



GLOBAL MARKETS REPORT

“The growing influence of private debt funds”

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INTRODUCTION

The private debt industry has experienced remarkable growth in recent years, primarily driven by the prolonged period of low interest rates and stricter banking regulations implemented after the 2008 financial crisis. Europe, in particular, has seen one of the most significant expansions in this industry, with a compound annual growth rate of nearly 14% since 2010.

First, it is important to define what private debt is. Private debt (or private credit) encompasses all financing operations where a non-bank lender provides loans to companies, offering an alternative to traditional financing. Target companies are usually small to medium-sized enterprises, often non-investment grade and frequently unrated; however, a credit assessment is typically conducted alongside the financing activity.

Private credit financing typically carries floating interest rates, meaning the interest owed fluctuates with market rates. In Europe, the median amount for private credit financing was €168m in 2023, with loan durations ranging from 3 to 7 years. Financing terms can reach 400bps over the lending rate for a publicly funded transaction, largely due to an “illiquidity premium” associated with this type of debt. At the same time, this spread represents one of the most attractive aspects of investing in private credit and has been crucial to its rise during the recent low-interest-rate period.

Private credit funds employ different strategies by adjusting the seniority of their loans and the purpose of lending, typically aiming to generate a stable revenue stream. In the euro area, funds generally adopt one of four main strategies: direct lending, mezzanine debt, special credit situations, and distressed debt. Direct lending is considered the least risky strategy, whereas the other approaches are associated with a higher probability of default.

Companies find two main advantages in using private credit instead of a regular bank loan. First, the process to secure a private credit loan is generally much faster than with traditional banks. This efficiency largely stems from the lighter regulatory framework governing private debt funds compared to banks, as well as their higher risk tolerance, which enables them to pursue operations that may be less feasible or attractive for banks. The second advantage is flexibility: private credit loans are highly customizable, making them an ideal choice for companies whose needs aren't met by conventional bank loan structures.

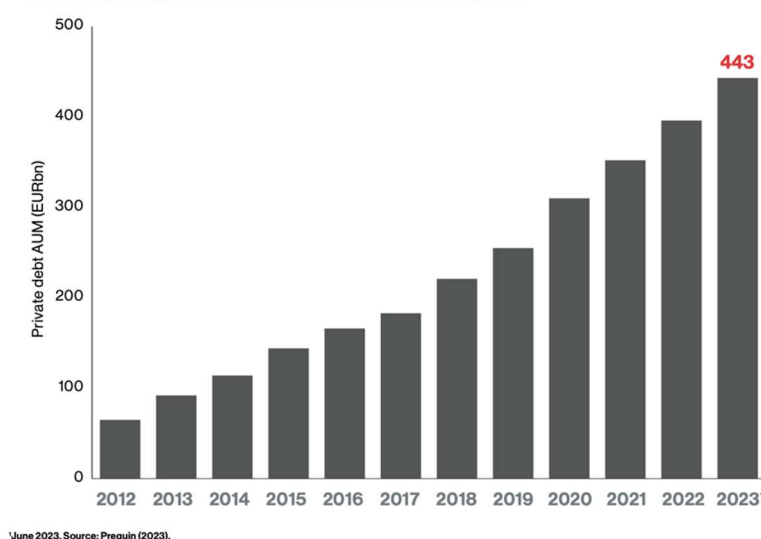
Together with these advantages, private credit has emerged as a key player in financing European companies, positioning itself as a flexible alternative to traditional bank loans.

