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CREDIT FUNDS 2022

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Twenty questions when structuring pan-European credit funds

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1 | Is there a preferred jurisdiction for the core fund vehicle?

Often, a fund sponsor starts with a preference in favour of a particular jurisdiction – for example, the sponsor might have existing funds there and existing infrastructure such as a general partner or a management company, or the anchor investor might have expressed a preference. Such preferences can of course be challenged, but they provide a starting point.

In very general terms, Luxembourg is the most common jurisdiction for domiciling pan-European credit strategies. However, we also see funds structured in Ireland, the United Kingdom, France, Germany and the Channel Islands, among others. The right answer lies in balancing existing preferences, infrastructure, tax considerations, costs, speed to market, and other commercial and operational factors.

2 | Who are the target investors?

Different investors will have different tax, regulatory and other considerations that might need to be accommodated through different parallel or feeder funds, perhaps in other domiciles. A large fundraise can rarely be accommodated through a single vehicle.

Accordingly, and to the extent possible, it is always helpful to have some sense of who the investors are likely to be. Different types of investors (ie, sovereigns and quasi-sovereigns, pension funds, insurance companies, endowments, family offices and high net worths) all have different requirements and preferences, and this can have a bearing on the structure. If it is known that a particular investor or group of investors is likely to be most interested in a particular strategy, these matters can be taken into account at an earlier stage.

3 | To whom and how will the fund be offered?

The broader the marketing campaign, the greater the likelihood that regulatory registrations and other accommodations will be needed (eg, local agents); this can have a long lead time so needs to be factored in. The intended marketing arrangements might also have a bearing on the management structure of the fund. If a wide pan-European fundraiser is contemplated, there is likely to be a strong case for using an EU-domiciled fund with an EU alternative investment fund manager (AIFM). If the sponsor does not already have this within its group, then a third-party AIFM can be used.

4 | What is the strategy of the fund?

The strategy has multiple interactions with fund structure. Firstly, the expected liquidity of the underlying investments might influence whether the fund should be open- or closed-ended. For example, relatively illiquid investments such as private term loans are ideally suited to a closed-ended fund structure. However, illiquid investments can be accommodated within open-ended funds and vice versa. Alternatively, a 'hybrid' structure involving elements of both open- and closed-ended funds might be more appropriate.

The investment strategy, the nature and source of the income and gains that will be generated, and an analysis of the tax treatment of such can also have a bearing on the fund structure. For example, the sponsor might determine to select an EU fund that will be respected as the beneficial owner of income rather than putting in place a downstream tax structure.

Another way that the strategy can influence the fund structure is the regulation of commercial lending activities in certain EU countries.

5 | In which markets will the fund invest?

If the strategy involves loan origination, it should be kept in mind that commercial lending is a regulated activity in many EU jurisdictions. In many jurisdictions, EU funds managed by an EU AIFM can carry on such activities. Accordingly, an 'onshore' EU fund structure can be helpful from a deal standpoint.

6 | What will the legal structure of the fund be?

The legal structure will be driven primarily by whether it is intended that taxation will be managed at investor levels based on the investors' status and any treaty benefits available to them (in which case a partnership or other tax-transparent structure is used) or within the fund structure (in which case a corporate is generally required).

The default structure for most closed-ended funds is a classic limited partnership wherein each investor has a capital account that is invested in parallel with those of the other investors (limited partners) in the structure. A partnership has the advantage of reserving the greatest flexibility for future downstream structuring. However,

there are many other structures available, including corporate forms (such as the Luxembourg SCA – a form of corporate limited partnership that issues share capital; or the Irish ICAV – a variable capital company). Funds can also take the form of ordinary companies (which might or might not have their shares listed) and unit trusts, as well as contractual arrangements such as FCPs. Standard closed-ended fund terms such as excuse provisions, default provisions, fee breaks and equalisation adjustments for subsequent close investors are more difficult to achieve within a corporate compared with a partnership structure.

7 | What will the regulatory structure of the fund be?

A number of credit funds also obtain their own regulatory approval at fund level, such as the Luxembourg specialised investor fund and the Irish qualifying investor alternative investment fund. However, if it can be avoided, most private fund sponsors would prefer not to have an additional layer of regulation at the fund level, so the most common route now is to select either entirely unregulated structures or very lightly regulated structures such as the Luxembourg reserved alternative investment fund (RAIF).

8 | What will the management fee basis and rate be?

The vast majority of closed-ended credit funds nowadays charge management fees on invested capital (ie, the aggregate 'acquisition cost' of the fund's investments) plus, during the investment period, committed and undrawn capital. There are several aspects to determining 'invested capital', including what to include when calculating acquisition cost and whether this fee basis will be reduced in the event of partial amortisations, write-downs or other revaluations. An alternative, albeit less common, model for closed-ended funds is to charge fees based on net asset value. In other cases, an alternative basis might be appropriate. Funds offering liquidity typically continue to charge management fees on net asset value.

Management fee rates vary in line with the expected risk and return profile of the fund, the amount of work required to invest and maintain the portfolio, and numerous other factors. One factor to consider is whether different fee rates (eg, early bird or size discounts) will be embedded into the fund terms or granted via side letters or rebate arrangements, subject to the fund mechanics.

9 | When will fees run from?

Considerations include whether overall level fees will start to run if a predecessor fund is still being invested. Also, as most funds now use subscription lines, the question whether fees should run from the date of investment or the date that capital is drawn to clean down the subscription line will arise. The interaction with how internal rate of return (IRR) and performance fees will be calculated is likely to be relevant here.

10 | How will the performance fee be calculated and paid?

It will be important to understand whether the original issuer discount and arrangement fees, as well as other transactional fees, accrue to the fund and count towards the performance fee or carried interest mechanism, or whether these will be accounted for in another way. The basis for calculating a return hurdle (eg, whether it will be IRR based, based on a cash return or potentially based on net asset value) will need to be considered. Also, will it be calculated on a whole portfolio basis or will some or all transactions be calculated separately?

11 | Will transaction fee income be earned in addition?

This question ties in with the previous consideration. Many credit strategies allow for a range of additional fee streams (such as arrangement fees, workout or advisory fees, syndication fees and monitoring fees, etc.), and consideration will need to be given to whether these will all accrue to the fund or whether the management company will be entitled to retain all or part of such fees (and if so, whether they will be offset from management fees in full or in part). This might differ from situation to situation.

12 | Is there potential for carried interest treatment (capital gains)?

Although many credit strategies will generate an income return in the form of interest payments, certain strategies (eg, distressed or special situations whereby debt may be resold at a premium, or strategies and opportunities whereby equity or equity-like instruments are acquired and appreciate in value) might allow the potential for capital gains. In this situation, consideration can be given to structuring the fund so as to allow investment professionals to receive a 'carried interest' taxed at capital gains rates.

13 | Will the fund be leveraged?

Some investors are attracted to leveraged strategies and others are not. The manager will need to consider whether to go one way or the other, or whether to accommodate both preferences by offering leveraged and unleveraged 'sleeves' or parallel funds (or a leveraged feeder into the main fund). To the extent possible, the likely requirements of a leverage provider can also be anticipated in the fund documents.

14 | Will multiple currency options be offered?

Will the fund be operated in a single base currency, or will investors have the opportunity to invest in different currencies? If so, will the fund operate a hedging programme? Other factors that will need consideration at the structuring stage are the fund structure; whether the fund will operate through parallel funds, 'currency classes' or feeders; how the hedging overlay is constructed; and matters such as whether there will be cross-collateralisation (which will likely produce more favourable transaction terms with the hedging counterparty) and the impact of margin requirements on projected cash distributions. Although open-ended credit funds

offering multiple currency classes might offer hedged non-base currency classes, closed-ended fixed-term funds do not typically offer hedged funds or classes.

15 | Will a note option be offered?

Certain insurance company investors might prefer to hold a note than an equity interest in the fund vehicle. This can be accommodated through a note-issuing feeder structure (or by making interests in a downstream vehicle directly available to certain investors). We see this being deployed for insurance investors in the United States, Europe and Asia, with different domiciles for the note-issuing vehicles.

16 | Will a downstream structure be used?

Using acquisition vehicles to book loans (rather than booking them into the main fund structure) can have a variety of advantages. Luxembourg and Ireland are commonly used for downstream structuring for European credit funds, although the new qualified asset holding company in the United Kingdom has a number of attractive features that might also make it worthy of consideration. The ultimate downstream structure might not be known until the fund's investment programme and the likely exit route are clear – and it might have to evolve to accommodate the needs of specific transactions along the way – but some consideration at the structuring stage is worthwhile. Such structuring also has costs attached (both upfront and ongoing, including, potentially, tax leakage); therefore, consideration should also be given to whether the need for a downstream structure can be avoided. For example, if the concern is withholding tax on loan interest, using a 'corporate' fund structure (such as a Luxembourg SCA) that would be respected as the beneficial owner of loans and is, in some cases, eligible for treaty relief can eliminate the need for a downstream structure. Alternatively, if the investor base is known at the time of structuring (a fairly rare luxury!), it might be that such investors are not expected to be subject to withholding taxes on their allocation of interest income or are eligible for a reduced treaty rate. Aside from the concerns around taxation, the use of a downstream special purpose vehicle might assist in facilitating the fund's exit from an investment at the end of the term.

17 | Will the fund look to syndicate investments?

If the fund will 'overbuy' positions and then look to syndicate them out to other investors (which might be other vehicles managed by the same sponsor or third parties), consideration will need to be given to a number of regulatory issues, as well as the commercial aspects such as sell-down pricing; how fees will be shared between the sponsor, initial fund and other purchasers; and the manager's ability to recycle the capital released.

18 | Will separate managed accounts / sidecars be offered in parallel?

The above considerations will apply if loans or other investments will be split across the main fund and separately managed accounts or sidecars. In addition, consideration should be given at the outset as to how such arrangements will be structured. For example, will the manager run an umbrella fund structure (such

as a Luxembourg RAIF) that can accommodate separate accounts in different sub-funds or 'sleeves' of the main structure, or will multiple stand-alone 'funds of one' be used? In addition, the manager will need to develop appropriate policies on conflicts and fair allocations and provide transparency around the allocation of transaction expenses among its various clients.

