 4.9bn euros. It was not until 2012 that the number of new debt funds exceeded that of the previous years. A total of eight direct lending funds were registered, with a volume of 2.7bn euros. In 2013 the annual volume of debt funds surged, climbing by a factor of five to 13.6bn euros. This level was exceeded again in the following year at 14.5bn euros. A total of 48 debt funds have been launched in the past two years, and this trend has continued in 2015: by June 15 debt funds which provide corporate loans had been launched, with a volume of 7.4bn euros. Thus the cumulative volume currently amounts to a total of 43.1bn euros.

Fig. 11: Direct lending funds in Europe

Includes placed debt funds and funds in the placement stage

*) = January to June 2015

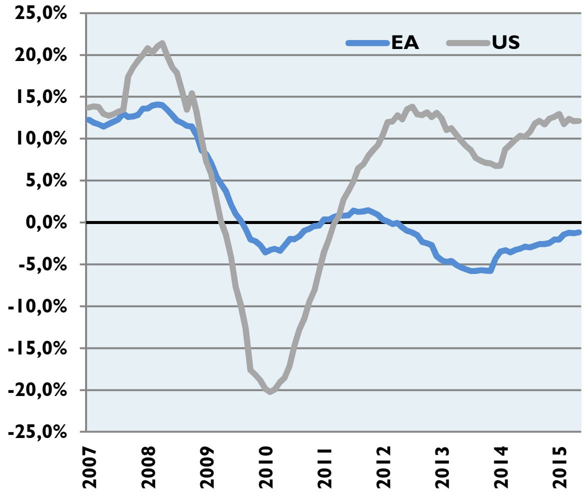


Source: Creditreform Rating

Here, the trend in bank loans seems to have played a special, virtually catalytic role (see fig. 12). The annual rate of change for loans to non-financial corporations has been negative in the euro area since March 2012. The rate of change remained under -4% throughout 2013. Since the beginning of 2014 the negative trend for loan volumes has lost its momentum. Nevertheless, lending in the corporate sector has remained in decline, amounting to a low -1.2% (y-o-y) in May 2015.

Fig. 12: Lending to non-financials

Year-over-year change in %

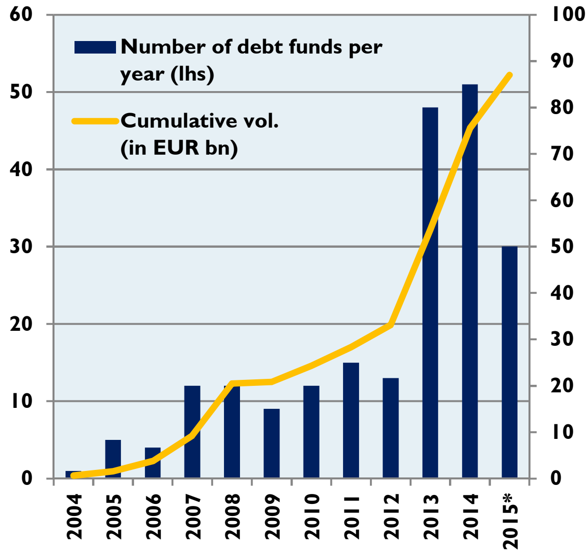


Source: ECB, Federal Reserve St. Louis, Creditreform Rating

Thus the trend in Europe largely reflects that of the direct lending funds in the USA; however, there are two key differences (see fig. 13). On the one hand, it is notable that the USA has to some extent the role of a forerunner; hence there was a considerable, albeit relatively small volume of debt funds between 2004 and 2006. In 2006 the cumulative volume of debt funds was as high as 3.8bn euros – a level not achieved in Europe until 2010. Between 2007 and 2012 the number of new debt funds in the USA fluctuated between 9 and 15 funds per year, resulting in an increase in volume to 33.1bn euros. On the other hand, the US market appears to be slightly more mature. The cumulative volume in 2015 amounted to a total of 87.0bn euros. Common to both, the European and American markets for direct lending, is the surge in the number of funds in 2013/14 – albeit that the US market is substantially larger. The number of debt funds launched in 2013 and 2014 totaled 48 and 51 funds respectively, with a volume of respectively 20.5bn and 21.9bn euros.

Fig. 13: Direct lending funds in the USA

Includes placed debt funds and funds in the placement stage
*) = January to June 2015



Source: Creditreform Rating

4. Search for yield? The performance of debt funds

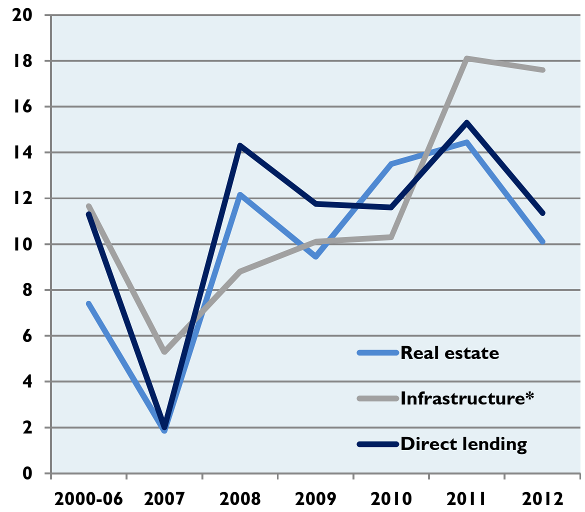
The prolonged period of low-interest rates poses enormous challenges for institutional investors in particular; the planned yields can hardly be realized through investments in bonds of high credit quality. In the light of this challenge, debt funds have increasingly become the focus for institutional capital providers. However, what can we say about the risk-return profile for debt funds?

