## Conference Agenda

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| **1** | Introduction  
*Alexandre Prost-Gargoz, Partner, Deloitte* |
| **2** | Evolution of the private debt industry in Luxembourg  
*Alexandre Prost-Gargoz, Partner, Deloitte* |
| **3** | Fireside chat - Perspective from a GP  
*Chris Connelly, Head of Operations, Partner ICG interviewed by Nick Tabone, Partner, Deloitte* |
| **4** | Luxembourg securitization companies: Loan portfolio restructuring & (re)financing  
*Dr. Sebastian Bos, Senior Manager, Deloitte* |
| **5** | Hot topics:  
  a) Private Debt: Tax considerations *Christophe Diricks, Partner, Deloitte*  
  b) Due Diligence process and risk management *Nicolas Schoukens, Director, Deloitte* |
Evolution of the private debt industry in Luxembourg

Alexandre Prost-Gargoz
Partner, Deloitte

17 November 2015
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Market Trends
Key trends in Private debt industry
The main trends to expect: superabundant capital vs assets, shadow capital, challenging returns and competition between GPs

**HIGH LEVEL OF CAPITAL, LOW YIELD, HIGH PRICED ASSETS**
Dry powder levels hit a record high of $179bn as at the end of Q2. Direct lending funds have seen an increase of 45% from December 2014 in the levels of capital available for new investments, while Europe-focused debt funds have seen an increase of 51%.

**“ALTERNATIVE LENDER” vs TRADITIONAL BANKING**
LPs are looking at different collaboration models fitting their needs with more flexibility than traditional banking.
This continuing change gives ability to:
(i) enhance more returns at a lower cost
(ii) provide flexibility on the equity structuring
(iii) tailor financing in niche markets

**FIERCE COMPETITION BETWEEN GP’S**
Trends in private debt fundraising seem to suggest investors are increasingly willing to invest with established fund managers that have the capability to deploy private financing capital on a large scale.

Median Net IRRs by Vintage Year: Direct Lending, Distressed Debt and Mezzanine
Global Quarterly Private Debt Fundraising, Q1 2010 - Q3 2015

Source: Preqin
Our outlook - Macro to micro

Private Debt Dry Powder by Fund Type, December 2006 - September 2015

Source: Preqin
Our outlook - Macro to micro

Breakdown of Private Debt Funds in Market by Fund Type

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>No. of Funds Raising</th>
<th>Aggregate Target Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Venture Debt</td>
<td>4%</td>
<td>42%</td>
</tr>
<tr>
<td>Special Situations</td>
<td>10%</td>
<td>37%</td>
</tr>
<tr>
<td>Fund of Funds</td>
<td>3%</td>
<td>15%</td>
</tr>
<tr>
<td>Mezzanine</td>
<td>26%</td>
<td>36%</td>
</tr>
<tr>
<td>Distressed Debt</td>
<td>15%</td>
<td>9%</td>
</tr>
<tr>
<td>Direct Lending</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Breakdown of Private Debt Funds in Market by Primary Geographic Focus

<table>
<thead>
<tr>
<th>Primary Geographic Focus</th>
<th>No. of Funds Raising</th>
<th>Aggregate Target Capital ($bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>116</td>
<td>66</td>
</tr>
<tr>
<td>Europe</td>
<td>67</td>
<td>37</td>
</tr>
<tr>
<td>Asia</td>
<td>18</td>
<td>9</td>
</tr>
<tr>
<td>Rest of World</td>
<td>23</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Preqin
Our outlook - Macro to micro

**Strategies Targeted in the Next 12 Months by Private Debt Investors**

- Direct Lending: 68%
- Mezzanine: 62%
- Distressed Debt: 55%
- Special Situations: 33%

**Region Targeted**

- Europe: 73%
- North America: 68%
- Asia Pacific: 28%
- Emerging Markets: 25%
- Rest of World: 16%

Our outlook - Macro to micro
European Alternative Lender market

Heading towards the US model…

Transition of US leverage loan investor concentration

Corporate Financing – Loans vs Bonds

How long will this process take in Europe?

European markets are still very bank market orientated...

…But Basel 3 regulation will accelerate the shift form bank lending to capital market funding

Major market opportunity for Europe

Source: S&P capital IQ leveraged commentary and data

Bank funding
Non Bank funding

Source: McKinsey Global Institute 2012
Notes: 1: Book value. 2: Includes Commercial Paper and other debt securities. 3: Includes loans from banks, non-bank financial institutions and other sectors (inc RE). Eurozone data is 2010

A shift away from bank lending likely to occur in the near future in Europe

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Alternative lenders increasingly targeting deals in Europe

- UK, France and Germany cover 83% of the deal flow.
- 47% of the transactions were in the UK, 25% in France and 11% in Germany.
- Out of the 33 lenders surveyed only 3 lenders have not completed a deal and a further 3 lenders have not completed deals outside of the UK.
- Unitranche product (45% of deals) is more popular in UK, while on the continent the senior product (37%) is dominant.
- In the UK 43% of transactions were related to LBO financing, compared to 38% in Europe.
- 11% of deals in Europe relate to bolt on M&A compared to 4% in the UK.