19 | Will the fund offer a co-investment programme?

Co-investment opportunities can be very popular with investors and a valuable way to build the general partner and limited partner relationship. Thought should be given at the outset to how co-investment opportunities will be offered and allocated, and on what commercial terms. Also, will the fund 'bridge' co-investments, or will speed and certainty of execution be important factors in determining who is entitled to participate and on what terms?

20 | How flexible is the fund for future changes?

The worsening macroeconomic environment is a timely reminder that some thought should be given at the start of a fund's life to what might happen at the end of it. As the private credit secondaries market continues to develop and 'continuation funds' become more commonplace in the private equity landscape, the sponsor might want the flexibility to do something other than run off the portfolio to term, and the fund agreement might be able to afford some helpful flexibility here.

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MARKET AND POLICY CLIMATE

Market snapshot

1 How would you generally describe the state of the market for private credit funds in your jurisdiction?

Germany is the largest economy in Europe with a high number of strong mid-sized companies that are highly attractive to private equity investors. The need for leveraged buyout financing as part of private equity transactions and a liberalised regulatory framework have contributed to the growth of loan origination provided by credit funds.

One of the main drivers for the success of private credit funds in the German market in recent years has mainly been regulation. Loan origination by investment funds was made possible by the German legislator in 2016. In addition, the increasingly strict capital adequacy requirements for banks under the Basel framework constitute a regulatory driver, as a result of which banks are withdrawing from parts of the lending business, thus creating a gap in the market that can be filled by credit funds.

Government and regulatory policy

2 How would you describe the general government and regulatory policy towards credit funds in your jurisdiction?

Germany introduced a framework for loan origination funds in March 2016 after the German supervisory authority (BaFin) declared the restructuring of loans that were held in the portfolio to be part of the portfolio management activities of alternative investment fund managers. The rules that were implemented allow certain German funds to originate loans but also non-German (particularly EU) funds to enter the German loan origination market. The revised regulatory framework has triggered substantial interest in the German debt fund market, particularly in relation to foreign funds engaging in lending activities with German borrowers. Furthermore, institutional investors continue to show growing interest in this asset class and seem receptive to investing in attractive credit fund strategies.

One of the key drivers of the liberalisation of the German regime was the European legal background. According to the European Venture Capital Fund Regulation (EuVECA Regulation), European Social Entrepreneurship Funds Regulation (EuSEF Regulation) and European Long-Term Investment Fund Regulation (ELTIF Regulation), these types of funds are already allowed to originate loans.

Since EuVECAs, EuSEFs and ELTIFs are AIFs and the Alternative Investment Fund Managers Directive (AIFMD) does not prohibit loan origination by AIFs, the European Securities and Markets Authority considered such lending to be part of the collective portfolio management of AIFs and thus permitted it under certain conditions.

Against this background, the German legislator created rules on loan origination as well as on the restructuring of existing loan receivables by AIFs in the German Investment Code (KAGB) and the German Banking Act (KWG).

According to the explanatory memorandum to the law, '*... non-bank-supported forms of financing such as lending through AIFs can make an important contribution to the financing of the real economy and offer a sensible expansion of indirect investment opportunities for certain investor groups. On the other hand, there are considerable risks associated with the granting of money loans outside the scope of the KWG, so that appropriate legal limits must be placed on the granting of money loans within the scope of the KAGB.*'

FORMATION AND MANAGEMENT

Forms of vehicle

3 What legal form of vehicle is typically used for credit funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? Is it possible to create umbrella structures that permit the creation of sub-funds? What are the legal consequences for investors, managers and investment advisers in respect of each of these structures?

The German Investment Code (KAGB) provides that, in principle, loan origination may be provided only for the accounts of closed-ended alternative investment funds (AIFs) whose investors may only be professional and semi-professional investors (Special-AIFs). A loan origination fund would typically be set up as a closed-ended special fund in the form of an investment stock corporation with fixed capital or limited investment partnerships (InvKG) established as a GmbH & Co InvKG. This structure is comparable with a closed-ended limited partnership structure. A new form of loan origination fund has been introduced recently, 'funds for development', which are impact funds and which aim to raise capital to actively support development policy goals and can be used only for such.

The German legislator has recently introduced the possibility to set up closed-ended funds in the form of Special-AIFs also in contractual form (*Sondervermögen*). *Sondervermögen* or *Spezial-Sondervermögen* are AIFs in contractual form and have

no legal personality of their own. They can be described as pools of assets. Typically, they are set up under a joint ownership system, in which investors hold joint title to the portfolio in proportion to their respective holdings, or in beneficial ownership, whereby the management company (KVG), which acts as the alternative investment fund manager (AIFM), holds title to the portfolio assets as a trustee.

KVGs must generally be fully licensed, although a light regime (registration) is available for sub-threshold AIFMs.

For AIFs in corporate form, in particular in the case of InvKGs, the liability of investors, who usually participate as limited partners, is limited to the amount of their capital contribution. As a general rule, AIFs in contractual form and their investors are not liable for the liabilities of the KVG. This includes liabilities of the KVG arising from transactions that it conducts for the joint account of the investors. Also, the KVG is not authorised to incur liabilities on behalf of the investors.

The applicable rules also provide for the possibility to create sub-funds with segregation of assets and liabilities.

Loan origination for the account of closed-ended Special-AIFs is subject to certain conditions. The ability of these AIFs to borrow is limited to 30 per cent of their aggregated contributed and uncalled committed capital. Furthermore, the KVG may not grant loans to consumers for the account of the Special-AIF. In addition, for the purpose of risk diversification, lending per borrower is limited to 20 per cent of the aggregated contributed and uncalled committed capital of the German Special-AIF.

Since the origination of loans and the acquisition of unsecuritised (secondary) loans involves specific risks, the KAGB stipulates additional organisational requirements for KVGs that manage such funds. Both fully licensed and sub-threshold KVGs that originate loans or invest in unsecuritised loan receivables for the account of the AIF must have an organisational and operational structure that is appropriate for these transactions and their scope and that, in particular, provide for processes for loan processing, loan processing control and the handling of problematic loans, as well as procedures for the early identification of risks, in particular:

- risk management procedures, taking into account specific risks arising from loan origination;
- the assessment, pricing and granting of credit (including criteria, governance and decision-making committee structures);
- credit monitoring, renewal and refinancing (including criteria, governance and decision-making committee structures);
- collateral management policy;
- concentration risk management policy;
- operational risk control appropriate to loan origination;
- assessment and scoring of borrowers;
- valuation, including collateral valuation and impairment;
- management of forbearance;
- identification of problem debt management; and

- capability and experience of staff in respect of the specific tasks connected with loan origination.

For the granting of shareholder loans (ie, loans to companies in which the Special-AIF itself holds an interest), the KAGB provides for facilitations if certain requirements are met. One relief, for example, is that the KVG does not have to comply with the borrowing limit of 30 per cent of the aggregated contributed and uncalled committed capital of the AIF.

In total, only 50 per cent of the aggregated contributed and uncalled committed capital of the AIF may be used for shareholder loans. The reliefs apply if one of the following conditions is met:

- the borrower is a subsidiary of the Special-AIF;
- the loan is subordinated; or
- the loans do not exceed twice the acquisition costs of the participations held in the company.

The legislator justifies the facilitation of shareholder loans with the practical needs of private equity and venture capital funds where the use of shareholder loans as a flexible element of corporate financing is appropriate.

In addition to the closed-ended Special-AIF, the following other fund vehicles may also grant shareholder loans, but may not originate external loans to other companies or consumers:

- certain open-ended Special-AIFs;
- hedge funds;
- certain closed-ended retail AIFs; and
- certain open retail AIFs.

Unregulated fund vehicles

4 Can the fund vehicle be unregulated? If so, does this affect the ability to originate loans or otherwise execute its investment strategy?

A loan origination fund must be operated by a fully regulated or a sub-threshold KVG and must adhere to specific investment restrictions:

- no loans may be granted to consumers;
- the granting of loans to a single borrower is limited to 20 per cent of the aggregated contributed and uncalled committed capital. This is to ensure a minimum diversification when granting loans; and
- the borrowing for the AIF (leverage) is limited to 30 per cent of the aggregated contributed and uncalled committed capital.

Formation process

5 What is the process for forming a credit fund vehicle in your jurisdiction? Are there any practical impediments to speed to market, such as account opening or banking and regulatory permissions?

If the fund is set up as a closed-ended Special-InvKG, in addition to drafting the limited partnership agreement (LPA), specific fund rules also must be drafted. They must be submitted to the supervisory authority (BaFin) by the KVG, although they don't need to be approved. The LPA must specifically stipulate that the interests may be acquired only by professional investors and semi-professional investors.

The Special-InvKG consists of at least one personally liable partner (general partner) and at least one partner with limited liability (limited partner). From a regulatory perspective, there is no upper limit to the number of partners, although for tax reasons no more than 100 investors may be invested directly or indirectly.

The general partners are directly and unlimitedly liable to the creditors for the funds' debts as joint and several debtors with their entire assets (company and private assets). If only limited liability companies (GmbHs) assume the general partner position, the result is a limitation of liability for the personally liable partners, as the liability of a GmbH is limited by law to its own assets. For liability reasons, the InvKG needs to be registered with the responsible commercial register, which can be effected, in principle, in two to four weeks.

Setting up a Special-AIF in contractual form (*Sondervermögen*) is a straightforward procedure, since, in principle, it requires the investor to sign a subscription agreement and to accept the fund rules. This is an advantage over the InvKG. There is no need to establish a company and register it in the commercial register. Also, units in a fund in contractual form (unlike InvKG interests) can be deposited and can be transferred more easily, whereas the transfer of interests in an InvKG must be recorded in the commercial register (and, for liability reasons, must be made subject to a deferral period until entry in the commercial register).

In addition, for a Special-AIF in contractual form, the fund rules must be in writing and available before any investor can invest. The fund rules of Special-AIFs as well as material changes to the investment terms and conditions must be submitted to BaFin by the KVG, although they don't need to be approved.

