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Fund Finance

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Luxembourg

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Overview

Luxembourg continues to strengthen its ranking as the world's second-largest fund domicile after the United States: the assets under management (**AuM**) of Luxembourg-domiciled funds stand at almost €5.6 trillion as at September 2021.[1] This increase is not only based on the growth of traditional Luxembourg-domiciled undertakings for collective investment in transferable securities (**UCITS**) funds, but also due to the continued strong growth in respect of alternative investment funds (**AIFs**), including private equity, real estate, infrastructure and debt. The overhaul of the limited partnership regime in 2013 followed by the successful introduction of the reserved alternative investment fund (**RAIF**) in 2016 reinforced Luxembourg's position as a jurisdiction of first choice for fund managers.

Concurrently with the surge in the AIF market, Luxembourg has seen a significant development in fund finance activity, supported by the possibility of implementing efficient security packages in the context of credit facilities for funds. Recent years have been particularly active as regards fund finance transactions in Luxembourg, with positive growth, strong credit performance and an absence of credit defaults. While capital call credit facilities, also called subscription line facilities, are still used and continue their steady growth, permanent leverage facilities and net asset value (**NAV**) facilities have become increasingly popular.

Fund formation and finance

Legal overview – fund formation

When selecting Luxembourg as their hub for setting up their investment fund, initiators generally opt for either a non-regulated ordinary commercial company (**SOPARFI**) or one of the following (regulated and non-regulated) fund regimes:

- an investment company in risk capital (**SICAR**), based on the Law of 15 June 2004, as amended, on the risk capital investment company (**SICAR Law**) (the SICAR is a vehicle specifically dedicated to private equity and venture capital investments, whether diversified or not);
- a specialised investment fund (**SIF**), based on the Law of 13 February 2007, as amended, on specialised investment funds (**SIF Law**);
- an RAIF, based on the Law of 23 July 2016, as amended, on reserved alternative investment funds (**RAIF Law**); or
- an undertaking for collective investment (**UCI**), based on Part II of the Law of 17 December 2010, as amended, on undertakings for collective investment (**Part II UCI**) – given the declining popularity of Part II UCIs with fund initiators (in light of the flexibility of the other available AIF regimes), this chapter will not cover any particular aspects related to funds formed as Part II UCIs.

On the basis of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers (**AIFMD**), implemented in Luxembourg by the Law of 12 July 2013 on alternative investment fund managers (**AIFM Law**), whose impact on financing transactions taking place within the framework of investment funds will be discussed below, an AIF is defined as a collective investment undertaking, or the compartments of which: (i) raise(s) capital from a number of investors; (ii) with a view to investing such capital in accordance with a defined investment policy for the benefit of those investors; and (iii) which is not covered by Directive 2009/65/EC on UCITS.

While the RAIF must qualify as an AIF within the meaning of the AIFM Law (and must accordingly appoint an authorised alternative investment fund manager (**AIFM**) as well as a depositary), exemptions under the AIFM Law may apply to the SICAR and the SIF (which are only required to appoint an AIFM if they qualify as an AIF).

It is important to note that any unregulated SOPARFI will be considered an AIF if it fulfils all of the above criteria, thereby triggering the application of the AIFM Law, including the obligation to appoint an AIFM and a depository in respect of the assets held by the SOPARFI (except if such SOPARFI is managed by an Exempted AIFM (as defined below)). This is even more relevant as Luxembourg has taken advantage of the AIFM Law to modernise the existing Luxembourg corporate and limited partnership forms and introduce a new special limited partnership without separate legal personality, thereby setting the stage for the use of Luxembourg unregulated limited partnerships as fund vehicles.

Insofar as the AIFM Law applies, an AIFM may freely market the AIFs it manages to professional investors (within the meaning of Directive 2004/39/EC, as amended (**MiFID**)) in the EU.

Leverage under the AIFMD and the AIFM Law

While non-regulated SOPARFIs, SICARs, SIFs and RAIFs are not subject to any legally imposed limits with regard to leverage, insofar as those vehicles qualify as AIFs and are considered leveraged, the AIFM Law may, nevertheless, need to be taken into consideration.

