

A black and white photograph of a person in a dark suit, possibly a waiter or a professional, carrying a tray with several documents and a hat. The person is walking, and the background is slightly blurred.

Alternative lending: an ever growing investment strategy

Luxembourg: the perfect place to set up your debt fund

Corporate financing in Europe has been going through a significant transformation over the past few years. With increased regulatory pressure and capital requirements affecting the banks' balance sheets, alternative lenders have emerged with sophisticated and flexible solutions attractive to borrowers. As a result, private credit has grown significantly in number and size of deals.

Placed at the heart of Europe, Luxembourg is ideally positioned to help debt fund managers deal with the complexity of European financial market rules and regulations. Luxembourg is one of the significant markets for loan funds in Europe, as mentioned by the IOSCO final report dated February 2017.

A comprehensive fund structuring toolbox

Debt fund managers choose Luxembourg when they need a tailored vehicle that can combine all of their marketing, regulatory and tax requirements, such as:

- A regulated vehicle supervised by the *Commission de Surveillance du Secteur Financier* (CSSF) or an unregulated vehicle in the AIFM environment
- Developing loan origination as part of their strategy
- Using an opaque vehicle or replicating the typical transparent partnership
- Satisfying investors' demand by issuing debt instruments as opposed to shares or vice versa
- Achieving segregation to avoid contagion of risk
- Minimising tax leakage for investors as well as enabling access to double tax treaties

Whatever your priorities are in terms of structuring your debt fund, the wide range of Luxembourg vehicles available shall allow you to satisfy the needs of your investors, accommodating (semi-) open-ended and closed-ended strategies with different levels of regulation.

Endless possibilities

The rapid development of Luxembourg's alternative investment fund servicing infrastructure, combined with the steadily evolving legal structuring toolbox, has enabled Luxembourg to become the leading EU centre for domiciling AIFMs, AIFs and their acquisition vehicles in the same jurisdiction.

Luxembourg debt fund products at a glance

	SOPARFI	Non-regulated Limited Partnership	Securitisation Vehicle	RAIF	SIF
Supervised by the CSSF	No	No	No	No*	Yes
Loan origination	Yes, under certain conditions**	Yes, under certain conditions**	Yes***	Yes	Yes
Active trading possible?	Yes	Yes	No	Yes	Yes
Time to market	Immediate	Immediate	Immediate	Immediate	CSSF prior approval required
Tax	Taxable (tax exemptions available)	Tax transparent	Taxable but neutrality easily achieved	Exempt (subject to subscription tax)	Exempt (subject to subscription tax)
Transfer pricing rules	Applicable	N/A	Applicable	N/A	N/A

* Indirectly supervised by the competent national authority in the jurisdiction of the AIFM

** See below

*** No credit activity *on [its] own account* and disclosure in issuance documentation of (i) criteria to select borrowers and (ii) characteristics of loans to be granted

Favourable approach to loan origination

Most debt fund managers have some sort of loan origination activity as part of their strategy. The CSSF has been closely monitoring the topic while allowing alternative investment funds to implement this strategy under certain conditions. More specifically and before deciding on a type of vehicle that shall accommodate loan origination as part of the strategy, debt fund managers should:

- Check whether the loan origination activity by such vehicle is regulated or not
- Consider obtaining a letter from the CSSF confirming that the loan origination activity is not subject to banking regulations, as needed – should every criteria comply with the CSSF requirements, this confirmation may be obtained within 2 to 4 weeks
- Check whether alternative lending is permitted in the jurisdiction where the borrower is located or whether a bank monopoly exists

A sophisticated regulator

One of the key factors in the success and attractiveness of Luxembourg undoubtedly lies in its regulatory framework.

When it comes to the debt fund industry, we liaise with the CSSF in the following situations:

- When the debt fund itself is regulated, i.e. when it requires a prior approval before being launched (this is the case for a SIF)
- When a non-regulated vehicle wishes to have a loan origination activity (a sign-off letter from the CSSF may be recommended)

Specific teams at the CSSF are dealing with these requests thereby ensuring a high level of sophistication of the staff when instructing these matters.

Investor preferences easily addressed

Beyond the typical regulatory and tax restrictions being imposed by investors on managers when structuring their funds, debt fund managers must also address specific investor preferences applicable to the operating models of the debt fund, including:

- Types of instruments: depending on their profiles, investors may require different types of instruments to be issued such as securities, notes, tracker shares and partnership interests
- Possibility to list instruments: some investors need to hold listed notes
- Use of master / feeder structures
- Use of parallel structures to easily replicate the investment strategy of off-shore vehicles to be distributed on the European market
- Provision of a robust security package to lending banks

The wide range of Luxembourg legal structures allows all of the above to be efficiently addressed.

Efficient tax structuring

Luxembourg offers a whole range of investment vehicles with various tax regimes that can generally accommodate all foreign requirements with respect to:

- Tax neutrality of the debt fund itself
- Tax efficient profit repatriation
- Treaty access
- Carried interest taxation

No other EU or off-shore domicile can lay claim to the same track record and industry compatibility in such a rapidly evolving current international legal, regulatory and tax environment.

Arendt can assist you with all aspects of your debt fund structuring

We advise a significant portion of the Luxembourg debt fund market. Our longstanding experience has given us an unprecedented expertise in this asset class.

At Arendt, we have followed the growth of the debt fund industry from its inception. We recognise that debt funds operate differently from typical private equity funds and the size of our firm has allowed us to dedicate a **specific team** to the structuring and operating of these debt funds.

In addition to **fund formation and regulatory lawyers**, we have joined forces with our **tax and finance teams** to advise on all terms of underlying investments. As such, we understand the specificities of operating debt funds and provide expert advice with respect to:

- **Market-practice legal terms:** performance-linked fees, duration of the investment period, re-investment, bespoke approach to financial covenants, etc.
- **Fund financing** arrangements to facilitate investments when funds are not yet available, to smoothly carry on follow-on investments, to bridge currency mismatch, to provide liquidity to cover pending management fees, etc.
- **VAT efficient** fee structuring
- Impact of the evolving **BEPS environment**
- **Transfer pricing** rules

Moreover, as an independent law firm, we have close contact with the best specialists in jurisdictions where borrowers are located, which is key when it comes to delivering a full and streamlined service to our clients.

Added-values for your success:

- Our team is composed of experts in all aspects related to alternative lending structuring
- We are available to provide specialist advice at any moment
- We are present at all the steps of the value chain, a unique attribute in Luxembourg

contact us: debt funds@arendt.com

Arendt & Medernach is the leading independent business law firm in Luxembourg. The firm's international team of 325 legal professionals represents clients in all areas of Luxembourg business law, with representative offices in Dubai, Hong Kong, London, Moscow, New York and Paris. Our service to clients is differentiated by the end-to-end specialist advice we offer, covering all legal, regulatory, taxation and advisory aspects of doing business in Luxembourg.