A depositary must be appointed in addition to the KVG and potentially a delegated portfolio manager. The depositary's primary responsibility is for the safekeeping of a fund's investments, including, in particular, financial instruments that can be entered into an account for financial instruments on the depositary's books and all financial instruments that can be physically transferred to the depositary. For assets that do not qualify as financial instruments, which is generally the case for loan receivables, an obligation to verify the legal ownership of the assets shall apply in place of the safekeeping obligation.

Substance requirements

6 Is a credit fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, a corporate secretary, employees, professional anti-money laundering (AML) officers or other substance? If so, how is that requirement typically satisfied?

In Germany, it is required to provide for sufficient substance for the KVG to be granted a licence to manage loan-originating funds. As a rule of thumb, a double-digit number of staff is expected by BaFin. However, substance requirements very much depend on the size of the business and the asset class. Substance requirements also apply to the entities acting as delegated portfolio managers or advisers where their activity is subject to a licence requirement.

Furthermore, where the fund is set up as an InvKG, general requirements of the German commercial code apply and the InvKG requires a domicile in Germany and must comply with the general book-keeping requirements. The KVG generally provides corporate secretarial and administrative services.

Access to information

7 What access to information about a private credit fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available? What information (in addition to that available to the general public) are shareholders and limited partners able to see? Is it possible to reduce access rights as a matter of contract?

Information in relation to Special-AIFs in contractual form (*Sondervermögen*) (eg, the identities of investors and the amounts of their investments) is not publicly accessible.

With regard to InvKGs, the information registered in the commercial register can, in principle, be accessed. The registration will comprise information relating to the general and limited partners. In addition, the amount of the limited partner's liability contribution (ie, the monetary amount stipulated as the maximum extent of their liability in the LPA) must be indicated. The liability sum is to be distinguished from the capital commitment that the limited partner has undertaken to pay and that is not disclosed. The LPA does not need to be filed and is therefore not publicly accessible.

Furthermore, the InvKG must file its annual financial statements with the commercial register and must publish them in the electronic Federal Gazette.

Investor liability

8 In what circumstances would the limited liability of investors in a credit fund formed in your jurisdiction not be respected as a matter of local law? Is there a list of actions in which investors can participate without losing their limited liability?

The claim of the closed-ended investment limited partnership against a limited partner for payment of the contribution expires as soon as the limited partner has paid their limited partner contribution. The limited partners are not obliged to compensate for losses incurred and are not obliged to make additional contributions.

Fund manager's fiduciary duties

9 What are the fiduciary duties owed to a credit fund formed in your jurisdiction and its third-party investors by that fund's manager, investment adviser or other similar control party or fiduciary? To what extent can those fiduciary duties be modified by agreement of the parties?

In performing its duties, the KVG must act independently of the depositary and exclusively in the interests of the investors. The KAGB requires the KVG to carry out its activities honestly, with due skill, care and diligence and in good faith, to act in the best interests of the investment funds it manages or in those of the investors in these investment funds and of the integrity of the market.

The KVG must take all reasonable steps to avoid conflicts of interest and, where they cannot be avoided, to identify, manage, monitor and, where appropriate, disclose such conflicts of interest in order to:

- prevent them from adversely affecting the interests of the investment fund and of investors; and
- ensure that the funds it manages are treated fairly.

It must have at its disposal the means and procedures necessary for the proper conduct of its business and to employ them effectively. It must comply with all regulatory requirements applicable to the conduct of its business in order to promote the best interests of the assets it manages or the investors in those assets and the integrity of the market and it must treat all investors fairly.

Gross negligence

10 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'simple negligence') standard of liability applicable to the management of a credit fund? If so, how does this standard differ from a simple negligence standard?

According to German law, the KVG is under the obligation to act with the due care of a prudent businessperson, which is an increased duty of care compared with the

duty of care of an ordinary reasonable person. In practice, however, liability is often limited to gross negligence and wilful misconduct.

Other special issues or requirements

11 Are there any other special issues or requirements particular to credit fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling vehicles formed in other jurisdictions into vehicles in your jurisdiction, what are the most material terms that typically must be modified and how common is this process? How long does it typically take?

It has become apparent that the investment stock corporation with fixed capital is not very practical, because the less flexible provisions of the German Stock Corporation Act apply. The closed-ended InvKG offers more flexibility but, depending on the downstream structure, however, it can present tax challenges (possible trade tax risk at the fund level as well as infection risk for tax-exempt investors).

Certain German regulated investors would need to have free transferability of their interests, which would need to be provided for in the fund documents or in a side letter.

Converting or redomiciling vehicles formed in other jurisdictions into German vehicles is generally possible as long as the converted or redomiciled vehicles correspond to and comply with the rules that are applicable to the German vehicle.

Fund sponsor insolvency or change of control

12 With respect to institutional sponsors of credit funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the credit fund and its general partner and investment manager or adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the credit fund's sponsor?

There are no specific regulatory consequences with regard to the insolvency of a fund sponsor. Where the fund sponsor has taken over an active role in the fund structure (eg, as KVG, general partner, investment adviser or portfolio manager), specific rules apply depending on the regulatory status of the respective party. Where the fund is structured as an InvKG, the LPA would normally contain provisions with regard to change of control mechanisms.

REGULATION, LICENSING AND REGISTRATION

Principal legislation and regulatory bodies

13 What principal legislation governs credit funds in your jurisdiction? Which regulatory bodies have authority over credit funds and its managers and investment advisers in your jurisdiction? What are the regulators' audit and inspection rights?

The German Investment Code (KAGB) is the principal set of rules that governs funds in Germany. In addition, management companies (KVGs) that act as alternative investment fund managers (AIFMs) to loan-originating funds are subject to a broad set of rules that govern their ongoing operations from an operational and risk management perspective. Also, parts of the German Banking Act apply.

The German Federal Financial Services Supervisory Authority (BaFin) is the main regulatory authority for the regulation of funds and their KVGs. BaFin has comprehensive inspection and audit rights.

In addition, KVGs that manage loan-originating closed-ended AIFs whose investors may only be professional and semi-professional investors (Special-AIFs) must notify the central registry of the Deutsche Bundesbank on a quarterly basis of borrowers whose loan volume amounts to €1 million or more.

Reporting and disclosure requirements

14 What ongoing reporting and disclosure requirements apply to credit fund managers and investment advisers in your jurisdiction?

The reporting obligations set out in the KAGB include both reports at the level of the KVG itself and at the level of the individual fund the KVG manages.

A German KVG is obliged to inform BaFin on an ongoing basis of the main instruments in which it is trading, including the fund's investment strategies and geographical and sectoral investment focus, the markets of which it is a member or where it actively trades and the diversification of the fund's portfolio, including its principal exposures and most important concentrations.

Additionally, a KVG is obliged to provide BaFin with the following information:

- the percentage of the fund's assets that are hard to value due to their illiquid nature;
- any new arrangements for managing the liquidity of the fund;
- risk management systems employed by the fund and the current risk profile of the fund; and
- information on the main categories of assets in which the fund invested and the results of periodic stress tests under normal and exceptional circumstances.

A KVG must also notify the BaFin of any material changes relating to the prerequisites of its licence, before implementing the changes.

In addition, KVGs that manage loan-originating Special-AIFs must notify the central registry of the Deutsche Bundesbank on a quarterly basis of borrowers whose loan volume amounts to €1 million or more.

The Central Register of Million Loans at the Deutsche Bundesbank determines the total indebtedness per borrower and borrower unit from the reported million loans. Lenders are then informed of the total indebtedness of their borrowers in a feedback report. This information is used for the Deutsche Bundesbank's own analyses (eg, in the event of impending corporate insolvencies) through to global evaluations to identify potential risks to the stability of the financial system.

Fund licensing and registration

15 What governmental approval, licensing or registration requirements apply to credit funds in your jurisdiction?

As was previously explained, fund managers in Germany are established as KVGs. KVGs are undertakings whose business is the management of funds and the supply of services or ancillary services to funds. KVGs can be formed as stock corporations (AG), limited liability companies (GmbH) or limited partnerships with a limited liability company as general partner (GmbH & Co KG). The minimum initial capital for a KVG is €125,000 for a KVG that is appointed as external manager and €300,000 for an internal KVG (ie, an internally managed AIF), although this increases as funds under management increase.

KVGs in the form of an AG and a GmbH require both a management board and a supervisory board. The management board is responsible for the day-to-day running of the company and must have at least two members with adequate experience of the investment management business. The supervisory board must have at least three members appointed by the shareholders to oversee the actions of the management board, who must also be suitably qualified and of sufficient standing. Furthermore, one member of the supervisory board must be independent of the shareholders, their affiliated companies and their business partners.

It does not make a difference whether there are significant investment activities in Germany or as to the type of borrower to which a loan is extended. There is also no difference in regulatory treatment between originating a loan and acquiring a position in an existing loan. In both cases, the same rules, in particular those with regard to the risk management, apply.

A Special-AIF does not require BaFin approval for its fund rules, although they must be filed with the regulator as well as any change thereof.

Registration of investment adviser

16 Is a credit fund's manager or investment adviser (or any of its officers, directors or control persons) required to register as an investment adviser in your jurisdiction? If so, is there a triggering activity for such registration?

A KVG can itself manage the portfolio of the fund or can delegate the management to a regulated entity to act as portfolio manager. KVGs require a licence from BaFin to operate under the KAGB.

A special regime applies to registered KVGs, which are those falling below the relevant threshold of the Alternative Investment Fund Managers Directive (small AIFMs) or the KAGB. Where the registered KVG manages only Special-AIFs, the KVG is subject only to registration and reporting requirements, which, however, are in contrast to managing regular Special-AIFs and are enhanced in relation to loan origination funds.

Furthermore, acting as a delegate portfolio manager or advising a fund from within Germany or on a cross-border basis would be deemed to be providing a financial service in Germany, which is a regulated activity under the Markets in Financial Instruments Directive regime as implemented in Germany. The manager or adviser would need to be licensed in Germany or would have to have passported its services into Germany if based in the EU. The same applies to non-EU managers and advisers with the exception that a passport would not be available.

Fund manager and investment adviser qualifications

17 Are there any specific qualifications or other requirements imposed on a credit fund's manager, investment adviser or any of its officers, directors or control persons in your jurisdiction?