Meaning of leverage

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

The AIFMD gives the European Commission the power to adopt delegated acts to specify the methods of leverage as defined in the AIFMD, including any financial and/or legal structures involving third parties controlled by the relevant AIF when those structures are specifically set up to, directly or indirectly, create leverage at the level of the AIF. It is important to note, in particular for private equity and venture capital funds, that leverage existing at the level of a portfolio company is not intended to be included when referring to those financial or legal structures.[2] The European Securities and Markets Authority (**ESMA**) considers, however, that debt raised by a financial structure held by an AIF that is a private equity fund as referred to in recital 78 of the AIFMD in order to finance the acquisition of assets shall be included in the calculation of the exposure where: (1) those structures are specifically set up to directly or indirectly increase the exposure at the level of the AIF; and (2) the AIF controls such a structure. If these two conditions are fulfilled, the debt raised by the financial structure is to be included in the calculation of the exposure of the AIF. If an AIF does not have to bear losses beyond its investment in a financial structure that is used to acquire non-listed companies or issuers, the financial structure should not be considered as having been set up to directly or indirectly increase the exposure at the level of the AIF.[3]

The European Commission has also used its powers under the AIFMD to clarify that borrowing arrangements entered into by an AIF are excluded from the leverage calculations if they are: (i) temporary in nature; and (ii) fully covered by capital commitments by investors (i.e. a contractual commitment by an investor to provide the AIF with an agreed amount of investment on demand by the AIFM).[4] The Level 2 Regulations give details of the method to be used by AIFMs to calculate leverage in respect of the AIFs they manage.

Impact of leverage under the AIFMD and the AIFM Law

Any leverage at the AIF level may affect whether or not the AIF must appoint an authorised AIFM and a depositary.[5] Under the AIFM Law, any vehicle qualifying as an AIF must appoint an AIFM, although a lighter regime applies to AIFMs managing: (i) AIFs whose total AuM, including any assets acquired through use of leverage, do not exceed a threshold of €100 million; or (ii) AIFs whose total AuM do not exceed a threshold of €500 million and which are unleveraged and have no redemption rights exercisable during five years following the date of the initial investment in each AIF (each a *de minimis* exemption).

AIFMs qualifying for a *de minimis* exemption (**Exempted AIFMs**) must nonetheless register with the relevant supervisory authority of their home Member State (**Regulator**). When registering, Exempted AIFMs must identify the AIFs they manage and provide the Regulator with information on their investment strategies. Once registered, Exempted AIFMs must regularly (at least annually) provide the Regulator with information on the main instruments in which they are trading, the principal exposures and the most important concentrations of the AIFs they manage, in order to enable the Regulator to monitor systemic risks effectively. If Exempted AIFMs cease to qualify for the *de minimis* exemption, they must notify the Regulator accordingly and apply for a full authorisation.

The AIFM Law also requires AIFMs to set a maximum level of leverage that they may employ on behalf of each AIF they manage, as well as the extent of the right to reuse collateral, or guarantees that could be granted under the leverage arrangement.

For each AIF they manage that is not an unleveraged closed-ended AIF, AIFMs must employ an appropriate liquidity management system and adopt procedures that enable them to monitor the AIF's liquidity risk, and ensure that the liquidity profile of the investments of the AIF complies with its underlying obligations. They must regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable them to assess the AIF's liquidity risk, and monitor that risk accordingly. On 29 September 2020, the Luxembourg supervisory authority for the financial sector (*Commission de Surveillance du Secteur Financier*, **CSSF**) issued a new circular regarding the guidelines of ESMA on liquidity stress testing in relation to UCITS and AIFs, which entered into force on 30 September 2020 (**ESMA Guidelines**). With this circular, the CSSF confirms that, as the national competent authority, it applies the ESMA Guidelines and has integrated them into its administrative and regulatory approach. The ESMA Guidelines set out the items to be covered in a liquidity stress testing policy and recommendations on the frequency of the stress tests (quarterly, unless a higher or lower frequency is justified by the characteristics of the fund, and at least annually).

The AIFM concerned must provide investors with disclosures in respect of the AIF in which they intend to invest, including, but not limited to: a description of the circumstances in which the AIF may use leverage; the types and sources of leverage permitted and the associated risks; any restrictions on the use of leverage and any collateral and asset reuse arrangements; and the maximum level of leverage that the AIFM is entitled to employ on behalf of the AIF. In addition, AIFMs managing EU AIFs employing leverage, or marketing

AIFs employing leverage in the EU, must disclose, on a regular basis for each such AIF: (i) any changes to the maximum level of leverage that the AIFM may employ on behalf of the AIF, plus any right to the reuse of collateral or any guarantee granted under the leveraging arrangement; and (ii) the maximum level of leverage that the AIFM is entitled to employ on behalf of that AIF.

