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Overview

The Netherlands is widely recognised as a leading international financial centre and has a mature investment funds industry with an attractive investment environment due to, amongst others, flexible corporate legislation, various tax structuring options, and an extensive network of bilateral investment treaties and tax treaties.

The most recent research conducted by the *Nederlandse Vereniging van Participatie-maatschappijen* (the Dutch Association of Private Equity Firms)[1] shows that in 2022, Dutch private equity firms raised around €5.9 billion in new funds. Of the €5.9 in new funds, approximately €1.4 billion was raised by Dutch venture capital funds. In 2022, 229 Dutch private equity and venture capital firms managed approximately €42.7 billion (committed capital) in 481 funds, and over €10.1 billion was invested by national and international private equity and venture capital firms in Dutch companies.

In 2023, we saw a decrease in the number of fundraisings, investor appetite and fund financings (specifically capital call facilities) in the Netherlands. This is mainly due to global, macroeconomic drivers and the rising interest rate environment, which are not specific to the Dutch market. On the fund financing side, these factors have increased demand from fund managers for alternative financing products, such as net asset value (**NAV**) facilities, as an additional source of capital during the fund's lifecycle.

The evolving fund finance market has proven to be of increasing interest to both Dutch and foreign lenders over the past couple of years, and market participants are more actively exploring other (more structural) fund finance solutions on top of the traditional capital call facilities.

Consequently, we are looking forward to an exciting 2024, which will provide new challenges for fund managers and fund finance lenders.

This chapter seeks to provide further background on the following aspects: (a) fund formation and the commonly used Dutch fund vehicles; (b) regulation of fundraising and fund managers; (c) fund finance in the Netherlands; (d) structuring the security package; and (e) the year ahead.

Fund formation and the most commonly used Dutch fund vehicles

A Dutch alternative investment fund (an **AIF**)[2] may be structured in various ways, both as corporate and contractual entities. Corporate entities have legal personality (*rechtspersoonlijkheid*), enabling them to hold legal title to assets, and are governed by mandatory corporate law, whereas contractual entities lack such legal personality and are unable to hold legal title, but enjoy the benefit of more contractual freedom. Frequently used corporate investment vehicles are the private limited liability company (*besloten* *vennootschap met beperkte aansprakelijkheid*) and the cooperative with excluded liability (*coöperatie met uitgesloten aansprakelijkheid*). Contractual investment vehicles are commonly established in the form of a limited partnership (*commanditaire vennootschap*) or a mutual fund (*fonds voor gemene rekening*). The ultimate selection strongly depends on the outcome of relevant tax and legal structuring analyses.

Regardless of whether a contractual or legal entity is selected, an AIF established in the Netherlands should consider that the European Alternative Investment Fund Managers Directive 2011/61/EU (the **AIFMD**) is applicable and has been implemented into the Dutch Act on Financial Supervision (*Wet op het financieel toezicht*, or the **AFS**). Consequently, the AIFMD and all rules and regulations promulgated thereunder (including Delegated Regulation (EU) 231/2013, the **Delegated Regulation**) must be complied with in the Netherlands by any alternative investment fund manager (an **AIFM**), unless an AIFM can benefit from exemptions (such as AIFMs managing AIFs below the Threshold (as defined below)).

If a Dutch licensed AIFM establishes an AIF as a contractual investment vehicle (lacking legal personality), it is – in principle – required under the AFS to also establish a single-purpose corporate entity to hold the assets of one or more of such AIFs set up by the licensed AIFM.

Regulation of fundraising and fund managers

The management or marketing of AIFs in the Netherlands by 'large' AIFMs triggers the obligation to obtain a licence in the Netherlands, subject to certain exemptions and grandfathering rules. AIFMs are considered 'large' if they, directly or indirectly, manage portfolios of AIFs whose assets under management amount to €500 million or more, or – when open-ended or leveraged – €100 million or more (together, the **Threshold**). An AIFM is deemed to manage an AIF in the Netherlands if such AIFM is established in the Netherlands, or if the AIF managed by it is established in the Netherlands.