AIFs are generally operated by a KVG that manages the portfolio of the fund or delegates the management to a regulated entity to act as portfolio manager. KVGs require a licence from BaFin to operate under the KAGB. The directors of the KVG must have appropriate expertise to direct a KVG that manages a credit fund. Generally, it is the responsibility of BaFin to determine whether a director's qualifications are sufficient based on legal, verifiable criteria. Appropriate expertise cannot be assumed on the basis of an absence of unfavourable information but must be positively identified in the director's curriculum vitae, particularly in respect of training, previous experience, current activities and examples of good stewardship.

In addition, as the origination of loans and the acquisition of unsecuritised (secondary) loans involve specific risks, the KAGB stipulates additional organisational requirements for KVGs that are originating loans or that invest into existing loans. Such KVGs must have adequate structures and procedures in place covering, in particular, credit processing, the management of non-performing loans and the early detection of risks.

When delegating portfolio management functions, the KVG must ensure that the delegate disposes of sufficient resources to perform the respective tasks and the persons who effectively conduct the business of the delegate are of sufficiently good repute and sufficiently experienced.

Political contributions

18 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a credit fund's manager or investment adviser or their employees?

There are no restrictions except if any such activity is sufficient to trigger bribery rules.

Use of intermediaries and lobbyist registration

19 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a credit fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

It is not required for activities relating to the marketing of funds to public pension plans or other governmental entities to register as lobbyist. The general rules that are applicable to marketing funds are also applicable to the marketing to public pension plans or other governmental entities.

Bank participation

20 Are there any legal or regulatory requirements that specifically apply to banks with respect to investing in or sponsoring credit funds?

In December 2016, BaFin issued guidance on limits of exposure against shadow banks (BaFin Guidance) in which it adopted guidelines on limits on exposures to shadow banking issued by the European Banking Authority (EBA) dated 3 June 2016 (EBA Guidelines). The BaFin Guidance contains restrictions in relation to investments made into shadow banking, which might have an impact on investments in loan-originating funds.

Anti-money laundering rules

21 What anti-money laundering (AML) rules and regulations apply to credit funds formed in your jurisdiction? Are there any requirements for due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a credit fund or the individual members of the sponsor? What AML requirements apply at the level of the fund? What level of scrutiny is required for AML checks regarding investments?

KVGs – as with all other obligated parties under the German Anti Money Laundering Act (AMLA) – have to fulfil the general, simplified and, if applicable, enhanced due diligence obligations, depending on the risk situation. The general due diligence obligations include, in particular, the duty to identify (KYC) and verify the contracting party and the beneficial owner as well as obtaining background information on the purpose of the business transaction, its evaluation and ongoing monitoring.

The duties in relation to the due diligence must be fulfilled by the KVG for the following circumstances:

- when establishing a business relationship;
- when carrying out a money transfer outside of an existing business relationship with an amount of €1,000 or more;
- when carrying out a transaction outside of an existing business relationship with a value of €15,000 or more;
- the transfer of crypto assets outside of an existing business relationship equivalent to €1,000 or more at the time of the transfer;
- on the existence of facts that property related to a transaction or business relationship is the object of money laundering, or the assets are related to terrorist financing; and
- in case of doubt as to whether the information collected on the basis of provisions of this Act regarding the identity of the contracting party, the identity of a person acting on behalf of the contracting party or the identity of the beneficial owner is accurate.

In addition, the KVG must determine the transaction and risk situation in a risk analysis, derive and implement appropriate safeguards from this analysis, and fulfil all documentation, recording and retention obligations under the AMLA. The auditor must examine whether the KVG has fulfilled its obligations under the Act.

A KVG must appoint an anti-money laundering officer at management level and a deputy who are both responsible for compliance with anti-money laundering regulations and who are directly subordinated to the management.

TAXATION

Tax obligations and exemptions

22 Is a credit fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Are there any applicable tax exemptions?

German credit funds organised in a contractual form (*Sondervermögen*) are subject to the special tax regime for investment funds, the German Investment Tax Act (GITA). Such investment funds are, in principle, considered as tax opaque. Although, in principle, investment funds are tax exempt, in respect of certain German source income, a German corporate taxation rate of 15.875 per cent applies. This includes, in cases of credit funds, income from loans that provide for profit contingent interest or other equity-like instruments (eg, *Genussrechte*). However, capital gains from such instruments are tax exempt.

German credit funds organised as a limited partnership (InvKG) are considered as tax transparent (ie, investors as limited partners are taxed on their respective share of taxable income). The relevant income is assessed through a German partnership tax return. As the activities of a German limited partnership engaged in loan origination may qualify as a trade or business (*Gewerbebetrieb*), German trade tax may apply at the level of the limited partnership.

Tax structuring

23 What range of downstream tax structures are available and commonly used in your jurisdiction to mitigate any tax leakage?

German credit funds typically hold loans to German borrowers directly. However non-German credit funds that may not benefit from a double tax treaty on their own may typically use a non-German asset holding vehicle to reduce or avoid German withholding taxation on interest income from German loans. However, German tax law provides for an anti-treaty shopping provision under which such blocker structures may be challenged by German tax authorities.

Local taxation of non-resident investors

24 Are non-resident investors in a credit fund subject to taxation or return-filing requirements in your jurisdiction?

In the case of German InvKGs, yes (see question 22). In the case of a German investment fund subject to the GITA (ie, a German *Sondervermögen*), no.

Local tax authority ruling

25 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a credit fund vehicle formed in your jurisdiction, or the services provided by the investment manager or investment adviser? Are there any special tax rules relating to investors that are residents of your jurisdiction?

German sponsors of German credit funds may consider seeking an advance tax ruling on the qualification of the investment activities of the credit fund as a trade or business (*Gewerbebetrieb)* to avoid the application of German trade tax.

Special tax considerations for sponsors

26 Are there any special tax considerations for credit fund sponsors?

No special tax regime for German sponsors of credit funds applies in respect of carried interest from credit funds. However, the German VAT treatment of management and performance fees needs to be analysed.

Tax treaties

27 Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to the fund vehicle or any downstream structure?

Non-German credit funds organised as a corporate (or other taxable) entity may benefit from reduced or an exemption from withholding taxes in respect of German source income under a double tax treaty (eg, funds organised in Luxemburg or Germany).

German credit funds organised under the GITA (ie, *Sondervermögen*) may benefit from reduced withholding taxes on foreign investments under respective tax treaties. However, as a German *Sondervermögen* is not a corporate legal entity, its tax status under a double tax treaty may be challenged by foreign jurisdictions.

Other significant tax issues

28 Are there any other significant tax issues relating to credit funds organised in your jurisdiction?

Not applicable.

OFFERING, SELLING AND INVESTMENT RESTRICTIONS

Offer and sale

29 What principal legal and regulatory restrictions apply to offers and sales of interests in credit funds formed in your jurisdiction, including the type of investors to whom such funds may be offered without registration under applicable securities laws?

Marketing alternative investment funds (AIFs) in Germany requires the funds to be registered with the German supervisory authority (BaFin) unless the fund or alternative investment fund manager (AIFM) can rely on reverse solicitation. Germany has also implemented the pre-marketing regime. The German pre-marketing provisions differentiate between pre-marketing and marketing activities using the following three criteria. Activities are deemed to be pre-marketing (rather than marketing) if the information provided to prospective professional and semi-professional investors:

- is not sufficient to enable investors to commit to subscribe units or shares of a particular AIF;
- does not include subscription forms or comparable documents, whether they are in draft or final form; and
- does not include constitutional documents, prospectuses or offering documents of an AIF not yet authorised in final form.

Also, to be considered pre-marketing, in cases in which the AIFM provides any draft prospectuses or offering documents, these documents must not contain information that can be deemed sufficient for investors to make an investment decision and must clearly state that:

- it does not constitute an offer or an invitation to subscribe for units or shares of an AIF; and
- the information presented therein should not be relied on as it is incomplete and subject to change.

If these requirements cannot be met, the activities are deemed marketing and the AIF must be registered for marketing in Germany.

Credit funds can be registered for marketing only to professional and semi-professional investors.

The German Investment Code (KAGB) distinguishes three types of investor categories: the professional, the semi-professional and the retail investor.

With regard to the definition of a professional investor, the KAGB refers to the definition of professional clients in Annex II of Directive 2014/65/EU on markets in financial instruments. A semi-professional investor within the meaning of the KAGB is any investor:

- who commits to investing a minimum of €200,000;
- who states in writing that they are aware of the risks associated with the envisaged commitment or investment;
- whose expertise, experience and knowledge were assessed by the AIFM and they were considered capable of making their own investment decisions and understanding the risks involved and that such a commitment is appropriate for the respective investor;
- to whom the AIFM confirms in writing that it has made the assessment mentioned above and the prerequisites regarding the investor's capabilities in relation to the intended commitment are fulfilled; and
- certain German institutions under public law.

Furthermore, a semi-professional investor also includes directors and employees of the AIFM who invest in a fund managed by the AIFM, as well as any investor who commits to investing a minimum of €10 million in an investment fund.

The category of retail investors comprises all investors that do not qualify as professional or semi-professional investors.

Types of investor and investment

30 Are there any restrictions on the types of investors that may participate in credit funds or the types of investments that may be held by credit funds formed in your jurisdiction?

Special-AIFs may be marketed only to professional and semi-professional investors. Credit funds may be offered only as Special-AIFs.

EXCHANGE LISTING AND SECONDARIES

Listing

31 Are credit funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing? Are there any restrictions on the type of vehicle or the terms of the credit fund that is seeking a listing?

Depending on the corporate form, a credit fund could, in theory, be listed. However, this is not customary and could be deemed to be an offering to the public. That would not be allowed because credit funds may be offered only to professional and semi-professional investors.

Restriction on transfers of interests

32 To what extent can a listed fund restrict transfers of its interests?

Under the applicable German listing rules, it would not be possible to restrict transfer of interests.

Secondary transactions

33 Can interests in a private credit fund established in your jurisdiction be transferred between investors? If so, are these typically subject to any contractual or regulatory conditions?

There are no legal or regulatory restrictions regarding the transfer between investors, assuming that the investors are eligible.