One indicator which is given significant attention in order to gauge performance is the so-called net internal rate of return (net IRR). The net IRR indicates the return minus fees and capital costs which an investor may expect from his investment based on past and expected future cash flows within a certain period.

With regard to the various investment objects, the recently launched infrastructure debt funds in particular have proven attractive (see fig. 14). In 2007, new funds in this asset category achieved an average net IRR of only 5.3%, climbing to 10.3% in 2010 and 17.7% in 2012. Thus the performance of this asset class was significantly better than that of any of the other asset classes we reviewed. In contrast to infrastructure debt funds, the trend for direct lending funds since 2008 has been characterized by lower volatility. From 2008 to 2012 the net IRR remained within a range of 11.4% (2012) to 15.3% (2011). Meanwhile, the performance of real estate debt funds has improved considerably. Despite a decline from 14.5% to 10.1% in 2012, the average net IRR is still well above the level seen at the beginning of the century (2000-06: 7.4%).

Fig. 14: Performance of debt funds by Asset class

Average net IRR (median) by vintage year, in %, *) investment strategies debt, primary, secondaries

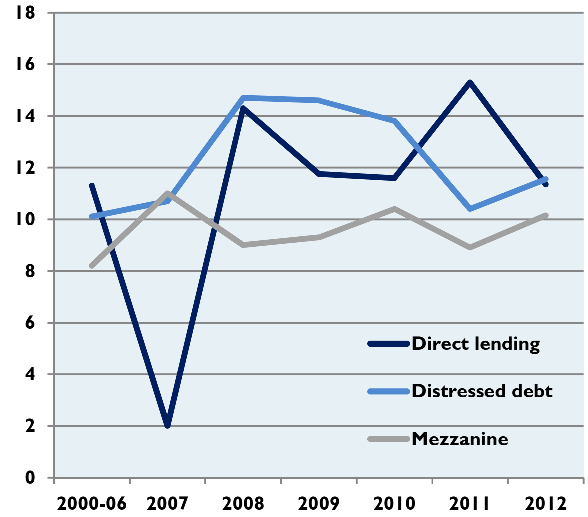


Source: Creditreform Rating

Examining the private debt funds according to strategy, some differences are apparent. After a surge in yield for the direct lending funds started in 2008 to 14.3% (2007: 2.0%), the following years saw a relatively volatile sideways movement (see fig.15). Recently, the direct lending funds launched in 2012 showed yields of 11.4%. New private debt funds, investing according to a distressed debt strategy, increased their average returns until 2008; since then, however, they have trended downward. Recently, the net IRR has seen a slight increase so that distressed debt funds, with 11.6% in 2012, displaying a IRR level similar to the beginning of the period of review (2000-06: 10.1%). By contrast, funds employing a mezzanine investment strategy are characterized by relatively comparable returns, dependent upon their year of placement. Here the net IRR fluctuates in a range of between 8.2% (2000-06) and 11.2% (2007).

Fig. 15: Performance of private debt funds by strategy

Average net IRR (median) by vintage year, in %

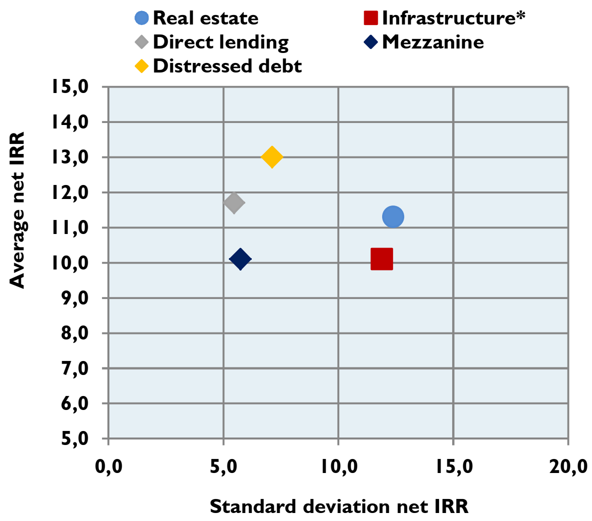


Source: Creditreform Rating

Whether or not the returns on a debt fund investment are regarded as attractive depends not least of all on the volatility of the returns. Returns with low volatility - measured by a low level of standard deviation of the net IRR - are as important for many investors as their average amount. In the comparison of debt funds launched in the period between 2007 and June 2015, the direct lending funds have the most attractive risk-return profile (see fig. 16). While mezzanine and distressed debt funds, with 10.1% and 13.0% respectively, are profitable to a similar extent as direct lending funds (11.7%), their return pattern exhibits more fluctuation. Thus the standard deviation of the net IRR for mezzanine and distressed debt amounts to 5.7% and 7.1% respectively. For direct lending funds, by comparison, it is lower (5.5%). In comparison with the real asset debt funds, all of the private debt strategies yield comparable returns with lower net IRR volatility. The standard deviation of the net IRR, at 11.9% for infrastructure debt funds and 12.4% for real estate debt funds, is approximately twice as high as for private debt strategies.