CURRENT EUROPEAN SITUATION

Volumes of the Private Debt industry in Europe

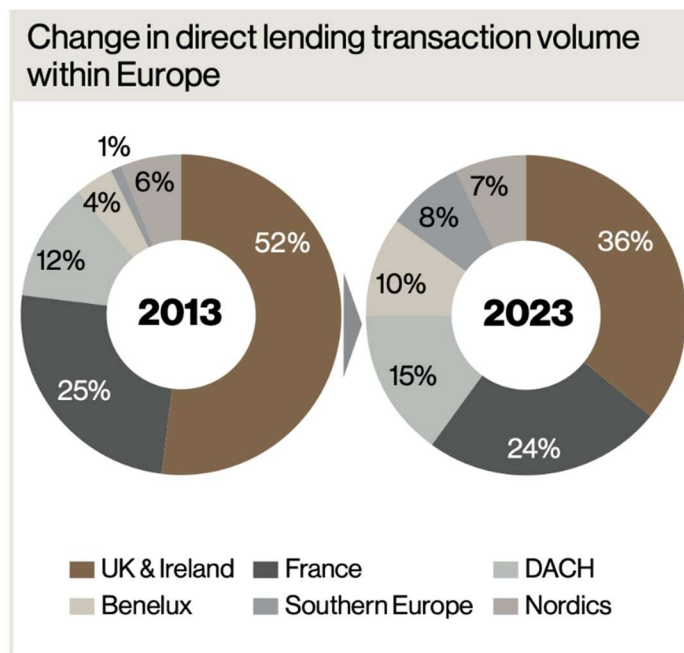
The European private debt market has experienced extraordinary growth in recent years, with volumes reaching unprecedented levels and reshaping the financial landscape for alternative investments across the continent. By late 2023, assets under management (AuM) in private debt funds across Europe had soared to €510 billion, a significant leap of 21.5% within just six months. This surge in volume is emblematic of private debt's transition from a niche market to an essential element within the financial portfolios of both institutional and private investors. Several factors have coalesced to drive this rise, reflecting broader economic shifts, regulatory adaptations, and changing investor preferences in an increasingly complex financial world. Traditional banks, historically the primary lenders to small and mid-sized enterprises, have been stepping back from direct lending due to tighter regulatory capital requirements and risk constraints, which were exacerbated by macroeconomic uncertainties. This contraction has created a vast financing gap, which private debt funds have moved decisively to fill, offering the liquidity and flexibility that traditional institutions have increasingly lacked.

The European private debt market continues to grow



Luxembourg has emerged as the epicenter of this transformation in Europe, becoming the jurisdiction of choice for private debt funds due to its advanced regulatory environment and a wide variety of fund structures. The Reserved Alternative Investment Fund (RAIF) and Special Limited Partnership (SCSp) structures, in particular, have proved immensely popular, supporting the expansion of private debt volume by providing fund managers with a flexible yet robust operational framework. RAIFs, which offer indirect supervision and therefore greater adaptability, have seen marked growth; they now represent around 62% of private debt fund structures, up by 9% from previous years. This structure's adaptability allows fund managers to respond rapidly to changing market conditions without sacrificing compliance with regulatory oversight. Meanwhile, SCSp structures have emerged as the dominant vehicle for unregulated debt funds, now comprising 86% of such structures. These partnerships allow for simplified operations and are particularly attractive to institutional investors, who value the ability to customize funds to meet diverse portfolio objectives without excessive regulatory burdens. This preference for Luxembourg-based structures highlights how volume growth in private debt is underpinned by innovative regulatory frameworks, creating an accommodating environment for large-scale investment in this asset class.

At the heart of this volume growth lies direct lending, which has become the predominant strategy within private debt, now comprising around 62% of the sector's activity. Direct lending is particularly popular because it allows private debt funds to offer bespoke financing solutions to companies that



Sources: Deloitte, Alternative Lender Deal Tracker (Q4 2013), cumulative over the last five quarters; and Deloitte, Private Debt Deal Tracker (H1 2023), cumulative over the last 43 quarters.

may otherwise struggle to secure capital. In regions such as France, Germany, and the Nordics, where mid-market companies are key economic drivers, demand for direct lending has surged. This trend is propelled by the ability of private debt to offer these companies not only access to capital but also contractual stability and, in some cases, additional protections. Direct lending within the private debt framework provides investors with attractive returns, typically ranging between 5% and 7%, while offering the added security of floating-rate instruments. In a high-interest-rate environment, these floating-rate loans become particularly appealing, as they provide investors with

protection against inflation and other market volatilities that might negatively impact fixed-income assets. This reliable return profile has played a crucial role in the rapid accumulation of capital within the private debt sector, as investors increasingly look for resilient investment options that can weather macroeconomic fluctuations.

The significant expansion in private debt volumes is also fueled by a growing emphasis on environmental, social, and governance (ESG) considerations. Although approximately 76% of private debt funds still fall under Article 6 in the SFDR, which involves limited ESG commitments, there is a growing shift towards funds classified under Article 8, which promotes sustainable and socially responsible investments. This pivot reflects the demands of an investor base that is not only interested in financial returns but also concerned with the social and environmental impact of their investments. This shift is further supported by evolving regulations across Europe that endorse greater transparency and accountability in investment practices, encouraging private debt funds to integrate ESG criteria into their decision-making processes. This ESG integration aligns private debt with broader investment trends and enhances its appeal to socially conscious investors, particularly in Europe, where sustainable finance continues to gain prominence.