PARTICIPATION IN PRIVATE CREDIT TRANSACTIONS

Legal and regulatory restrictions

34 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private credit transactions or otherwise affect the structuring of private credit transactions completed inside or outside your jurisdiction? Can a private credit fund hold non-loan or non-debt investments and, if so, are such holdings subject to any restrictions? Is a private credit fund established in your jurisdiction subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrowers?

The statutory provisions that are applicable to closed-ended alternative investment funds (AIFs) whose investors may only be professional or semi-professional investors (Special-AIFs) permit investment in any type of asset, provided that its market value can be determined. In contrast to the provisions for closed-ended domestic mutual funds, there is no exhaustive catalogue of permissible assets for Special-AIFs. Thus, closed-ended domestic Special-AIFs are largely free to choose their assets. The general principle of risk diversification does not have to be observed, so a closed-ended Special-AIF established as a special fund may also be called a single-asset fund. However, there is a restriction for loan-originating funds. The granting of loans to a single borrower is limited to 20 per cent of the aggregated contributed and uncalled committed capital. This is to ensure a minimum diversification when granting loans.

A closed-ended Special-AIF is generally not subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrowers.

Use of leverage

35 Are there any legal or practical restrictions on funds formed in your jurisdiction having a subscription line (and providing security over investor interests) or having true leverage (and asset level security) in the fund?

For the closed-ended Special-AIF, borrowings can be made only up to the amount of 30 per cent of the aggregate contributed capital and uncalled committed capital, calculated on the basis of the amounts available for investment after deduction of all fees, costs and expenses borne directly or indirectly by the investors.

Compensation and profit sharing

36 Are there any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund? Is there anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund?

According to the European Securities and Markets Authority, carried interest is a form of variable remuneration that should be performance based and risk adjusted to limit excessive risk taking. To achieve this aim, an alternative investment fund manager (AIFM) should ensure that incentives to take risks are constrained by incentives to manage risk. An AIFM must therefore first return all capital contributed by the investors of the AIF it manages and an amount of profits at a previously agreed hurdle rate (if any) to the investors of the AIF, before the carried interest can be paid.

UPDATE AND TRENDS

Key developments of the past year

37 What are the most significant recent trends and developments relating to credit funds in your jurisdiction? What impact do you expect such trends and developments will have on global credit fundraising and on credit funds generally?

In November 2021, the EU Commission published its first of the Alternative Investment Fund Managers Directives. It includes proposals to establish an EU-wide harmonised regime of minimum requirements for loan-originating alternative investment fund (AIFs). It is expected that the proposed amendments will facilitate AIFs to originate loans in all member states and that a level playing field between different member states is created that will reduce compliance costs. One of the key targets of the proposal is also to improve risk management to monitor and prevent risks to financial stability and to protect investors.

The proposed amendments include that:

- loan origination will be identified as a new permitted activity for alternative investment fund managers (AIFMs);
- AIFMs that engage in direct loan origination and purchase of loans in the secondary market must add policies, procedures and processes in place for granting loans, assessing credit risk, and administering and monitoring the credit portfolio;
- new disclosure and reporting requirements will be introduced;
- to limit conflict of interest, AIFMs and their staff should not receive loans from loan-originating AIFs that they manage. Similarly, the AIF depository and staff or the AIFM delegate and its staff should be prohibited from receiving loans from the associated AIFs;
- any AIF that engages in loan origination 'to a significant extent' – defined as the notional value of the loan origination being at least equal to 60 per cent of the net asset value – must be established as a closed-ended AIF; and
- an AIF must retain 5 per cent of the notional value of loans it has originated and subsequently sold on the secondary market.

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MARKET AND POLICY CLIMATE

Market snapshot

1 How would you generally describe the state of the market for private credit funds in your jurisdiction?

The private credit funds market is an emerging asset class in the Greater China region. According to Preqin, fund managers based in the region have raised over US$10 billion for private credit funds since 2019. Private credit funds in the region are now increasingly diverse in their investment strategies, which include direct lending, mezzanine financing, distressed debt and special situations strategies. In respect of debt issuers, smaller private businesses are increasingly turning to the private credit market for funding needs, given that access to bank loans might be constrained by the volatile economic environment. This trend is also expected to continue as the private credit route offers issuers more flexibility and is less regulated compared with bank loans.

Government and regulatory policy

2 How would you describe the general government and regulatory policy towards credit funds in your jurisdiction?

There are no specific government policies targeting private credit funds in Hong Kong. However, the Hong Kong government has increasingly been active in enhancing Hong Kong's appeal as the private fund jurisdiction of choice in Asia.

There are two important recent development in relation to private funds – namely, the introduction of new onshore Hong Kong fund structures and tax exemption for private funds and fund managers.

Statutory regimes in Hong Kong for new legal structures, such as open-ended fund companies and limited partnership funds were introduced in 2018 and 2020, respectively, to provide fund managers with the choice of a more cost-effective and equally flexible onshore Hong Kong structure as compared with the more widely used offshore fund structures. Further, in April 2019, the Hong Kong government implemented the Revenue (Profits Tax Exemption for Funds) (Amendment)

Ordinance 2019 to exempt funds, regardless of domicile, structure or location of management, from Hong Kong profits tax, subject to their meeting certain conditions (the Unified Funds Tax Exemption). However, not all private credit funds are able to benefit from the Unified Funds Tax Exemption as it depends on the type of strategy and investments made by the particular private credit fund. The exemption does not apply to interest income and dividends that exceed 5 per cent of the fund's trading receipts. Accordingly, private credit funds that rely more heavily on interests and dividends to generate returns might have a higher tax burden.

In addition to the Unified Funds Tax Exemption, the Hong Kong government has also introduced the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021 to attract private fund managers to locate to Hong Kong and benefit from tax exemption on carried interest.

Collectively, these developments have made Hong Kong one of the most attractive jurisdictions for private fund formation and fund management.

FORMATION AND MANAGEMENT

Forms of vehicle

3 What legal form of vehicle is typically used for credit funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? Is it possible to create umbrella structures that permit the creation of sub-funds? What are the legal consequences for investors, managers and investment advisers in respect of each of these structures?

Historically, fund managers in Hong Kong have typically used private credit fund vehicles formed in offshore jurisdictions. However, the introduction of the limited partnership fund (LPF) and the open-ended fund company (OFC) have provided options for fund managers to form funds domiciled in Hong Kong. OFCs are generally used for open-ended structures and LPFs are more preferred for closed-ended structures.

Limited partnership fund

An LPF is formed contractually between the general partner (GP) and the limited partners (LPs) (or investors) by entering into a limited partnership agreement (LPA), which must be registered with the Hong Kong Registrar of Companies (RoC) pursuant to the Limited Partnership Fund Ordinance (LPFO).

The structure and constitution of an LPF is similar to those for LPs typically operated in offshore jurisdictions, including that:

- it must comprise one GP and at least one LP;
- it does not itself have legal personality;

- the LP's liability is generally limited up to its agreed capital commitment and the GP's liability is unlimited; and
- safe harbour provisions exist in the LPA to enable LPs to be involved in certain affairs of the fund without compromising the LP's limited liability.

However, the LPF offers flexibility for the LPA to determine the scope and extent of the GP's fiduciary responsibilities and, unlike certain offshore jurisdictions, there are no restrictions to using the LPF for an open-ended structure or a closed-ended structure – in other words, the LPF can be structured as a hybrid fund.

The GP must meet certain eligibility requirements set out in the LPFO. If the GP itself has no legal personality, it must appoint an authorised representative with legal personality to be (1) responsible for the control and management of the LPF and (2) jointly and severally liable with the GP for the debts and obligations of the LPF.

The GP is required to appoint an eligible investment manager (IM) to carry out the day-to-day investment management functions of the LPF (which can be the GP itself, if eligible under the LPFO). Although not explicitly stated in the LPFO, either the GP or the IM should be licensed by the Securities and Futures Commission (SFC) for Type 9 regulated activity (asset management) under the Securities and Futures Ordinance (SFO) if the LPF invests in securities (which include those in certain private companies) or futures contracts, or both. The IM will enter into a service contract with the GP, under which the IM will be contractually bound to provide services relating to those functions.

In practice, credit fund managers and investors are free to determine the terms of the LPF by contract under the LPA, subject to certain limited restrictions in the LPFO. No SFC approval is required.

Although it is theoretically possible to create an umbrella structure with an LPF permitting the establishment of sub-funds, given that there are no statutory provisions to cater for an umbrella structure, there could be issues in respect of the segregation of assets and liabilities between the sub-funds.

Open-ended fund companies

An OFC is a corporate vehicle created by statute that has a separate legal personality and is primarily subject to the SFO (including Part IVA on OFCs), the Securities and Futures (Open-ended Fund Companies) Rules (OFC Rules) and the Code on Open-ended Fund Companies (OFC Code). Unlike conventional Hong Kong incorporated companies, an OFC is not subject to statutory restrictions on capital reduction or distributions from capital. It is otherwise similar to corporate collective investment scheme vehicles currently available in other jurisdictions, such as the Cayman Islands, Luxembourg and Ireland. It can also be structured as an umbrella structure, under which separate sub-funds can be established and will be subject to statutory ringfencing, in that the assets and liabilities of a sub-fund will be separated from another under Hong Kong law.

The OFC operates like a conventional company but is formed only for the purpose of collective investment. The decision-making processes of an OFC may be conducted by the board or delegated to an SFC-licensed IM for Type 9 regulated activity (asset management) under the SFO. The constitution of the OFC, being the instrument of incorporation (equivalent to the articles of association of a conventional company), may be amended and remains as a single document. Shareholder liability is limited to their shares in OFCs. In accordance with the OFC Code, directors should use reasonable care, skill and diligence to oversee the activities of the IM and custodian as part of their overall duty to oversee the operations of the fund.

Directors of companies are also subject to common law duties, which can be broadly described as:

- acting in good faith in the interests of the company;
- exercising powers for a proper purpose;
- avoiding conflicts between personal interests and interests of the company; and
- not making secret profits.

In practice, it is less common for a private credit fund to be structured as an OFC. Although there is no restriction on what an OFC may invest in and there is no requirement that it must be open-ended (even though it is called an open-ended fund company), an OFC is nonetheless subject to a higher level of oversight by the SFC (eg, approval of the launch of the sub-fund by the SFC, compliance with certain prescribed custody requirements and approval by the SFC of changes of directors).