Deal volume main geographies

<table>
<thead>
<tr>
<th>Region</th>
<th>UK</th>
<th>Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013 % increase</td>
<td>240</td>
<td>120</td>
</tr>
<tr>
<td>2014 % increase</td>
<td>69</td>
<td>50</td>
</tr>
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</table>

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Our outlook - Macro to micro

Market Insights

• North America is the main contributor, Asia growing
• Current allocation to Private Debt is below targets
• Strong appetite for Europe
• Expectations in terms of banks deleveraging

• Diversification from PE houses to alternative asset managers
• Strong competition
• Large funds closed benefitting from the cash recycling
• Leverage is affordable and increasingly available via banks or alternative sources

• Larger number of “hidden champions” than USA, Japan and China combined
• Multiples lower that in the US but price levels are on average expensive
• Strong focus of the industry

• Innovation in the local jurisdiction comes from new regulations and new products: AIFMD, SLP, EuVECA, ELTIF*
• Central location in Europe with critical mass to deploy more infrastructure
• Preferred platform of US GPs for Europe inbound investment
• Good solution for direct lending and deleveraging
### Largest Private Debt Funds Closed in Q3 2015

<table>
<thead>
<tr>
<th>Fund</th>
<th>Firm</th>
<th>Fund Type</th>
<th>Fund Size ($mn)</th>
<th>Geographic Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Debt Partners II</td>
<td>Intermediate Capital Group</td>
<td>Direct Lending</td>
<td>3,400</td>
<td>Europe</td>
</tr>
<tr>
<td>ICG Europe Fund VI</td>
<td>Intermediate Capital Group</td>
<td>Mezzanine</td>
<td>3,300</td>
<td>Europe</td>
</tr>
<tr>
<td>AXA Private Debt III</td>
<td>Ardian</td>
<td>Direct Lending</td>
<td>2,200</td>
<td>Europe</td>
</tr>
<tr>
<td>Castlelake IV</td>
<td>Castlelake</td>
<td>Distressed Debt</td>
<td>1,900</td>
<td>US</td>
</tr>
<tr>
<td>Clearlake Capital Partners IV</td>
<td>Clearlake Capital Group</td>
<td>Special Situations</td>
<td>1,400</td>
<td>US</td>
</tr>
<tr>
<td>Athyrium Opportunities Fund II</td>
<td>Athyrium Capital Management</td>
<td>Venture Debt</td>
<td>1,200</td>
<td>US</td>
</tr>
<tr>
<td>Chambers Energy Capital III</td>
<td>Chambers Energy Capital</td>
<td>Direct Lending</td>
<td>900</td>
<td>US</td>
</tr>
<tr>
<td>Permira Credit Solutions Fund II</td>
<td>Permira Debt Managers</td>
<td>Direct Lending</td>
<td>900</td>
<td>Europe</td>
</tr>
<tr>
<td>Golub Capital Partners IX</td>
<td>Golub Capital</td>
<td>Direct Lending</td>
<td>600</td>
<td>US</td>
</tr>
<tr>
<td>International</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ADV Opportunities Fund I</td>
<td>ADV Partners</td>
<td>Special Situations</td>
<td>500</td>
<td>Asia</td>
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Fireside chat - Perspective from a GP

Chris Connelly, Head of Operations, Partner ICG - interviewed by Nick Tabone, Partner, Deloitte

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Luxembourg securitization companies: Loan portfolio restructuring & (re)financing

Dr. Sebastian Bos, Deloitte - Restructuring

17 November 2015
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Luxembourg securitization companies

Hot topics

• Revival of European securitisation
  • White paper by EcB and BoE (May 2014)

• Simple, Transparent, Comparable/Standardized (STC/STS) securitisation
  • EU STS securitisation framework proposal (September 2015)
  • Basel Committee STC securitisation consultation paper (November 2015)

• Capital Requirements Directive/Regulation (CRD IV/CRR), Liquidity Coverage Ratio (LCR)

• Renaissance of European Commercial Mortgage-Backed Securities (CMBS)
  • Real Estate: From single-loan to multi-loan securitisation
Luxembourg securitization companies

