BAI Fact Sheet

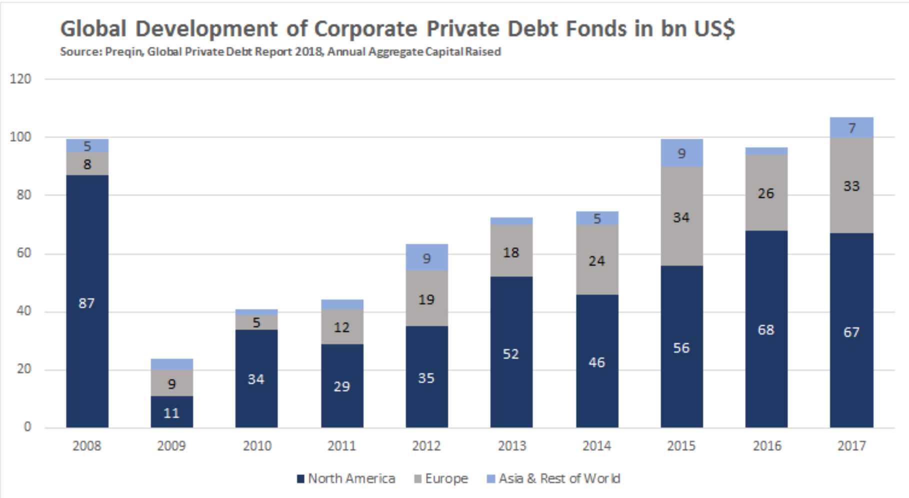
Corporate Private Debt

Definition and distinction of Private Debt and Corporate Private Debt

There is no uniform definition of private debt. In most cases, private debt means the provision of loans by non-banks without involving the capital market. In Germany terms like “non-exchange-based debt” or “privately placed obligations” are also used for the Anglo-sax term of private debt. Either way, it does not matter to whom the loan is granted for which purpose. Thus, financings of infrastructure or real estate as well as aircraft or trade may also fall under this generic term, as long as a loan fund or another non-bank provides these financings. If companies are financed, this is also referred to as corporate private debt. This form of credit provision enables institutional investors, such as insurance companies or foundations, to participate in the market for SME loans through a credit fund without having to set up their own credit risk departments.

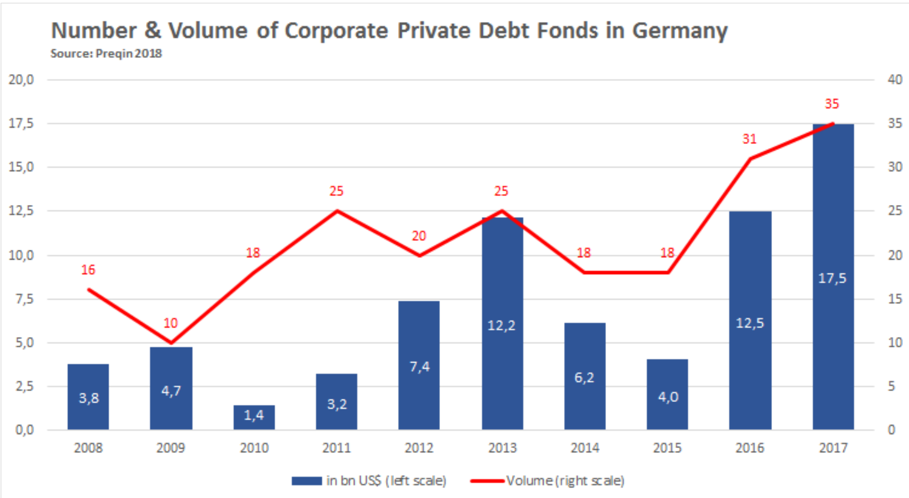
Global development of Corporate Private Debt funds

There is no linear growth of corporate private debt funds but it rather depends on economic and regulatory developments. While the majority of corporate loans in the United States are provided by credit funds rather than banks, the share in Europe is still much smaller but demonstrates strong growth. This is because banks focus on improved credit ratings of their credit portfolios since Basel III has been published in 2010. The resulting gap in corporate financing has led to an increased demand of credit funds. In North America, on the other hand, the market for credit funds has not recovered to pre-crisis level since 2009. Overall, the annual capital raised for corporate loan funds is increasing worldwide and in 2017 it has exceeded the 2008 level.