Unregulated fund vehicles

4 Can the fund vehicle be unregulated? If so, does this affect the ability to originate loans or otherwise execute its investment strategy?

The fund vehicle can be unregulated if its offering documents are not distributed to the Hong Kong public or, if they are distributed to the Hong Kong public, the offering documents are distributed pursuant to an exemption under the SFO and, if the fund is in the form of a corporate, also the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

Formation process

5 What is the process for forming a credit fund vehicle in your jurisdiction? Are there any practical impediments to speed to market, such as account opening or banking and regulatory permissions?

Limited partnership fund

LPFs need to be registered with the RoC by the proposed GP. A law firm must present the relevant documents and information to the RoC. Once the RoC is satisfied that the application contains the relevant documents and the information has been provided in the specified manner and the specified fee is paid, the RoC will register the fund as an LPF and issue a certificate of registration to the LPF as proof

of its registration. The GP must also apply for a business registration certificate from the Inland Revenue Department within one month of the date on the certificate of registration. Technically, this can be done within two to three business days provided that the documents are ready to be filed with the RoC.

The initial incorporation fee is around HK$3,034 (approximately US$400) and a business registration certificate for the LPF and the GP each costs HK$2,000 (approximately US$255) but might vary from time to time. An annual return must be filed by the GP with the RoC within 42 days after each anniversary of registration date, and such a filing fee is HK$105 (approximately US$13).

A corporate secretary and a registered office provider will typically be engaged. In addition, an LPF must also appoint an IM, an anti-money laundering (AML) responsible person and an auditor. Custodians are not mandatory as long as there is proper custody of assets.

Open-ended fund company

An OFC is formed by registering with the SFC and obtaining a certificate of incorporation issued by the RoC. The SFC will notify the RoC of the OFC's registration and the SFC's registration will take effect upon issuance of a certificate of incorporation by the RoC.

The applicant needs only to deliver an incorporation form, a copy of the instrument of incorporation, a notice to business registration office and fees required to the SFC. The RoC will register the relevant documents and issue a certificate of incorporation and business registration certificate in relation to the OFC after approval is given by the SFC to the OFC's registration.

The initial incorporation fee is around HK$3,034 (approximately US$400) and a business registration certificate for the OFC costs HK$2,000 (approximately US$255) but might vary from time to time.

A corporate secretary and a registered office provider will typically be engaged. In addition, an OFC must also appoint an eligible IM, an eligible custodian and an auditor. Also, one independent director must be appointed.

Practical matters in relation to both LPFs and OFCs

There are no minimum capital requirements at the fund level.

Based on previous understanding from service providers, the opening of a bank account in Hong Kong is expected to at least take three weeks, and in certain cases might take up to six months.

Substance requirements

6 Is a credit fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, a corporate secretary, employees, professional anti-money laundering (AML) officers or other substance? If so, how is that requirement typically satisfied?

Limited partnership fund

A corporate secretary and a registered office provider will typically be engaged. In addition, an LPF must also appoint an IM, an AML responsible person and an auditor. Custodians are not mandatory so long as the GP ensures that there are proper custodial arrangements for the assets of the fund.

Open-ended fund company

A corporate secretary and a registered office provider will typically be engaged. In addition, an OFC must also appoint an eligible IM, an eligible custodian and an auditor. Also, one independent director must be appointed.

Access to information

7 What access to information about a private credit fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available? What information (in addition to that available to the general public) are shareholders and limited partners able to see? Is it possible to reduce access rights as a matter of contract?

Limited partnership fund

The identities of investors and the amounts of their capital commitments are private. The registration of an LPF will not disclose the identities of the LPs to the public. However, records with that information must be kept at the registered office in Hong Kong and be accessible to law enforcement officers when necessary. Access rights cannot be reduced as a matter of contract.

Open-ended fund company

The identities of investors and the amounts of their capital commitments are private. The ownership of shares in an OFC will be recorded by noting shareholders' particulars and holdings in the register of shareholders, which must be kept at the OFC's registered office or at another address filed with the RoC. The register may be inspected by a shareholder as to their own shareholding, by the custodian or IM, or by the SFC and relevant public bodies or public officers. Access rights cannot be reduced as a matter of contract.

Investor liability

8 In what circumstances would the limited liability of investors in a credit fund formed in your jurisdiction not be respected as a matter of local law? Is there a list of actions in which investors can participate without losing their limited liability?

Limited partnership fund

In general, the investor's (ie, the LP's) liability to the fund is limited to its agreed contribution or commitment. If, however, the LP participates in the management of the fund, its limited liability status might be compromised.

Open-ended fund company

As the OFC functions essentially as a traditional company, the limited liability status of an OFC's shareholders will typically be limited to their contributed capital and for any unpaid amount on the shares in the OFC unless a court sees that there is a need to pierce the corporate veil (eg, the court finds that the OFC operates as a facade or a scam or is otherwise involved in fraudulent activities). Specific rights afforded to an OFC's shareholders to undertake certain activities will often be provided in legislation or the OFC's instrument of incorporation.

Fund manager's fiduciary duties

9 What are the fiduciary duties owed to a credit fund formed in your jurisdiction and its third-party investors by that fund's manager, investment adviser or other similar control party or fiduciary? To what extent can those fiduciary duties be modified by agreement of the parties?

In relation to LPFs, fiduciary duties are owed by the GP. According to the LPFO, the scope and extent of the GP's fiduciary responsibilities can be predefined in the LPA.

In relation to OFCs, fiduciary duties are owed by the directors. In accordance with the OFC Code, directors should use reasonable care, skill and diligence to oversee the activities of the IM and custodian as part of their overall duty to oversee the operations of the fund.

Directors of an OFC are also subject to common law directors' duties typically owed by directors of the traditional corporate form, which can be broadly described as:

- acting in good faith in the interests of the company;
- exercising powers for a proper purpose;
- avoiding conflicts between personal interests and interests of the company; and
- not making secret profits.

Where the IM is licensed by the SFC, it will also be subject to the fiduciary duties imposed on it under the relevant codes of conduct published by the SFC.

Gross negligence

10 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'simple negligence') standard of liability applicable to the management of a credit fund? If so, how does this standard differ from a simple negligence standard?

There is no specific definition of 'gross negligence' under Hong Kong law. However, this standard can be contractually defined in the LPA (in the case of an LPF) or the subscription agreement (in the case of an OFC) if needed.

Other special issues or requirements

11 Are there any other special issues or requirements particular to credit fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling vehicles formed in other jurisdictions into vehicles in your jurisdiction, what are the most material terms that typically must be modified and how common is this process? How long does it typically take?

Under the re-domiciliation mechanism, an overseas corporate fund or an overseas limited partnership can be re-domiciled to Hong Kong as an OFC or an LPF, respectively, if it satisfies the same set of eligibility requirements for a new fund to be registered as an OFC or an LPF.

Fund sponsor insolvency or change of control

12 With respect to institutional sponsors of credit funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the credit fund and its general partner and investment manager or adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the credit fund's sponsor?

In relation to LPFs, other than dissolution provisions in the LPA, the LPFO sets certain circumstances whereby the fund may be automatically dissolved. These include when the GP is bankrupt, dissolved or dead. In addition, the LPA will typically provide for GP removal.

REGULATION, LICENSING AND REGISTRATION

Principal legislation and regulatory bodies

13 What principal legislation governs credit funds in your jurisdiction? Which regulatory bodies have authority over credit funds and its managers and investment advisers in your jurisdiction? What are the regulators' audit and inspection rights?

The Securities and Futures Ordinance (SFO) is the main legislation that governs investment funds, specifically in relation to the marketing and distribution of funds and the licensing of managers and investment advisers. In addition, the SFO provides the Securities and Futures Commission (SFC) with the power to issue rules, guidance and circulars that supplement the SFO.

In terms of inspection rights, Part VIII of the SFO provides the SFC with broad powers to supervise a licensed fund manager. In particular, the SFC has the power to enter the premises of licensed managers and investment advisers, inspect, and make copies or otherwise record of any record or document, and make enquiries.

Under section 159 of the SFO, the SFC can also appoint auditors to examine or audit, either generally or in relation to a particular matter, the accounts and records of the licensed manager and investment adviser in the event that the SFC:

- finds that the manager or the investment adviser has failed to satisfy financial resources requirements;
- has reasonable cause to believe that the manager or the investment adviser has failed to comply with financial resources requirements or any other prescribed requirements; and
- receives a report from the manager's or the investment adviser's auditor in relation to the same.

Reporting and disclosure requirements

14 What ongoing reporting and disclosure requirements apply to credit fund managers and investment advisers in your jurisdiction?

Under the Fund Manager Code of Conduct issued by the SFC, fund managers will need to disclose certain information to investors (eg, material conflict of interests, side pocket arrangements, leverage exposures, valuation arrangements, custody arrangements and any other material risks associated with the fund). If applicable, material preferential redemption terms under a side letter must also be disclosed.

In relation to disclosures to the SFC, a manager must disclose upon request assets and liability information at the manager level. Although there are no specific requirements to make disclosures about identities of fund investors or any change in ownership, management or control of a fund, the manager may be required to respond to such requests and enquiries from the SFC from time to time.

Fund licensing and registration

15 What governmental approval, licensing or registration requirements apply to credit funds in your jurisdiction?

Registration upon establishment

Where the credit fund is structured in the form of open-ended fund company (OFC), the OFC is required to be registered and approved by the SFC. No SFC registration is required where the credit fund is structured in the form of an LPF.

Registration for public offering

Public offerings of interest in a fund to investors in Hong Kong trigger requirements to register the fund and obtain authorisation from the SFC. However, there are certain exemptions from these registration and authorisation requirements if the fund's offering documents are not distributed to the Hong Kong public or, if they are distributed to the Hong Kong public, the offering documents are distributed pursuant to an exemption under the SFO and, if the fund is in the form of a corporate, also the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO).

Money lending business registration

In Hong Kong, a person carrying on the business as a money lender will require a money lender's licence pursuant to the Money Lenders Ordinance (MLO) unless an exemption applies. The question is whether the fund is carrying on a business of making loans or advertises or announces itself or holds itself out in any way as carrying on that business of making loans.