Dutch AIFMs that fall below the Threshold may manage and market their AIFs without an AIFMD licence in the Netherlands, provided that either:

a) the AIF's units or shares are exclusively offered to professional investors within the meaning of the AFS (*e.g.* banks, insurers, pension funds, brokers, AIFMs, AIFs, or qualifying large corporates); or
b) the AIF's units or shares are offered to fewer than 150 persons, or have a nominal value of, or are offered for a consideration payable per investor of, at least €100,000, provided that a banner or selling legend as to the AIFM's unregulated status (in a predefined size and layout) is printed on the AIF's offering documents,

and in each case, the relevant AIFM is registered with the Dutch authority for the financial markets to monitor compliance with the sub-Threshold regime, and to effectively monitor any build-up of systemic risks. Dutch AIFMs are furthermore required to disclose to the Dutch Central Bank (*De Nederlandsche Bank*), amongst others, information on the main instruments in which the AIFs are trading, the principal exposures, and the most important concentration of the AIFs managed.

Dutch AIFMs that do not require a licence for managing and marketing their AIFs in the Netherlands may voluntarily apply for such licence, provided such AIFM complies with all applicable AIFMD requirements (as implemented into Dutch law). Not many Dutch AIFMs have chosen to apply for an AIFMD licence voluntarily.

Additionally, considering that AIFs making private equity investments are not excluded from the scope of the venture capital regulation (Regulation 345/2013/EC, or **EuVECA**), EU-based managers of (EU) AIFs that comply with the conditions of EuVECA may benefit from an EU marketing passport as introduced therein. Such passport allows for the marketing of units or shares to potential investors investing at least €100,000 or to investors that are treated as professional clients (within the meaning of Directive 2014/65/EU), in each case provided that they have confirmed their awareness of the risks associated with their investment. Potential investors that do not otherwise qualify as professional investors may opt to be treated as such.

Finally, what is likely the final text for amendments to the Alternative Investment Fund Managers Directive (**AIFMD2**) was released in the beginning of November 2023. AIFMD2 will likely become effective in 2026. AIFMD2 includes, *inter alia*, a number of provisions that apply to AIFs engaging in loan origination. An AIF will be subject to a 300% leverage cap (where the AIF is closed-ended) and a 175% leverage cap (where the AIF is open-ended), if its strategy is mainly loan origination or where the nominal value of the loan originated represents at least 50% of the NAV. Member States may impose stricter leverage limits. Sublines secured on capital commitments will not count towards exposure. Exceptions apply for AIFs if they solely originate shareholder loans, the notional value of which is not exceeding, in aggregate, 150% of the AIF's capital.

Fund finance in the Netherlands

With decreasing availability of capital for investments, the need for alternative financing solutions by Dutch AIFMs and AIFs is expected to continue its upturn. Depending on the type of AIF, the need for financing can vary, but is typically limited to (i) traditional capital call facilities, and (ii) credit facilities to provide structural leverage or liquidity for the AIF (NAV of investments).

There is limited data publicly available on the use of the various types of fund financing in the Netherlands, which makes it difficult to assess the size of the Dutch fund finance market. In our experience, secured capital call facilities continue to be the main type of financing selected by AIFMs. It has become customary to explicitly refer in the relevant fund documentation to the possibility to take out this type of financing and the creation of security by the AIF on its assets (including receivables that investors owe to the fund). The purpose and use of traditional capital call financings are expected to further expand. In addition to bridging capital calls, those financing arrangements are also being used to 'bridge' the third-party financing to be arranged for at the level of the portfolio company (*i.e.* at bidco level) and thus speed up acquisition processes. Over the past few years, there has been an increasing interest in the ability to obtain NAV or hybrid facilities at (or just below) fund level. For existing funds, the ability to incur structural leverage is not yet always catered for in fund documents. Dutch fund managers are using NAV facilities particularly when the undrawn investors' commitments are low or the fund investment period has ended and the fund seeks liquidity for investor distributions or add-on investments, or to provide additional liquidity for their distressed portfolio companies. For continuation funds, NAV facilities are used to finance the exit of limited partners not rolling over. At fund manager level, NAV facilities are typically used for working capital, investments, distributions and succession planning.