In addition to the disclosures to be made, AIFMs must also provide the Regulator with information in respect of the AIFs they manage. In this context, AIFs employing leverage on a substantial basis must make available information on: the overall level of leverage employed by each AIF they manage; the breakdown between leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives; and the extent to which the AIFs' assets have been reused under leveraging arrangements. This information includes the identity of the five-largest sources of borrowed cash or securities for each of the AIFs managed by the AIFM, and the amounts of leverage received from each of those sources for each AIF. For non-EU AIFMs, the reporting obligations referred to in this paragraph are limited to EU AIFs that they manage and non-EU AIFs that they market in the EU.

Structuring the security package

Capital call credit facilities are typically secured by the available commitments of the funds' investors. These facilities are subject to a borrowing base determined by the value of the pledged/assigned investors' commitments satisfying certain eligibility criteria. Investors' commitments relating to Luxembourg funds may be structured in different ways and may take the form of equity capital commitments (i.e. to make equity contributions to the fund) and/or debt capital commitments (i.e. to provide debt financing to, or to subscribe for, debt instruments issued by the fund).

The security package typically comprises: (i) a pledge by the fund of the rights in and to the available capital commitments of the investors and the claims against the investors in relation to those commitments; and (ii) a pledge over the bank account into which investors are required to pay their contributions. The fund's underlying investments are not usually part of the security package for capital call credit facilities.

Luxembourg law typically governs the security interests granted by the borrowing fund over the rights in and to the investors' available capital commitments, and any claims against the investors in relation to such commitments. The relevant security interest is in the form of a financial collateral arrangement governed by the Law of 5 August 2005 on financial collateral arrangements, as amended (**Collateral Law**). According to the Collateral Law, security interests over claims against the investors may be created by way of a pledge or an assignment for security purposes. Pledges are the most common security interests over investors' commitments in relation to Luxembourg funds. The pledge/assignment agreement must be evidenced in writing, and the relevant security interest agreement must be executed by the fund (as pledgor or assignor), the fund's general partner and the security taker. It may be signed by way of electronic signature, subject to certain conditions. If the AIFM is empowered to make capital calls and/or enter into borrowing and security interest arrangements on behalf of the fund, it must be added as party to the security interest agreement.

According to Luxembourg conflict-of-law rules, the courts in Luxembourg will generally apply the *lex loci rei sitae* or *lex situs* (the law of the place where the asset subject to the security interest is situated) in the case of creation, perfection and enforcement of security interest over the asset. Thus, Luxembourg law will apply in relation to the creation, perfection and enforcement of security interests over assets that are located or deemed to

be located in Luxembourg or governed by Luxembourg law. Claims (*créances*) governed by Luxembourg law or owed by a debtor located in Luxembourg, or accounts opened with banks located in Luxembourg, will be considered located in Luxembourg and thus falling within the scope of the Collateral Law. In addition, the provisions of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), as amended, must be considered. According to that regulation, claims against a third party (other than claims in relation to cash held in bank accounts) will be considered situated in the EU Member State within the territory of which the third party required to meet the claims (i.e. the debtor) has its centre of main interests.

Concerning claims against investors that are subject to security interests, certain conflict-of-law rules must be taken into consideration when structuring the security package. According to article 14 of Regulation (EC) 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (**Rome I Regulation**): (i) the relationship between the security provider and the security taker is governed by the law applicable to the contract between the security provider and the security taker under the Rome I Regulation; and (ii) the law governing the pledged/assigned claim will determine its assignability, the relationship between the security taker and the debtor, the conditions under which the pledge or assignment may be invoked against the debtor, and whether the debtor's obligations have been discharged. Because the fund documentation and subscription agreements are typically governed by Luxembourg law, that law will apply to such matters. Since the Rome I Regulation does not provide explicitly for any conflict-of-law rules concerning the enforceability of and possibility to invoke a pledge/assignment over claims against third parties, some Luxembourg legal practitioners consider that a pledge over, or assignment of, claims would become invocable *vis-à-vis* third parties other than the debtor if the legal formalities applicable in the debtor's jurisdiction are duly complied with.

Given that investors in Luxembourg funds are generally located in different jurisdictions outside Luxembourg, the lenders and the security takers will need to take the above considerations into account when structuring the security package.