As the European private debt market continues on its trajectory of growth, the rapid increase in volume signals both its resilience and its adaptability in meeting the financing needs of a diverse range of businesses. Private debt funds are now a vital component of the continent's financial system, providing tailored financing solutions that are increasingly replacing traditional lending models. The combined impact of favorable regulatory frameworks, investor demand for flexible and secure assets, and the growing integration of sustainability criteria has positioned private debt as a cornerstone of Europe's financial ecosystem. This growth in volume not only reflects the sector's strong past performance but also indicates its potential for continued expansion, with private debt poised to support economic growth and innovation across Europe for years to come.

Private Debt funds' performance analysis

In the realm of private debt, funds cover a wide range of strategies, each tailored to different market conditions and risk appetites. From the relative safety of direct lending to the high-stakes allure of distressed and special situations, the private debt industry offers a tapestry of options for investors. Mezzanine financing, along with infrastructure and real estate debt, further enriches this space, blending income potential with varying degrees of risk and market sensitivity. Together, these fund types constitute a complex ecosystem where performance is not only a product of underlying assets but also of the larger economic environment and investor expectations of illiquidity premiums.

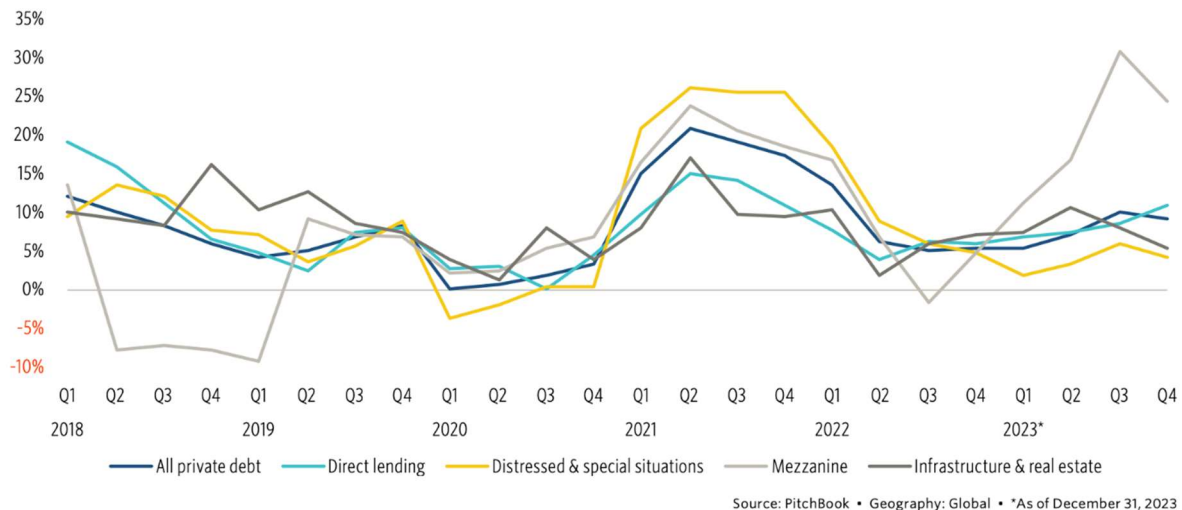
Private debt funds, being unlisted and non-tradable, rely on IRR (Internal Rate of Return) as a proxy for real returns, offering a more nuanced perspective than mere asset appreciation. The illiquidity of these investments is a significant factor, as investors typically demand higher returns to compensate for the inability to swiftly liquidate holdings. This “illiquidity premium” is central to private debt’s appeal, especially in comparison to more liquid assets. Over the past few years, IRRs across fund types have underscored the value of this premium, with returns peaking significantly during certain economic conditions.

For example, in 2021, private debt funds saw notable returns achieving an impressive 18.1% IRR, reflecting strong recovery dynamics as the global economy rebounded from the disruptions of 2020. This surge was not isolated to a single category but spanned across fund types, underscoring a broader trend. Distressed and special situations funds, often considered a high-risk, high-reward segment, soared to an exceptional 24.5% in 2021, showcasing their ability to capitalize on market dislocations. Mezzanine funds, too, demonstrated impressive resilience, growing from a modest 4.2% in 2020 to 19.9% in 2021, and eventually reaching a remarkable 20.9% in 2023, reflecting how mezzanine financing can thrive in an environment of economic recovery and credit demand.