An important consequence of incurring such leverage at the level of a Dutch AIF is that, depending on the details of the financing, the relevant AIFM managing such AIF may be required to obtain an AIFMD licence in the Netherlands, as further discussed below.

Whether or not an AIF incurs leverage may affect the relevant AIFM's regulatory status (*i.e.* it may lead to a lower Threshold being applied for purposes of determining whether an AIFMD licence is required in the Netherlands and is not allowed for EuVECA labelled funds if such borrowings are not covered by capital commitments). Additionally, if AIFs deploy leverage, the AIFMD (and rules and regulations promulgated thereunder) imposes additional obligations on an AIFM managing such AIF.

The term 'leverage' is defined by the AIFMD as any method by which an AIFM increases the exposure of an AIF it manages, whether through borrowing of cash or securities, or leverage embedded in derivative positions, or by any other means.

While determining whether an AIF deploys leverage within the meaning of the AIFMD and when calculating exposure, the Delegated Regulation dictates that AIFs should 'look through' corporate structures. Therefore, exposure that is included in any financial and/or legal structures involving third parties controlled by the relevant AIF, where those structures are specifically set up to increase, directly or indirectly, the exposure at the level of the AIF, should be included in the calculation. However, for AIFs whose core investment policy is to acquire control of non-listed companies or issuers, AIFMs should not include in the calculation any leverage that exists at the level of those non-listed companies and issuers, provided that the relevant AIF does not have to bear potential losses beyond its capital share in the respective company or issuer.

On the other hand, borrowing arrangements entered into by the AIF are excluded under any of the abovementioned methods if these are:

a) temporary in nature; and
b) fully covered by 'capital commitments' from investors (*i.e.* the contractual commitment of an investor to provide the AIF with an agreed amount of investment on demand by the AIFM).

Even though the Delegated Regulation considers in its recitals that revolving credit facilities (**RCFs**) should *not* be considered as being temporary in nature, it is the prevailing view that capital call facilities (by way of an RCF or otherwise) can be structured as being temporary in nature if certain requirements otherwise applicable to non-RCFs are similarly complied with. In order to structure these facilities as temporary in nature, certain features can be implemented, such as: (i) a mandatory clean down to occur once every 12 months (followed by a period during which the facility is not used); and/or (ii) an obligation to repay each loan, with the proceeds of capital contributions, within 12 months of drawing such loan.

Structuring these capital call facilities as temporary in nature fits their purpose, as these facilities are typically utilised to bridge the liquidity gap at the level of the AIF to be funded ultimately out of the proceeds of capital contributions. Such a time gap between inflowing money from investors and outflowing money for investments can be caused by: (a) the period, often 10 business days, it takes before capital drawn by the AIFM is actually contributed to the AIF; (b) the desire of the AIFM to bundle capital calls (so not to burden the investors with drawdowns of smaller amounts); (c) a defaulting investor not contributing; and (d) the AIFM delaying certain capital calls, as this may boost the internal rate of return for investments in and by the AIF.

Structuring the security package

Credit facilities to be granted to AIFs can be secured in a variety of ways. For example, where the fund borrows against the NAV of its investments, security may be granted over the assets in which an AIF would (indirectly) invest, although a pledge over equity interests in portfolio companies is regularly not pursued given the complexities it may trigger on the vesting and enforcement of the pledge and the limited risk of bankruptcy at fund or fund holding level. Where the borrowing entity is a special purpose vehicle wholly owned by the fund, and not the fund itself, a lender might require the fund to grant a pledge over the equity interests in that fund holding, a guarantee, or an equity commitment letter to be issued by the fund. The latter can be either in favour of the fund holding or a lender, depending on regulatory and tax considerations. The security package for a NAV facility commonly consists of a right of pledge over (i) bank accounts on which (dividend) distributions by portfolio companies are received, and (ii) any unpaid dividend claims. Capital call credit facilities granted to AIFs are typically secured by a right of pledge over (i) the bank account (which is considered a receivable on the account bank under Dutch law) on which capital contributions are made by the AIF's investors, and (ii) all receivables or contractual obligations that the investors owe to the AIF, such as the right to make drawdowns from the capital commitments.