On 12 March 2018, the European Commission published a proposal for a regulation on the law applicable to the third-party effects of assignments of claims (**EU Commission Proposal**). This proposal will have an impact on the current conflict-of-law rules and will reduce the uncertainties that surround the enforceability of security interests over claims against debtors (including investors) located in different jurisdictions. The new rules clarify which law applies to the third-party effects of assignments of claims in cross-border transactions. The EU Commission Proposal defines the term "assignment" as "a voluntary transfer of a right to claim a debt against a debtor". The term includes outright transfers of claims, pledges, transfers by way of security or other security rights over claims. As a general rule, the law that governs the third-party effects of assignments of claims is the law of the country where the assignor has its habitual residence. If adopted, the new regulation will provide increased certainty with respect to the perfection and enforceability of security interests over claims against investors (located inside or outside of the EU) in relation to their commitments, and it will significantly reduce the discussions around the applicable creation, perfection and enforceability formalities.

The Collateral Law allows a security interest to be created over present and future claims, provided that they are identified or identifiable at the time of entry into the security interest agreement. It is common practice for the security provider to provide the security taker periodically with an updated list of the investors' commitments.

Under Luxembourg law, pledges/assignments for security purposes that are not notified to or accepted by the investors are fully recognised and enforceable. However, the debtor of a pledged/assigned claim may be validly discharged from its obligation *vis-à-vis* the security provider if it had no knowledge of the pledge/assignment in favour of the security taker. It is therefore usual for lenders to require security interests granted by the fund to be notified to and accepted by the investors, in order to ensure that the investors act in accordance with the security taker's instructions and pay the available commitments to the pledged accounts if the security interest is enforced. Another reason for notifying the investors of the creation of the security interest over their commitments is to ensure that the investors will not be able to invoke their good faith if they act in a way that adversely affects the rights of the security taker (for instance, if the investors accept a release of their commitments, which are subject to a pledge). Additional remedies, such as "*action paulienne*", may be available to the security taker in case of detrimental acts of the fund and the investors acting in bad faith in relation to the pledged commitments.

Notices may be served to the investors by different means (registered letters, emails, electronic communications, etc.). Alternatively, notices may be included in the financial reports (distributed to the investors) or published on an investor portal.

It is usually required by the lenders that the investors waive any defences, right of retention or set-off and counterclaim the investors may have with regard to the pledged/assigned claims and any transferability restrictions that may be applicable. According to the Collateral Law: (i) a debtor of a claim provided as financial collateral may waive its rights of set-off in writing or a legally equivalent manner, as well as any other exceptions *vis-à-vis* the creditor of the claim provided as collateral and *vis-à-vis* persons to whom the creditor assigned or pledged such claim as collateral; and (ii) the waiver is valid between the parties and enforceable against third parties. A proper waiver will give comfort to the lenders that the investors will pay their capital commitments upon the enforcement of the security interest without challenging their obligations.

Given the above, and to pre-empt any difficulties with the investors, it becomes usual to include "bankable" financing provisions in advance in the fund documentation (notably the partnership agreements and/or the subscription arrangements), such as: investors' acceptance of the possibility for the fund and its general partner to borrow and pledge the available capital commitments; the security taker's right to initiate and enforce capital calls; waivers of set-off and defences to funding; provisions allowing the security taker to give instructions to the investors upon the occurrence of an event of default; and subordination of the investors' claims, etc. Particular attention should be paid to the "no third-party right" provisions in limited partnership agreements. Lenders and security takers should be expressly mentioned as third-party beneficiaries in order to avoid any interpretation issue as to whether they may benefit from the waivers of the investors' defences and set-off rights, and other "bankable" financing provisions included in the fund documentation. In addition, if the investors' capital commitments are structured as obligation to subscribe for units or shares, a specific undertaking of the investors to fund their commitments, notwithstanding the impossibility of the fund to issue such units or shares (notably in case of bankruptcy), should also be included in the fund documentation. Such undertaking is also important in case of suspension of the NAV calculation of the fund, which may result in a suspension of the issuance of units or shares in certain cases.