Exemptions are available under the MLO if the money lender is a specified person or it makes a specified loan. The common exemptions relied upon include:

- a loan made by a person whose ordinary business does not primarily or mainly involve the lending of money, and the loan is made in the ordinary course of that business;
- a loan made by a holding company to its subsidiary, or by a subsidiary to its holding company or another subsidiary company or the same holding company;
- a loan made to a company that has a paid-up share capital of not less than HK$1 million or its equivalent; or
- a loan made to a company secured by a mortgage, charge, lien or other encumbrance registered under the CWUMPO.

The MLO contains a wide definition of what constitutes a loan. It includes advance, discount, money paid for or on account of or on behalf of or at the request of any person, or the forbearance to require payment of money owing on any account whatsoever, and every agreement (whatever its terms or form may be) that is in substance or effect a loan of money, and also an agreement to secure the repayment of any such loan. Secondary purchase of loans, loan restructurings and other transactions may or may not be caught depending on circumstances.

Registration of investment adviser

16 Is a credit fund's manager or investment adviser (or any of its officers, directors or control persons) required to register as an investment adviser in your jurisdiction? If so, is there a triggering activity for such registration?

Yes, a manager or an investment adviser carrying on, or holding itself as carrying on, a business of dealing in securities, advising on securities and asset management (or any other regulated activity) will need to be licensed with the SFC.

Fund manager and investment adviser qualifications

17 Are there any specific qualifications or other requirements imposed on a credit fund's manager, investment adviser or any of its officers, directors or control persons in your jurisdiction?

Where the manager or investment adviser is required to be licensed to engage in the regulated activity of dealing in securities or otherwise holds client assets, it will need to maintain a minimum paid-up share capital of HK$5 million and a minimum liquid capital of HK$3 million. If it is not required to be licensed to engage in the regulated activity of dealing in securities or otherwise hold client assets, there is no minimum paid-up share capital requirement, but it must maintain a minimum liquid capital of HK$100,000. Typically, credit fund managers or investment advisers do not hold client assets, but they may be licensed to engage in the regulated activity of dealing in securities.

There are also certain competence requirements for every responsible officer who exercises overall management oversight over the manager or oversees the key business line of the manager. For example, such officers must have sufficient relevant industry (eg, three out of the past six years or five of the past eight years) and two years of management experience and must be knowledgeable about the financial products managed by the manager or regularly advised on by the investment adviser.

An SFC-licensed corporation is also required to appoint a manager-in-charge for each of its eight core functions, namely:

- overall management oversight;
- key business line;
- operational control and review;
- risk management;
- finance and accounting;
- information technology;
- compliance; and
- anti-money laundering and counterterrorist financing.

Political contributions

18 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a credit fund's manager or investment adviser or their employees?

In Hong Kong, bribery and corruption offences are governed by the Prevention of Bribery Ordinance (PBO). In respect of the public sector, section 4 of the PBO provides that it is an offence for any person to offer any advantage to a public servant, and for any public servant to solicit or accept any advantages, without lawful authority or reasonable excuse, as an inducement to or reward for or otherwise on account of that public servant.

Use of intermediaries and lobbyist registration

19 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a credit fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

No, apart from the licensing requirements under the SFO in respect of the marketing of the fund or its services as manager or investment adviser.

Bank participation

20 Are there any legal or regulatory requirements that specifically apply to banks with respect to investing in or sponsoring credit funds?

There are no specific restrictions on banks in respect of investing in or sponsoring credit funds (assuming that 'investing in' and 'sponsoring' are not referring to any act in which the bank is acting as an intermediary).

Anti-money laundering rules

21 What anti-money laundering (AML) rules and regulations apply to credit funds formed in your jurisdiction? Are there any requirements for due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a credit fund or the individual members of the sponsor? What AML requirements apply at the level of the fund? What level of scrutiny is required for AML checks regarding investments?

Dealing with subscription monies

A fund or an individual member of the sponsor must observe the provisions of the Drug Trafficking (Recovery of Proceeds) Ordinance (DTO), the Organised and Serious Crimes Ordinance (OSCO), the United Nations (Anti-Terrorism Measures) Ordinance (UNATMO) and the Weapons of Mass Destruction (Control of Provision of Services) Ordinance (WMD(CPS)O).

Generally, both individuals and organisations are subject to the DTO and the OSCO, whereby it is an offence of money laundering if a person deals with any property, including money, that they know or have reasonable grounds to believe is proceeds of drug trafficking or any indictable offence. It is also an offence when any person fails to disclose knowledge or suspicion that a property represents proceeds of drug trafficking or any indictable offence. Dealing includes the act of receiving and disposing.

Further, it is also an offence under the UNATMO if a person (1) provides or collects any property knowing or with intention or has reasonable grounds to believe that the property will be used for terrorist acts, or (2) makes property or financial services available to or for the benefit of terrorists or their associates.

Similarly, the WMD(CPS)O prohibits the provision of services (including any financial services) that will or might assist the development, production, acquisition or stockpiling of weapons of mass destruction, or the means designed for the delivery of such weapons.

Reporting obligations

Under the general obligations in the DTO, OSCO, UNATMO and WMD(CPS)O, if any person knows or suspects that a transaction involves any property, including money, that is the proceeds of, or used in connection with, or is intended to be used in (1) drug trafficking, (2) an indictable offence or (3) a terrorist act, they must file a suspicious transaction report to the Joint Financial Intelligence Unit, a joint unit of the Hong Kong Police Force and the Hong Kong Customs & Excise Department, as soon as practicable. In the suspicious transaction report, the identity of the relevant investor and the amount of investment involved (among other things) will need to be disclosed. Failure to file such a report may constitute a criminal offence.

Funds structured as LPFs

In addition to the general obligations as described above, the GP of an LPF must appoint a person (who may be the GP or another person that is either a licensed bank, a licensed corporation conducting regulated activity, an accounting professional or a legal professional) as a responsible person to carry out measures in compliance with the requirements under Schedule 2 to the Anti-Money Laundering Ordinance, including conducting due diligence on its LPs and certain record-keeping requirements.

TAXATION

Tax obligations and exemptions

22 Is a credit fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Are there any applicable tax exemptions?

Yes, a credit fund is subject to taxation in Hong Kong unless it is able to qualify for the Unified Funds Exemption. The Unified Funds Exemption is typically available for arising from 'qualifying transactions' and transactions incidental to the carrying out of such qualifying transactions of up to 5 per cent of the fund's total trading receipts (such as interest income). Qualifying transactions, however, do not extend to direct loan transactions, but they may apply to debt securities.

In general, there are no withholding tax regimes in Hong Kong for any dividends, distributions, capital gains or other gains paid to the investors. For individuals, personal investment income and capital gains are generally not subject to tax in Hong Kong unless such income or gain is part of that individual's trade, profession or business. For corporate investors, profit tax may be payable if it carries on a trade, profession or business and derives profit from such activities in Hong Kong.

Tax structuring

23 What range of downstream tax structures are available and commonly used in your jurisdiction to mitigate any tax leakage?

The tax structures used in downstream investments can vary depending on many factors, including the specific tax status of the fund investor and the originator and the tax requirements of foreign jurisdictions.

Local taxation of non-resident investors

24 Are non-resident investors in a credit fund subject to taxation or return-filing requirements in your jurisdiction?

This depends on whether the investor carries on a business in Hong Kong.

Local tax authority ruling

25 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a credit fund vehicle formed in your jurisdiction, or the services provided by the investment manager or investment adviser? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It is not usual for a fund to obtain a ruling.

Please note that a Hong Kong resident who, inter alia, (1) alone or jointly with associates (as defined in the Inland Revenue Ordinance (IRO)), holds a 30 per cent or more beneficial interest in a fund that is exempt from profits tax under section 20AN or section 20AO of the IRO or (2) holds any percentage of the beneficial interest in a tax-exempt fund that is an associate of the Hong Kong resident investor will be deemed to be subject to tax on their share of the fund's profits from specified transactions that are otherwise taxable under the general charging provisions.

Special tax considerations for sponsors

26 Are there any special tax considerations for credit fund sponsors?

For tax years commencing on or after 1 April 2020, carried interest earned by, or accrued to, qualifying persons (including corporations licensed under the Securities and Futures Ordinance) and certain of its employees, in connection with the investment management services provided by them to a fund certified by the Hong Kong Monetary Authority (HKMA) to be eligible, will be taxed at zero per cent in Hong Kong.

In considering the certification, the HKMA will assess, among other things, (1) whether a fund managed by a qualifying person has invested in certain securities of, or issued by, a private company and (2) whether the qualifying person has for the applicable tax year an operating expenditure of HK$2 million or more incurred in Hong Kong and an average number of two full-time employees qualified in and in fact carrying out investment management services.

Tax treaties

27 Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to the fund vehicle or any downstream structure?

Yes, double taxation relief is available for certain jurisdictions in respect of certain downstream transactions relating to capital gains, interests and dividends.

Other significant tax issues

28 Are there any other significant tax issues relating to credit funds organised in your jurisdiction?

In general, dividends or overseas branch profits repatriated to Hong Kong are not subject to Hong Kong tax. Capital gains are also tax exempt.

Stamp duty is imposed on certain documents such as share transfers, leases and sales of real property, except where intra-group relief, stock borrowing relief or Islamic bond scheme relief under the IRO is applicable.

OFFERING, SELLING AND INVESTMENT RESTRICTIONS

Offer and sale

29 What principal legal and regulatory restrictions apply to offers and sales of interests in credit funds formed in your jurisdiction, including the type of investors to whom such funds may be offered without registration under applicable securities laws?

If the fund's offering documents are not distributed to the Hong Kong public or, if it is distributed to the Hong Kong public, the offering documents are distributed pursuant to an exemption under the Securities and Futures Ordinance (SFO) and, if the fund is in the form of a corporate, also the Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO). One of the exemptions available under the SFO and the CWUMPO is that the fund is distributed only to professional investors in Hong Kong, which includes certain institutional investors, large corporates and high net worth individuals.

Types of investor and investment

30 Are there any restrictions on the types of investors that may participate in credit funds or the types of investments that may be held by credit funds formed in your jurisdiction?