In case of NAV financings, fund and constitutional documents of the fund entities should be reviewed, with particular focus on (i) the possibility to use leverage and grant security interests, (ii) limitations on borrowing or incurrence of indebtedness, (iii) the permitted duration for borrowings and other indebtedness, and (iv) the permitted use of loan proceeds. If equity interests issued by a holding entity are part of the collateral securing the NAV financings, the constitutional documents, the shareholders' arrangements and the financial arrangements at the level of the holding and underlying entities have to be considered in order to assess whether there are any restrictions or change of control provisions.

<u>Bank accounts</u>

Dutch funds are usually set up with one single Dutch bank account per fund entity. With respect to creating a right of pledge over Dutch bank accounts, the applicable general terms and conditions are of relevance. The general terms and conditions used by most Dutch account banks create a first-ranking right of pledge over such bank account for the benefit of the account bank, and state that the bank account cannot be (further) pledged. Consequently, the cooperation of such account bank is required to create a (first-ranking) right of pledge over a Dutch bank account. It is becoming increasingly difficult to convince Dutch account banks to cooperate and consent to the creation of a right of pledge over bank accounts for the benefit of third-party lenders.

<u>Investor receivables</u>

Pursuant to Dutch law, security over receivables can be established by way of a disclosed right of pledge, or by way of an undisclosed right of pledge. A disclosed right of pledge is created by way of a security agreement (or notarial deed) and notification of the right of pledge to the relevant debtors of the receivables that are being pledged. An undisclosed right of pledge is created either by way of a notarial deed or by way of a security agreement that is registered with the Dutch tax authorities for date-stamping purposes. A disclosed right of pledge can be created over present and future receivables, whilst an undisclosed right of pledge can only be created over present receivables and future receivables directly arising from legal relationships existing at the time of creation of such undisclosed right of pledge. Therefore, for an undisclosed right of pledge, it is common practice to file supplemental security agreements with the Dutch tax authorities periodically and at any time a new investor accedes to the fund to also secure present and future receivables resulting from legal relationships that have been entered into after the date of the initial security agreement (or notarial deed).

Both the disclosed and undisclosed right of pledge over receivables of the AIF on its investors are used in practice; choosing one form of pledge over the other depends, to some extent, on whether it is commercially desirable to disclose the right of pledge to the relevant investors and whether an undisclosed right of pledge is acceptable to the lender. With pledge notices customary to be sent to investors in key jurisdictions such as Luxembourg, the United Kingdom and the United States, it has become common over the last few years to notify investors of a right of pledge over the investor receivables in the Netherlands as well. Dutch law allows for sufficient flexibility as to the form of such notification to be made; consequently, such notification can be made by uploading the notice to the AIF's investor portal or referencing the right of pledge in any investor reporting document, making the process of serving notice a fairly effortless procedure. Therefore, in the majority of transactions, there will be a disclosed right of pledge over investor receivables notifying the investors not by separate pledge notice, but via the investor portal of periodic investor reports.

The qualification of the receivable owed by the investor to the AIF as either an existing claim that is conditionally payable or a future claim whose existence is conditional and important for determining whether the receivable can be made subject to a bankruptcy proof right of pledge. If the claim is considered a future claim, any right of pledge that is created in advance will only take effect if such claim comes into existence prior to the pledgor being bankrupt; any claim that comes into existence after bankruptcy will fall within the bankruptcy estate of the pledgor.