Concerning the right of the fund to make capital calls and enforce the obligations of the investors to contribute capital, it should be considered that such right is an ancillary right

to the pledged/assigned claim (*droit lié à la créance gagée/transférée*) and, as a result, the security taker may be entitled to exercise that right in accordance with the provisions of the security interest agreement. This view is supported by the Collateral Law, which provides that the pledge/assignment of a claim implies the right for the security taker to exercise the rights of the security provider linked to the pledged/assigned claim. Without prejudice to and independently of the above, Luxembourg security interest agreements provide for a power of attorney granted by the security provider and its general partner in favour of the security taker to make the capital calls, send funding notices and require the investors to make payments into the pledged accounts, it being understood that this power of attorney may be subject to certain limitations arising under Luxembourg law.

The Collateral Law allows the enforcement of a security interest over claims upon the occurrence of an event of default (freely determined by the parties) without prior notice (*mise en demeure*). Subject to the terms of the fund documents and certain Luxembourg regulatory requirements, in respect of pledges, the security taker (as pledgee) may, *inter alia*: (i) serve a funding notice on the investors, requesting payment into the pledged accounts; (ii) request direct payment from the investors; (iii) appropriate the pledged claims (at a value determined using the valuation method agreed upon by the parties); (iv) sell the pledged claims by way of a private sale (at arm's length conditions) or a public sale; or (v) request a court to attribute the pledged claims. Concerning assignments for security purposes, in the event of the security provider's failure to perform the relevant financial obligations, the security taker (as assignee) is discharged from its obligations to retransfer the assigned claims up to the amount of the secured obligations.

The security interest over bank accounts (held in Luxembourg) into which investors are required to fund their contributions may be created by way of a pledge in accordance with the Collateral Law. The pledge agreement must be evidenced in writing and perfected in accordance with Luxembourg law. It may be signed by way of electronic signature subject to certain conditions. In practice, as a result of their general terms and conditions, Luxembourg account banks have a first-ranking pledge over such accounts. Provided the terms and conditions do not prohibit pledges, the pledge will become valid and enforceable against the account bank and third parties once the existence of the pledge has been notified to and accepted by that bank.

Luxembourg funds may also use NAV or asset-backed financing arrangements. These borrowing arrangements are facilities made available to a fund (or a special purpose vehicle (**SPV**) held directly by the fund) with recourse to the portfolio of assets of the fund. The borrowing base is calculated on the NAV of the assets of the fund (being the primary source of repayment). Lenders will analyse the underlying investments as well as cashflows and other distributions that the fund will receive from those investments. Depending on the investment strategy of the fund, the security package may be composed of pledges over shares, loans, claims and/or bank accounts into which investments proceeds are to be paid with the aim to allow the lender to control the underlying assets or distributions paid on such assets. These financing arrangements constitute leverage and shall be included in the leverage calculation of the borrowing funds.

Hybrid products mixing capital call financing and NAV financing features may also be used by Luxembourg funds.

<u>Involvement of AIFMs in fund finance transactions</u>

The AIFM being entrusted with the portfolio management and risk management of the AIF, it is important to consider on a case-by-case basis whether the AIFM needs to be involved in

relation to subscription line financing arrangements. The review of the AIFM documentation is part of the due diligence made by subscription line lenders to understand whether and how the AIFM should be involved in the financing. Different situations may arise. The general partner of the fund may have delegated to the AIFM the power to issue drawdown notices to the investors and/or the power to enter into financing arrangements on behalf of the fund. In other cases, the fund documents may provide that the AIFM has to consent to the fund's financing arrangements and/or the security interests over the fund's assets.

In relation to NAV and leverage financings, obtaining the AIFM's consent must be considered, given that the entry into such financings may interact with the portfolio management and risk-management duties of the AIFM, and such arrangements shall be taken into consideration by the AIFM for leverage calculation and disclosure purposes.

Depending on the powers of the AIFM, the provisions of the fund documents and the type of financing, lenders may require that the AIFM becomes a party to the finance documents or issue a letter confirming its consent or non-objection. Delegation by the AIFM to portfolio or investment managers must also be taken into consideration.

It is also common for Luxembourg funds to be directly or indirectly involved in the financing of their portfolio entities, by issuing guarantees, letters of comfort or equity commitment letters. It must be assessed whether the consent of the AIFM is required, given that such arrangements may be part of the investment strategy and portfolio management of the fund in certain situations. In addition, guarantees, equity commitment letters or similar instruments issued by the fund may constitute leverage at the level of the fund in certain cases. Therefore, the AIFM may need to take the relevant arrangements into consideration for leverage calculation and disclosure purposes.