Development of Corporate Private Debt funds in Germany

The development of credit funds in **Germany** has been volatile so far. Dominating is still the financing by house banks. However, many loans from (house) banks are either passed on or shared with credit funds. Overall, credit funds tend to accept more non-beneficial credit ratings with a corresponding risk-/return-profile due to the fact that their portfolio is usually much more diversified than the ones from banks. Volumes in 2016 and 2017 reveal that Germany took a large share of European growth in this sector. This was mainly due to the elimination of the legal obligation that credit checks can only be carried out having a banking license (fronting bank). This rule had hindered the development of credit funds in Germany until then; the elimination pushed the growth. It remains to be seen whether this trend continues or constitutes a catch-up effect only.



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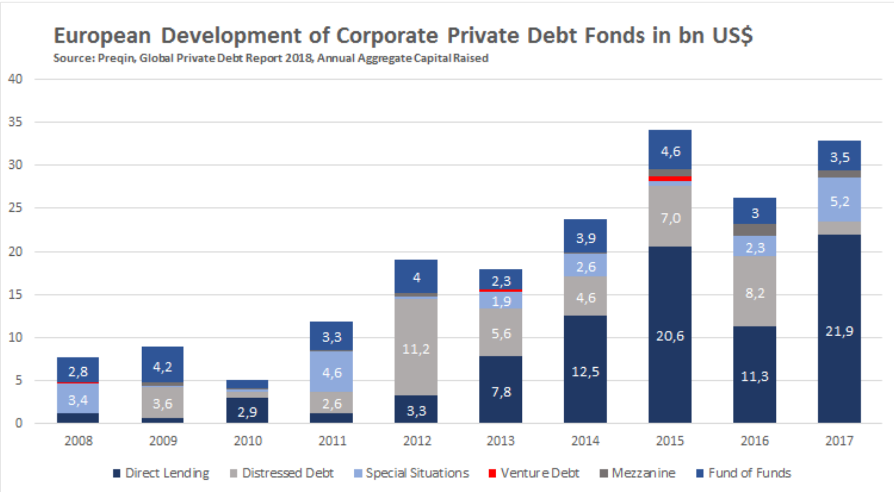
Categories of Corporate Private Debt funds

Generally, there are five categories of credit funds, based on the respective company situation: direct lending, distressed debt, special situations, venture debt and mezzanine.The fastest growing category in recent years is direct lending, the direct provision of loans from credit funds to companies. Above all, these are used to finance acquisitions (LBO) or operational growth. The second category of distressed debt refers to financing corporations with liquidity issues or during a restructuring phase with a correspondingly lower credit rating. The third category of special situations summarizes all other funding reasons. This comprises succession regulations, e.g. in which a company is split or individual heirs are paid out. Pre-financing of profit distributions for debt financed shareholders also falls into this category. The fourth category of venture debt is a form of financing well established start-ups which is rather uncommon in Europe because such a form of financing is virtually impossible for banks to process. Mezzanine forms in turn, are widely available and partially offered by banks but do not prevail in Europe. This category is mainly chosen if the company situation does not allow any further debt financing. On top, there are overarching “funds of funds” that are in high demand with investors due to their high degree of diversification.



Structure of Corporate Private Debt funds

A credit fund can be set up in a securitized or non-securitized way based on the investors’ desires. The risk-/return profile depends on the financing purpose but even more on the credit tranches selected. The funds either invest in senior secured debt only, rarely in junior / subordinated loans and often in unitranches. A unitranche is a mix of senior and subordinated secured tranches. A special case is the 1st-out / 2nd-out structure, in which the 1st-out tranche (bank) has the right to access credit securities first while the 2nd-out tranche (fund) is subordinated (referred to as “Unknown” in graph). This type is often chosen for joint financings of banks and credit funds because it allows offering comparably low interest rates. In total, at least 54% of offered tranches in Germany are securitized (some refer to category “Unknown”).