Benefits to originators, investors and asset managers

- **Balance sheet restructuring**
  - Continue long-standing business relationships with clients
  - Leverage on knowledge of asset managers/loan servicers
  - Cheaper financing/refinancing

- **Multi-compartment structure**
  - Pooling of loans
  - Cost savings
  - Bulk purchases (e.g. in shipping industry)

- **Potential role in revised business model for Luxembourg banks & branches**
  - Existing commercial client base
  - Local knowledge and untapped opportunities
  - “Skin in the game” and beyond
Luxembourg securitization companies
Tapping opportunities in the market

• **Shipping**
  - Operating vessels: Bulker, Container, Tankers
  - Storage: Tankers

• **Real Estate**
  - Legacy portfolios
  - Multiple-loan CMBS
  - U.S.: Single-family rental (SFR)

• **Infrastructure**
  - Renewables (e.g., wind, solar)

• **German Mittelstand**
  - Pooling by industry
  - Brewery loans
Luxembourg securitization companies

Challenges

• **Wants of originator/sponsor vs needs of investors**
  • Choice of vehicle
  • Note structure (e.g., simple, tranching, profit participating, indexing)
  • Rating and listing

• **Loan/asset documentation**
  • Incomplete/missing documentation
  • Staffing

• **Small/medium-sized originators/asset managers**
  • Missing track record
  • Lack of resources
  • Loan servicing platform
Luxembourg securitization companies

Your contacts

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(a) **What's new on tax side?** Christophe Diricks, Partner, Deloitte  
(b) **Due Diligence process and Risk management.** Nicolas Schoukens, Director, Deloitte |
Hot Topics

Private Debt: Tax considerations

Christophe Diricks

17 November 2015
There are operational aspects to consider when establishing a debt structure…

- Avoiding the need of a banking license
- Flexibility in respect of the choice of a regulated or unregulated structure
- Flexible in terms of investment policy i.e. primary market (loan origination) or secondary market (distressed or discounted debt)
- Flexible accounting rules (Lux GAAP or IFRS)
- Low maintenance costs
- Flexible in terms of flows of income (fixed vs. variable)
- Accommodating US investors: CTB election
...and tax issues

- Neutrality for treaty protected investors:
  - The structure should have access to double tax treaties (DTTs) in order to mitigate the withholding tax at source (WHT) on interest payments
  - The structure should mitigate taxation on interest income, capital gains and potentially FX gains
  - The structure should avoid WHT on distributions to investors

- Substance is key especially in light of upcoming BEPS (action 6)

- The entity should demonstrate beneficial ownership of the income to access some DTTs (e.g. UK, Spain, Czech R., South Africa, …) and get WHT relief

- VAT efficient
Numerous tools are available in Luxembourg…

- SIF
- SICAR
- UCITS
- UCI
- Securitization Vehicle*
- Soparfi
- SLP**

More Regulated

Less Regulated

Less Flexible

Non regulated

Regulation & Safety

Unregulated unless issues securities to the public on an ongoing basis

** Could be indirectly regulated in case falls within AIFMD scope
Loan origination

- The origination of loans, which encompasses both the creation of new loans and the modification of existing loans, is the traditional activity of the banking sector.

When originating loans, investors should thus pay attention to avoid being considered as carrying out an activity subject to banking license.

Luxembourg banking regulation

- The Luxembourg banking law (as interpreted by the CSSF) applies to banking institutions and PFS but DO NOT APPLY to:
  - Intra-group transactions
  - Acquisitions of existing loans
  - Securitization undertaking, UCI, SIF, SICAR and any other entity which is subject to specific legislation even if it operates through wholly owned or controlled SPVs
  - One-off: SOPARFIs granting a single loan or performing a one-off operation
  - Private lending: SOPARFIs granting loans to a limited circle of people that can be identified

...for multiple investment policies including loan origination
However, the selection of the vehicle will depend on the investment policy.

**Setting the scene: Vehicle selection**

- **Investor**
- **EU Manager**
- **Securities**
- **Securitization vehicle (Luxembourg)**
- **Loans**
- **Bank**
  - Make a loan
  - Acquire a loan
  - Extend a loan
  - Management Fees

**Securitization vehicle: only for passive strategy**

- SV acquires/grants loans to the extent these loans are implemented thanks to a third party (e.g. bank) and the PPM specifies how borrowers are selected.
- SV cannot generate any additional risk and cannot act as an entrepreneur or trader.
- Re-investment of the proceeds in principle not permitted unless transferred to dedicated compartment.

**Benefits**

- Tax neutral (CIT/MBT/NWT)
- Access to DTTs
- No WHT on dividend/interest payments
- No need for a banking license
- SV can be either unregulated or regulated
- Out of AIFMD’s scope and VAT exemption on management fees (under certain conditions)
- Segregation
Thanks to AIFMD, which would shift debt funds to a more regulated environment, we should be able to address BEPS!