Direct lending, though more conservative, also showed variability, with IRRs oscillating between 13.2% in 2018 and a low of 2.7% in 2020, only to recover to 12.5% in 2021. The relatively stable returns of infrastructure and real estate funds, which reached their peak IRR of 11.1% in 2021 before settling around 7.8% in 2023, appeal to investors prioritizing consistency and lower volatility. These funds, while generally less responsive to economic cycles, still capture a moderate illiquidity premium without exposing investors to the sharper fluctuations seen in other strategies.

Private Debt funds one-year horizon IRRs by fund type:

	2018	2019	2020	2021	2022	2023
All private debt	9,2%	6,1%	1,5%	18,1%	7,6%	7,9%
Direct lending	13,2%	5,8%	2,7%	12,5%	6,0%	8,6%
Distressed & special situations	10,7%	6,4%	-1,1%	24,5%	9,6%	3,9%
Mezzanine	-2,2%	3,5%	4,2%	19,9%	6,8%	20,9%
Infrastructure & real estate	10,9%	9,8%	4,3%	11,1%	6,3%	7,8%



Interestingly, private debt fund returns appear aligned across continents, with European and American funds delivering comparable performance. This convergence highlights the global nature of private debt, where cross-border capital flows and similar economic pressures create a unified landscape. Investors, whether in Europe or North America, seem equally inclined to demand substantial premiums for illiquidity, creating an environment where returns are less region-specific and more reflective of global economic tides.

Given the variability among fund types, a multi-strategy approach appears prudent for investors navigating the private debt market. By diversifying across direct lending, mezzanine, distressed debt, and infrastructure, investors can balance the allure of high returns with a buffer against risk. This strategy harnesses the power of the illiquidity premium across multiple segments, smoothing out returns over time and allowing investors to adapt as economic conditions shift.

REGULATORY FRAMEWORK IN EUROPE

Regulation is one of the most important aspects to account for when it comes to analyzing the private credit industry. For example, the lighter regulation framework applied for private debt funds compared to the bank's one represents one of their most important competitive advantages in the market, allowing them to be more flexible in defining the deal's terms.

In the European Union, private credit funds are regulated with specific rules that regulate alternative investment funds (so called AIFs), which aim to protect investors and ensure the financial stability of European financial markets. The regulation framework for these funds has recently been updated, introducing AIFMD 2.0, which entered into force on 15 April 2024. AIFMD 2.0 includes transitional provisions and specific exemptions from certain rules for funds established before 15 April 2024, as well as for loans already held in their portfolios. Each member state of the European Union must adopt the necessary laws to ensure that AIFMD 2.0 rules are implemented by 16 April 2026.

AIFMD 2.0

The first significant change introduced by AIFMD 2.0 concerns the restriction on "originate to distribute" strategies. This prevents funds from originating loans with the only purpose of selling them to third parties, a process that takes place using collateralized loan obligations (CLO) vehicles, which are sold to investors in tranches. The updated directive also establishes a new risk retention

requirement, mandating that an AIF retain at least 5% of the notional value of any loan it subsequently sells, except in specific permitted cases (e.g., during fund liquidation or if the loan's quality deteriorates). AIFs are required to hold this 5% stake until the loan reaches maturity or for a minimum period of eight years if the loan's maturity extends this term. Additionally, AIFMD 2.0 introduces enhanced requirements for reporting, disclosure, diversification, and implements conflict-of-interest safeguards for AIFs involved in loan origination activities.

Furthermore, private credit funds (or other AIFs which invest 50% or more of their NAV into loans that they originate), will be subjected to additional requirement under AIFMD 2.0. Firstly, there are leverage caps, equal to 175% of the NAV for open-ended funds and 300% of the NAV for closed-ended funds. Secondly, all loan originating funds must be closed-ended, unless their manager is able to prove to the competent authorities of the home Member State of the fund manager that their liquidity risk management is compatible with the investment strategy and the redemption policy. In addition, all the already existent open-ended funds will have to select at least two “appropriate” liquidity management tools from a list of seven, the decision have to be based on an assessment of the suitability of these tools to the fund’s investment strategy, its liquidity profile and its redemption policy.