Fig. 16: Risk-return profile for debt funds by asset class

In %, debt funds launched in Europe between 2007 and June 2015 *) investment strategies debt, primary, secondaries



Source: Creditreform Rating

The relatively high volatility of infrastructure funds here is surprising. However, it should be noted that this initial risk-return analysis is based on a relatively small sample of infrastructure debt funds with a fairly heterogeneous portfolio structure. In the long term, with increasing additions to this sample of infrastructure debt funds employing the same debt strategy, we expect a less volatile return profile as well as a decline in the standard deviation in net IRR to the level of the private debt funds.

5. Where there's a will... EU governments creating conditions for further growth

We expect the long-term capital for real assets and in particular for enterprises to be increasingly provided by means of alternative sources of finance. Hence the market for debt funds should continue along the dynamic path it has been on for the past three years. The search for yield on the part of institutional investors, who in turn encounter banks wishing to reduce their high-risk positions in order to fulfill regulatory requirements (de-risking), should contribute to this.

To be sure, demand-side factors will certainly continue to be important driving forces behind this trend. However, we believe it will especially be legislative and regulatory impulses which will result in alternative sources of finance such as debt funds playing a far more significant role in the financial landscape in future than is currently the case.

As mentioned earlier, enterprises in Europe - in particular small and medium-sized enterprises (SME) - rely primarily on banks to cover their financing needs. The fact that SMEs hardly have access to capital markets and rely significantly less often on market-based sources than on banks for their financing is confirmed in the latest ECB survey on access to finance of enterprises (SAFE, see ECB Economic Bulletin, 4/2015). Unfortunately, enterprises in Europe continue to be faced with relatively restricted lending, despite the improvement in financing conditions in the past several months. This is critical inasmuch as that for enterprises without access to other financing opportunities, any restrictions on lending mean an impairment of their ability to invest in the growth of the enterprise. Alternative financing instruments could play a pivotal role in raising capital - not only in times of crisis, when the situation in capital markets is tense.

In this regard, the EU Commission has recognized the urgent need for action in Europe. The central role of banks in corporate financing is certainly, among other factors, due to the significance of the SME for economic development, which is greater in Europe than in other economic areas. It should be stated, however, that the underlying regulatory and legal framework plays a crucial role in the development of capital markets. Accordingly, the commission published the Green Paper for Building a Capital Markets Union (COM(2015) 63/2), 18.02.2015), in which they formulated the objective of improving enterprises' access to finance and in particular expanding and diversifying sources of financing.

In order to close gaps in financing and to promote the provision of capital via financial markets, the EU Commission took initial measures as early as 2013 by issuing directives on European venture capital funds (EuVECA-VO, regulation (EU) Nr. 345/2013) as well as the European Social Entrepreneurship Fund (EuSEF-VO, regulation (EU) Nr. 346/2013) which aim to facilitate financing for start-ups and social enterprises. These two directives were supplemented in April 2015 by the regulation on European long-term investment funds (ELTIF, regulation (EU) no. 2015/760), which creates a regulated European vehicle enabling long-term financing for infrastructure projects and enterprises. The most significant innovation is that direct lending to an enterprise is explicitly declared as a permissible asset. These investment funds can provide loans to enterprises, thus providing services similar to those of banks.

In addition, legal and/or regulatory groundwork has recently been laid in a number of EU countries which permit lending on the part of alternative investment funds (AIF). In this vein, the Central Bank of Ireland published the AIF Rulebook in which the management procedures for so-called loan originating funds are regulated. In Malta and Latvia lending on the part of investment funds is in principle permitted according to the Investment Services Act and the Law on Alternative Investment. In Italy the Decreto competitività was issued which permits insurance enterprises and securitization companies to lend under certain circumstances.

In addition, the French government established the Fonds de prêts à l'économie, which enables insurance companies to lend directly to an SME. The British parliament established the Business Finance Partnership, whereby GBP 1.2bn was provided to non-banks to provide loans to SMEs.

In Germany, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) declared debt funds as permissible. Accordingly, the BaFin changed its administrative procedures insofar that it regards lending as well as loan restructuring and prolongation by AIFs as part of the collective asset management and thus as permissible (WA 41-Wp 2100 - 2015/0001). In this case the Kapitalanlagegesetzbuch (KAGB) has precedence over the Kreditwesengesetz (KWG) as a so-called Lex specialis.

This change is of major importance for both the German debt funds and AIFs which originate in the EU and in non-member states, wishing to operate in Germany. Until this legal notice, the KWG fundamentally prohibited AIFs launched in Germany from granting loans for the account of investment assets, making debt funds dependent upon cooperation with a bank (a 'fronting bank') in order to finance an enterprise in Germany.

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