AIFMD

**Tax substance criteria**
- Motive test
- Management and control
- Infrastructures and resources
- Beneficial ownership
- Other business income

Managed by the head office

Substance convergence

AIFMD substance criteria
- Minimum functions
  - Final decision making
  - Portfolio management
  - Risk management
  - Interaction with authorities
- Limitation to delegation
  - Letter-box entity
  - Leveraging on the substance
- Reporting
- Certification

BEPS

Substance convergence: Shift to a more regulated environment for the funds

2018

2019 – 2020
Due diligence process

Nicolas Schoukens

17 November 2015
Table of Contents

1 Understanding private debt investments
2 Understanding private debt fund vehicles
3 Private debt fund investing
4 Conclusions
1. Understanding Private Debt Investments

The structure

FoF / Investors

Debt fund 1

Investment 1

... 

Debt fund N

Investment N

...
1. Understanding Private Debt Investments
Review of the capital structure

Balance sheet structure*

<table>
<thead>
<tr>
<th>Assets</th>
<th>Common Equity</th>
<th>Preferred Equity</th>
<th>Mezzanine Debt</th>
<th>Subordinated Debt</th>
<th>Unitranche Debt</th>
<th>Senior Debt</th>
</tr>
</thead>
</table>

* The list of funding sources is not exhaustive
1. Understanding Private Debt Investments
Relevance of specific due diligence dimensions

**Balance sheet structure***

- **Assets**
  - Common Equity
  - Preferred Equity
  - Mezzanine Debt
  - Subordinated Debt
  - Unitranche Debt
  - Senior Debt

**DD Focus:**
- Cash Flow: Search for growth even if requires investment
- Asset Base: Usually not a major point of due diligence

* *The list of funding sources is not exhaustive*
1. Understanding Private Debt Investments
Relevance of specific due diligence dimensions

**Balance sheet structure**

- **Assets**
  - Common Equity
  - Preferred Equity
  - Mezzanine Debt
  - Subordinated Debt
  - Unitranche Debt
  - Senior Debt

**Legal Due Diligence**

- Comprehensive (inward and outward)
- Focused on Contract

**Valuation**

- Situation Specific (tailor made)
- Usually Benchmark Based

* The list of funding sources is not exhaustive
2. Understanding Private Debt Fund Vehicle
The structure

FoF / Investors

Debt fund 1

... ...

Debt fund N

Investment 1

... ...

Investment N

Investment 1

... ...

Investment N
2. Understanding Private Debt Fund Vehicle
What fund managers look at portfolio level

Selected areas of focus

- Rating
- Maturity / Duration
- Currency
- Industry / Geography
- Diversification
- Yield Premium

Investment Portfolio (Debt Instruments)

Rating

Maturity / Duration

Currency

Industry / Geography

Diversification

Yield Premium

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2. Understanding Private Debt Fund Vehicle
What fund managers look at portfolio level
3. Selecting Private Debt Funds

The structure

- FoF / Investors
- Debt fund 1
  - Investment 1
  - Investment N
- Debt fund N
  - Investment 1
  - Investment N
3. Selecting Private Debt Funds
Timeline of investments in a debt fund

- Investment strategy
- Existing track record
- Operational soundness
- Risk management quality
- Etc.

Financial specifics:
- Net Asset Value
- Risk/Return Profile

Portfolio specifics:
- Duration, industry, geography, rating, etc
- Lookthrough???

- Cash-on-Cash
- IRR
- Liquidity
- Etc.
3. Selecting Private Debt Funds

The due diligence process

Selection process

**DUE DILIGENCE**

- **Operations***
  - Audit process
  - Accounting standards
  - Valuation policy
  - Risk management
  - Reporting

- **Regulatory***
  - Governance and internal advisory board
  - Policies and procedures
    - E.g. conflict of interest

- **Team and Strategy***
  - Team track record
  - Deal sourcing capability
  - Internal due diligence
  - Investment monitoring
  - Remuneration

- **Legal***
  - Legal structure (closed or open)
  - Tax regime
  - Redemption policies

* not exhaustive
4. Conclusions

- **At investment level**: investment decision influenced by asset characteristics
  - Cash flows
  - Guarantees
  - Etc.

- **At fund level**: investment decision process relies on drivers specific to asset class
  - Importance of position in capital structure

- **At FoF/investor level**: fund selection process and due diligence principles not specific to asset class
  - Investment strategy
  - Existing track record
  - Operational soundness
  - Risk management quality
  - Etc.