In Dutch literature and case law, the prevailing view is that the receivable owed by the investor to the AIF qualifies as a future receivable arising from an existing legal relationship, which receivable comes into existence once the AIFM sends the relevant capital call notice to the relevant investor and therefore can also be made subject to an undisclosed right of pledge as of the date of the capital call notice (without periodical supplemental security being required, unless the investor base changes as that will be considered a new legal relationship between the fund and the new investor – in case of a disclosed right of pledge, a change to the investor base will typically require notification to be served on the new investor). However, if the AIFM sends the capital call notice after the pledgor's (the AIF's) bankruptcy, then the receivable comes into existence after such pledgor's bankruptcy and therefore forms part of the pledgor's bankruptcy estate unencumbered by any right of pledge. It is, however, the prevailing view in Dutch legal literature that the parties to the fund agreement may agree on the qualification of a receivable as either an existing claim payable under condition of a capital call being made or a future claim coming into existence under the condition of a capital call being made – as such, fund documentation will typically contain a clause that explicitly states that any receivable owed by the investor to the AIF is considered an existing but conditional claim, conditional upon the capital call being made. A right of pledge created over an existing but conditional receivable is also valid if the condition (the capital call) is met after the pledgor's bankruptcy.

However, there is limited case law confirming that such a provision would work to avoid any of the aforementioned issues. There is also some debate in literature on whether a pledgee may issue capital call notices solely based on its right of pledge. To mitigate those risks, the pledgee may request to be granted a direct, independent right to issue capital call notices in default situations. Often, a direct agreement to be entered into between the pledgee and the investors is not (commercially) feasible. Nowadays, we do see that fund documentation caters for the possibility for the pledgee (as an independent right) to make capital calls by submitting capital call notices (to avoid the need to arrange this at a later stage via direct agreements). Alternatively, the AIFM may grant a power of attorney or mandate to the pledgee to issue, in certain default situations, a capital call notice in the AIFM's name to the investors (again, this right is often acknowledged in the fund documentation). However, as a power of attorney or mandate is terminated, by operation of law, in the event of bankruptcy of the entity that has granted the power of attorney, the latter option is less favourable to the pledgee.

Another element to take into consideration when structuring the security over the AIF's assets is that receivables and contractual rights may, through a clause in (the general conditions to) the contract from which such receivables or contractual rights arise, be made non-assignable/transferable or 'non-pledgeable'. Depending on the wording of the relevant provision of the contract, such non-assignability clause could have an effect *in rem*, in which case creating a right of pledge over such receivable or right will simply not be possible. The fund documentation should be carefully checked on this.

The year ahead

As emphasised, 2022 and 2023 were interesting and important years for Dutch fund formation and fund finance markets. Despite the current national and international geopolitical developments, the Netherlands' position as a mature and well-equipped jurisdiction for funds and investments remains unaffected. We expect that 2024 will be an important year for the Dutch private equity and venture capital markets as we see an increasing number of parties go to the market again and have experienced increasing activity in the life sciences and impact sectors. With the Dutch fund finance markets maturing, we expect to see an increase in the diversity and volume of the fund finance products offered in the Netherlands; for example, by an increase in the number of NAV facilities, hybrid facilities, general partner solutions and co-investment facilities offered. We are seeing an increasing number of fund managers utilising NAV facilities as well and expect that trend to continue in 2024. We are also seeing an increasing number of non-Dutch lenders showing interest in the Dutch market. In view of, amongst other things, the evolving legislation in this respect (such as Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (the **SFDR**)), a key development will likely be the further integration of ESG factors in fund facilities, whereby measurable ESG performance indicators can directly impact the applicable interest margin.

* * *

Endnotes

1. An interactive graphic providing an overview of the NVP's findings can be found on its website: https://nvp.nl/feiten-cijfers/marktcijfers (this reference is accurate on the date of this publication).
2. We note that this chapter does not focus on collective investment undertakings that require a licence pursuant to Article 5 of Directive 2009/65/EC (UCITS).

* * *

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Global Legal Insights – Fund Finance provides in-depth analysis of laws and regulations across 21 jurisdictions, covering fund formation and finance, key market developments and the year ahead.

This year's edition also has 27 expert analysis chapters covering subscription, NAV and hybrid facilities, diligence, derivatives, U.S. lender remedies, comparison of European, U.S. and Asian markets, umbrella facilities, side letters, assessing lender risk, securitisation, rated subscription lines, ESG, single asset back-levering transactions, rated note structures and insurance investments, financing secondary fund acquisitions, preferred equity, fund manager M&A, leverage at the fund level in Europe, and collateralised fund obligations.

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