Involvement of depositaries in fund finance transactions

Authorised AIFMs must appoint a depositary in Luxembourg for each AIF they manage. It is also mandatory for RAIFs, SIFs and SICARs to appoint a depositary in Luxembourg. The depositary of a Luxembourg fund is generally in charge of the safekeeping and supervision of the fund's assets and the control over the transactions of the fund (including compliance with investment policies and monitoring of the cashflows). As the ultimate purpose of depositaries is to enhance investors' protection, lenders should ensure that the legal obligation to appoint a depositary is met by the fund. In addition, lenders must verify whether the depositary should be notified of and/or provide its consent in relation to the financing transaction and the related security package. Certain depositary agreements may contain a pledge over the fund's assets in favour of the depositary. In this case, it must be assessed whether such pledge conflicts with the financing arrangements and, if so, requires a specific release of such pledge from the depositary. On the fund side, the best practice is to inform the depositary of any financing arrangements relating to the fund, in order to allow the depositary to properly perform its duties.

GDPR impact on fund finance transactions

Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data (**GDPR**) regulates how personal data (relating to natural persons) is processed and transferred. In the context of fund finance transactions, a point of attention is how personal information regarding investors and their commitments may be transferred to the lenders in order to determine the borrowing basis and take the security interests over the available capital commitments. As a result, GDPR provisions and consents are included in the fund documentation in order to authorise the fund and its general partner to share such information with the lenders and transfer such information outside of Europe.

EU Securitisation Regulation

Regulation (EU) 2017/2042 of the European Parliament and of the Council of 12 December 2017, laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (**EU Securitisation Regulation**), came into force on 1 January 2019. Certain fund finance transactions (notably leveraged transactions) and borrowing entities may potentially fall within the scope of the EU Securitisation Regulation, which would trigger a broad array of obligations for the borrowing entity, but also for originators, sponsors and certain investors (among others, requirements with regard to risk retention, due diligence, transparency and disclosure, restrictions on sale to retail investors, etc.). In order to determine whether such obligations would be applicable, one must assess whether the transaction meets the definition of "securitisation" as set out in the EU Securitisation Regulation and whether any of the involved entities may be considered a securitisation special purpose entity (**SSPE**) for the purpose of the EU Securitisation Regulation.

Article 2(1) of the EU Securitisation Regulation defines "securitisation" as a transaction or scheme, whereby the **credit risk associated with an exposure or pool of exposures is tranched**, having both of the following characteristics:

- payments in the transaction or scheme are dependent upon the performance of the exposure or the pool of exposures; and
- the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

It follows from the above definition that a transaction would only fall within the scope of the EU Securitisation Regulation if the securitised credit risk were tranched. The EU Securitisation Regulation defines "tranche" as:

- a contractually established segment of the credit risk associated with an exposure or a pool of exposures;
- where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in another segment; and
- without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments.

Furthermore, the transactions falling within the "specialised lending" exception (as described in article 147(8) of Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms) are not subject to the EU Securitisation Regulation, even if the above conditions are satisfied.

In addition, it must be assessed whether any of the involved entities may be considered an SSPE for the purpose of the EU Securitisation Regulation. According to article 2 of the EU Securitisation Regulation, an SSPE is defined as "a corporation, trust or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplish that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator".

The definition of securitisation under the EU Securitisation Regulation is thus quite large and it is therefore advisable to assess each transaction (notably any transaction involving entities investing in credit assets and receiving financing with different payment priorities and seniorities) and the involved entities on a case-by-case basis to determine whether the above conditions are met.

Outlook

Significant drivers for the success of Luxembourg as a European hub for the structuring of AIFs, in particular over the past few years, have been:

- the success of the modernisation of the Luxembourg partnership regime, which has been able to offer fund initiators accustomed to Anglo-Saxon partnerships a new onshore alternative for fund structuring; and
- the addition of the RAIF to the Luxembourg fund structuring toolbox, replicating, without any regulatory supervision at product level, the flexibility of regulated AIF regimes.

There is no reason to doubt that this trend will continue and sustain a growing demand from fund managers for financing solutions.

* * *

Endnotes

1. As at 30 September 2021.
2. According to recital 78 of the AIFMD.
3. ESMA questions and answers on the application of the AIFMD, ESMA34-32-352.
4. Commission Delegated Regulation (EU) 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (**Level 2 Regulations**).
5. SIFs, SICARs and RAIFs are obliged to appoint depositaries in any event on the basis of the SIF, SICAR and RAIF Laws, respectively.

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