To conclude, AIFMD 2.0 introduces a new set of rules aimed at enhancing the financial stability of the European market. However, there is a risk that these rules may be overly restrictive, potentially limiting the competitiveness of European private credit funds on a global scale.

The European picture

Having said that, it is important to keep in mind that the regulation is not perfectly homogeneous all over Europe, and each state has its own rules on some key aspects of private credit industry, which leads to significant differences among European countries regarding the operating aspects of private debt funds. The main factors that differ among the different states are banking license requirement for originating a loan to companies in the same jurisdiction, tax regime and withholding taxes, loans subordination (in the particular case where the fund owns the borrower), freedom in setting interest rates and fees, enforcement of guarantees. Therefore, it is fundamental to make a comparison among the main countries in Europe in order to have a clear insight into this industry within the European market.

France

In France, under certain conditions, it is possible for funds to make a new loan without a banking license. An example of a financial entity allowed to grant new loans are alternative investment funds that are authorized to use the ELTIF (European long term investment fund) label pursuant to the ELTIF regulation. If those conditions are not met, an unlicensed fund may use a bond financing structure as an alternative, otherwise they may seek for sub-participations or fronting structure, even though the latter would still require to be compliant with the French banking monopoly requirement.

Usually there are no withholding taxes applied to interest payments made by French borrowers. Rules are different if the payment is made in a non-cooperative state or territory, which list is updated every year, in this case it may be applied a 75% withholding tax.

In France it is not possible for a borrower owned by a fund to equitably subordinate the latter’s loans.

France does not have any particular anti-usury limitation, so interest and fees can be agreed freely between a fund and its borrower, even though the interest may only be compounded on an annual basis.

Lastly, French enforcement regime is considered debtor-friendly, since the process to enforce guarantees may be long and the lender can exercise its rights of security enforcements only after a payment default.

Germany

In Germany it is mandatory to have a banking license, a European passport or an exemption from German license rules to make a loan. Furthermore, those license requirements do not only concern the loan origination, but also the change in terms of existing loans. However, since 2016, German AIFs and their fund managers are exempted from the banking license requirement, the rule is still valid for non-German funds.

There are no withholding taxes for interest paid to the fund, so making payment to a foreign lender does not cause problems from a tax perspective. However, there are two main exceptions: hybrid loans (e.g. loans that can be converted into equity) and loans secured by German real estate.

Loans granted by a shareholder holding more than 10% of the total equity of the borrowing company are subordinated to repayment claims of any other creditor in the event of formal insolvency of the company, the same rule applies in case of indirect shareholding.

Interests and fees can be agreed freely. Indeed, despite the necessity to be compliant with usury/immoral lending limitations, those represent a very rare issue in practice.

Finally, the enforcement regime is mostly lender-friendly, but the procedure varies according to the different situations that may and may be long and complex sometimes. The enforcement can be exercised only after a payment default.

Italy

Even though lending is generally an activity reserved to certain entities such as banks and other financial intermediaries, it is possible, under certain circumstances, for Italians and Europeans AIFs to grant loans to third parties for business purposes.

The majority of funds is subjected to withholding tax, but no withholding tax is applied to interest and other proceeds arising from medium to long-term loans (i.e. over 18 months) granted by EU licensed banks, insurance companies and white-listed institutional investors subjected to regulatory supervision.

It is possible for the borrower to subordinate its debts when it would be deemed reasonable for a shareholder to provide equity to the borrower instead of debt or where there is an excessive imbalance between debt and equity. Nevertheless, the guidelines for what can be considered reasonable are not clear.

In Italy it is not possible to freely agree on fees and interests due to usury limits imposed by the Ministry of Economics and Finance. This applies to all types of financing and all types of remuneration are counted on to determine whether the loans are usurious.

To conclude, Italy is considered a debtor-friendly jurisdiction, since enforcement can take several years, and the debtor is given many chances to challenge the creditor's rights. Furthermore, judges

can sometimes limit lenders' enforcement operations or award damages to the borrower in case of misuse of contractual protection.

Luxembourg

In Luxembourg, every fund that qualifies as an AIF can originate loans even without a banking license. However, it is a responsibility of the fund (or of its manager) to ensure that the operation have the proper organizational and governance structures, as well as an appropriate risk and liquidity management.

