

Fund Gated Due to Mismatch

Stockholm (HedgeNordic) – Whereas the portfolio of senior secured loans issued by **Scandinavian Credit Fund I** has so far remained relatively immune to the COVID-19 pandemic, fleeing investors put a strain on the Stockholm-based direct lending fund. With redemption requests amounting to about one-fifth of its portfolio, Scandinavian Credit Fund I has decided to impose redemption “gates” to deal with the mismatch between the illiquidity of its investments and the sudden liquidity preference of investors.

Managed by Stockholm-based asset manager Kreditfonden, Scandinavian Credit Fund I provides senior secured loans with maturities between three and 48 months to small and mid-sized companies in Scandinavia. Since the direct lending fund is an open-ended vehicle offering monthly liquidity, there is some mismatch between the fund’s liquidity terms and the liquidity of its underlying investments, as previously explained by CIO Fredrik Sjöstrand (*pictured*). This mismatch was particularly noticeable during the month of March because of the swift preference for liquidity from investors during the coronavirus-fuelled panic.

“Following the outbreak of COVID-19 in Sweden, the fund has received an increased number of early redemption notifications from investors of approximately SEK 780 million,” explains Sjöstrand in a letter to investors. These redemption requests account for about 19 percent of the fund’s outstanding loan portfolio of SEK 4.2 billion. Because the underlying loans have maturities ranging from three months to 48 months, Scandinavian Credit Fund I could not meet all redemption requests without affecting the investments of both exiting and remaining investors.

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“We have closed the fund for withdrawals as we received large redemption requests,” says Sjöstrand, adding that “it is not possible to carry out early redemption at the investor’s request without the risk of substantially disadvantaging other investors in the fund.” However, Scandinavian Credit Fund I will process the redemption requests as soon as underlying loans are disbursed. “We wait until loans are due,” explains Sjöstrand. “This means that it may take a while, maybe between six and eight months, before we can meet all the outflows.”

“We will start paying out redemptions in May “pro-rata”,” says Sjöstrand. The amount to be paid out in May depends on the liquidity of the fund at that point. Sjöstrand and his team expect the liquidity to be in the range of SEK 120 million and 180 million. “It is worth mentioning that there is a secondary market where investors can sell their fund units (or profit share loans) at the market,” further adds Sjöstrand. “But we do not recommend it, since there is a risk of selling at a deep discount,” he emphasizes.

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Stockholm-based Kreditfonden has become a significant player in the market for direct loans to Nordic companies and has taken a conservative approach to originating loans from day one. In addition to using a standard package of covenants for borrowers, Scandinavian Credit Fund I only lends money to businesses with tangible assets that can be pledged as collateral. Lending capital at

a discount to collateral values allows the fund to recover the loan amount even when borrowers default, Sjöstrand previously explained HedgeNordic.

Less liquid strategies such as direct lending have gained interest among investors in the low-return environment over recent years. Since launching at the beginning of 2016, Scandinavian Credit Fund I has delivered an annualized return of 6.7 percent through the end of March this year. The fund targets an annual return between six and eight percent net of fees every year. Whereas Scandinavian Credit Fund I has successfully fulfilled its promise to deliver high single-digit returns in each of the past four years, some investors appear to have been forced to completely neglect that the direct lending fund operates in the business of originating longer-dated loans that take time to pay off.

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“We have never claimed to be a highly liquid investment and most of our investors are very long term, being aware of and accepting the underlying liquidity risk,” says Sjöstrand. “The fact that we need some time to find the liquidity to meet early redemption orders under the current extreme market conditions should come as no surprise. We are working in the best interest of our investors.”