Luxembourg does not present any withholding tax on interest paid to the fund and the loans cannot be equitably subordinated by the borrower when the fund is its owner. There is also complete freedom when it comes to decide fees and interests, even though the Luxembourg court may reduce them when they could constitute a penalty for the borrower.

Finally, Luxembourg is a very creditor-friendly jurisdiction, and the enforcement process is straightforward, since can be exercised without any further formality and there is no need to assess the price of the asset given in pledge. In general enforcement actions are very difficult to challenge in Luxembourg, despite some rare exceptions (e.g. in case of fraud)

Final considerations

Examining the regulatory landscape across various European countries highlights the substantial impact of differing frameworks on the distribution of private debt funds across Europe. Indeed, some countries such as Luxembourg represent the ideal environment for this kind of activity, and for this reason are the ones which witnessed the most significant growth. On the other hand, other countries, like Italy, do not have an adequate regulation to allow this industry to thrive. This uneven regulatory landscape suggests that more harmonized policies could play a crucial role in fostering a balanced growth of private credit funds across Europe.

FUTURE GROWTH AND TRENDS

Expected growth of the Private Debt industry in Europe

The Private Debt industry in Europe is on a growth trajectory, with assets under management (AuM) in private debt funds across Europe expected to increase significantly by 2026. European direct lending, in particular, is estimated to see an annualized growth rate of 15.6% over the next four years.

While higher rates have slowed M&A activity involving private equity sponsors (who account for around 80% of private debt deals in Europe), sponsors are now under pressure to deploy their capital reserves. With European interest rates projected to trend downward following the European Central Bank's recent 25 basis point cut from 4% to 3.75%, private credit is likely to see a renewed wave of M&A-driven activity. The ECB has also reported a rise in corporate credit demand for the first time since 2022, raising expectations for greater deal volumes in 2025. Higher interest rates had previously slowed sell-side processes and reduced deal volumes; however, rate cuts could reignite deal activity and potentially increase leverage levels. Although this might reduce yields for investors, the illiquidity premium keeps the asset class attractive. Nonetheless, for some investors, lower benchmark rates may make fixed income, with its locked-in returns, more appealing than variable-rate private debt investments.

Future trends

Evergreen fund structures—which offer a perpetual fund term, ongoing investment capability, and liquidity rights for investors—are gaining traction in Europe and are expected to become increasingly attractive. While more established in the U.S. market, European investors are recognizing the distribution potential and flexibility that evergreen structures provide for private credit. In contrast to traditional closed-ended vehicles, where there is a time-limited window during which general partners (GPs) can fundraise, an evergreen fund can accept new capital as needed, offering continuous flexibility. These structures also allow for ongoing investments and redemptions, appealing to investors seeking enhanced liquidity options. They provide exposure to less liquid portfolio segments while balancing liquidity needs through a redemption and run-off framework. In Europe, these funds are growing in popularity due to their flexibility, ongoing investment capabilities, and liquidity provisions, making them an appealing choice for private credit investors.

European private debt funds are expected to expand their reach, as more funds are looking to diversify their exposures to the lower mid-market direct lending space. This diversification could enhance portfolio resilience and capture opportunities in a broader segment of the market.

Private debt fund ETFs are a new product that may make their way to the European market. Investment giants, including Apollo Global Management, BlackRock, Capital Group, KKR, and State Street, are competing to launch private-credit exchange-traded funds in the U.S. These funds would allow investors to access the \$1.7 trillion market of loans made by nonbank financial institutions to corporations and consumers.

In Europe, the introduction of such ETFs will depend on whether the loans in question meet the UCITS (Undertakings for Collective Investment in Transferable Securities) definition of transferable securities or money market instruments (MMIs). UCITS defines an MMI as instruments with regular yield adjustments, which may make it possible to invest in floating-rate, unsecuritized loans. However, for an instrument to qualify as an MMI, it must be “liquid, freely transferable, and capable of being accurately valued,” which may not align with the characteristics of such loans.

There are a few ways issuers could structure a private credit UCITS ETF, such as through a portfolio of credit-linked notes (CLNs) or by creating an Alternative Investment Fund (AIF) ETF wrapper. AIFs have more flexible investment guidelines than UCITS and are typically marketed to institutional investors. Therefore, an ETF structured similarly to SSGA’s U.S. proposal would either require creative interpretation of UCITS eligibility criteria or changes to the regulations. However, the ETF industry is known for its innovative solutions to investor challenges, meaning private credit fund ETFs could still become a part of the European market in the future.

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