There are no restrictions if the fund is not distributed to the Hong Kong public, which includes any class of the public. However, there is no further authority or guidance on what constitutes public.

If the fund is distributed to the Hong Kong public under an exemption, then the type of investors that can participate depends on the exemption that is being relied on.

Note that in relation to funds formed as limited partnership funds (LPFs), the limited partners cannot solely consist of entities in the same group of companies of the general partner after the second anniversary of the registration date of the LPF. If this remains the case, the LPF may be struck off the LPF register. This requirement

appears to be intended to discourage fund managers from forming LPF vehicles without any genuine investors.

EXCHANGE LISTING AND SECONDARIES

Listing

31 Are credit funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing? Are there any restrictions on the type of vehicle or the terms of the credit fund that is seeking a listing?

Typically, a fund listed in Hong Kong would also require authorisation by the Securities and Futures Commission in the form of an exchange traded fund, most of which are index-tracking funds. Therefore, it is not typical for a private credit fund to be listed.

Restriction on transfers of interests

32 To what extent can a listed fund restrict transfers of its interests?

A listed fund may specify in its constitutional documents that certain classes of investors are restricted from holding fund interests and reserve the right to compulsorily redeem non-eligible investors if notified of such holdings.

Secondary transactions

33 Can interests in a private credit fund established in your jurisdiction be transferred between investors? If so, are these typically subject to any contractual or regulatory conditions?

Transfers between investors are possible but will be subject to the restrictions and conditions as set forth in the fund's constitutive documents. Typically, consent from the general partner or board of directors is required.

PARTICIPATION IN PRIVATE CREDIT TRANSACTIONS

Legal and regulatory restrictions

34 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private credit transactions or otherwise affect the structuring of private credit transactions completed inside or outside your jurisdiction? Can a private credit fund hold non-loan or non-debt investments and, if so, are such holdings subject to any restrictions? Is a private credit fund established in your jurisdiction subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrowers?

Except for the requirements to register as the money lender, private funds formed in Hong Kong are generally not subject to any legal or regulatory restrictions that affect their participation in private credit transactions or otherwise affect the structuring of private credit transactions completed inside or outside Hong Kong.

Private credit funds established in Hong Kong are generally not subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrower.

Use of leverage

35 Are there any legal or practical restrictions on funds formed in your jurisdiction having a subscription line (and providing security over investor interests) or having true leverage (and asset level security) in the fund?

These are not generally subject to legal restrictions. However, where leverage is used and the fund is managed by a manager licensed by the Securities and Futures Commission (SFC), the maximum expected leverage and the calculation methodology of leverage must be disclosed to investors.

Compensation and profit sharing

36 Are there any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund? Is there anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund?

No, as long as these arrangements are properly disclosed and agreed to by the investors. However, where the sharing arrangement includes a condition to direct businesses to another party, this may trigger the requirements relating to soft dollars and rebates under the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC.

In addition, in relation to carried interests, fund sponsors may consider structuring their carried interest arrangements if they wish to qualify for the carried interest tax concession.

UPDATE AND TRENDS

Key developments of the past year

37 What are the most significant recent trends and developments relating to credit funds in your jurisdiction? What impact do you expect such trends and developments will have on global credit fundraising and on credit funds generally?

In August 2021, the Securities and Futures Commission (SFC) published the Consultation Conclusions on the Management and Disclosure of Climate-Related Risks by Fund Managers (Consultation Conclusions), which set out the SFC's expectations as to how fund managers should consider climate-related risks in carrying out investment and risk management, and how to make appropriate disclosures of the same. The new requirements will apply to all managers licensed in Hong Kong who exercise discretionary investment management over the assets of an investment fund, including both authorised and private funds (including private credit funds). Fund managers who manage only discretionary accounts are currently out of scope.

Among other things, a fund manager ensures that both its board and its management are engaged in the integration of climate-related risks across the fund manager's organisation. It must also ensure that climate-related risks are taken into account in investment management processes. Additional requirements apply where the fund manager has HK$8 billion or above assets under management.

In addition, in relation to private placements, the SFC launched a two-month public consultation on 10 June 2022 on proposed amendments to the Securities and Futures Ordinance, which, among other things, seeks to require that advertisements relating to funds are issued only to professional investors who are identified in advance.

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MARKET AND POLICY CLIMATE

Market snapshot

1 How would you generally describe the state of the market for private credit funds in your jurisdiction?

Depending on the investment strategy, Luxembourg debt funds are either originating loans or acquiring loans. According to the Private Debt Fund Survey 2021 from KPMG and the Association of the Luxembourg Fund Industry, 45 per cent of Luxembourg debt funds are classified as loan originating funds. Assets under management of Luxembourg private debt funds are estimated to be around €180 billion. This figure includes regulated and unregulated alternative investment funds (AIFs) when managed within the scope of Directive 2011/61/EU on alternative investment fund managers, as amended (AIFMD) but excludes AIFs managed by alternative investment fund managers (AIFMs) exempted from the scope of AIFMD.

Approximately half of Luxembourg debt funds have assets under management below €100 million, and around a third have assets under management between €100 million and €500 million. Five per cent have assets under management in excess of €1 billion.

For historical reasons, specialised investment funds (SIFs) under the act of 13 February 2007 on specialised investment funds, as amended (the SIF Act), are still the leading fund type for debt funds (56 per cent), followed by reserved alternative investment funds (RAIFs) under the act of 23 July 2016 on reserved alternative investment funds, as amended (the RAIF Act). The number of SIFs continues to decrease in the private debt space (minus 11 per cent) and the number of RAIFs continues to increase (plus 8 per cent).

The most popular legal form is the special limited partnership (*société en commandite spéciale* (SCSp)), of which the number of corporate vehicles is increasing.

Government and regulatory policy

2 How would you describe the general government and regulatory policy towards credit funds in your jurisdiction?

Luxembourg has not established a specific fund regime dedicated to private credit funds.

AIFs are collective investment undertakings that are raising capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.

Any Luxembourg AIF can pursue a credit investment strategy, provided that it does not carry out a professional lending activity falling within the scope of the Luxembourg act of 5 April 1993 on the financial sector, as amended (the Financial Sector Act). The Financial Sector Act regulates financial service providers, including those undertaking on a professional basis a lending activity without taking deposits like credit institutions. Such activity qualifies as business activity and can, in principle, not be undertaken by an AIF as its object is limited to investment activity.

FORMATION AND MANAGEMENT

Forms of vehicle

3 What legal form of vehicle is typically used for credit funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? Is it possible to create umbrella structures that permit the creation of sub-funds? What are the legal consequences for investors, managers and investment advisers in respect of each of these structures?

Credit funds are formed either as corporate vehicles or as limited partnerships.

For corporate vehicles, credit funds are generally formed as investment companies with variable capital under either the Specialised Investment Funds Act (SIF Act) or the Reserved Alternative Investment Funds Act (RAIF Act). The legal form is typically a limited liability company (*société anonyme* (SA)) or a corporate partnership limited by shares (*société en commandite par actions* (SCA)) under the act of 10 August 1915 on commercial companies, as amended (the Companies Act). The main difference is that the SA is generally managed by a board and has one type of shareholder that do not intervene in the conduct of management of the SA. The SA may also have a two-tier management structure with a supervisory board and a management board.

The SCA instead has two types of shareholder: one or more unlimited shareholders, which are jointly and severally liable with the SCA and, in principle, entrusted with the management of the SCA, and one or more limited shareholders whose liability is limited to their contributions (or commitments) to the SCA and that are not permitted to intervene in the external management of the SCA.

In limited partnerships, most credit funds adopt the form of an SCSp. Less frequently, credit funds may also be formed as a common limited partnership (*société en commandite simple* (SCS)). The SCS, which is the traditional form of limited partnership, has a legal personality under Luxembourg law. Although the SCSp does not have a legal personality, it has many features similar to those of a legal person – for instance, it has its own domicile, and assets, including loans, are recorded on its behalf despite the lack of legal personality. SCSps and SCSs may also be subject to the SIF Act or the RAIF Act. This would, for instance, allow for the creation of ring-fenced compartments.

SIFs are funds that are directly regulated by the Commission de Surveillance du Secteur Financier (CSSF), the supervisory authority for the financial sector in Luxembourg. They can either be managed within the scope of the Alternative Investment Fund Managers Directive (AIFMD), be exempted from the scope of the AIFMD as their alternative investment fund manager (AIFM) is registered as a sub-threshold AIFM or be out of scope of the AIFMD if the specialised investment fund (SIF) does not qualify as an alternative investment fund (AIF).

Contrary to SIFs, reserved alternative investment funds (RAIFs) must always be managed by an external AIFM authorised in one of the member states of the European Economic Area (EEA). The RAIF does not, however, need to be specifically authorised by the CSSF – its management will be notified by the AIFM to its competent supervisory authority.

Less frequently used for credit funds, SIFs and RAIFs may also be structured as common funds (*fonds commun de placement* (FCPs)). The FCP is a contractual co-ownership scheme without legal personality. It is established, managed and dissolved by a management company under the Luxembourg act of 17 December 2010 on undertakings for collective investment, as amended (the UCI Act).

SIFs and RAIFs may be structured with ring-fenced compartments irrespective of the legal form the SIF or the RAIF has adopted. The rights of the investors and creditors relating to a compartment or arising in connection with the creation, operation or liquidation of a compartment are limited to the assets of that compartment unless a provision to the contrary is included in the constitutive documents.

Each compartment can display specific features set out in the issuing document of the relevant SIF or RAIF. For instance, a compartment may have its own investment strategy and its own rules on leverage, be open-ended or closed-ended, or have its portfolio be managed by different delegates of the AIFM.

Each compartment may have different classes of units whose assets are invested in common but that are, for instance, subject to different fee structures, distribution policies, marketing targets, hedging policies, denomination in different currencies or its own rules governing the issue and redemption of units.

Cross-investments between compartments of the same SIF or RAIF are permitted.

Where the credit fund is established as an SCSp or an SCS that is not subject to the SIF Act or the RAIF Act, no compartments may be established. In practice, different SCSps or SCSs will be formed that may be managed by the same general partner.

Unregulated fund vehicles

4 Can the fund vehicle be unregulated? If so, does this affect the ability to originate loans or otherwise execute its investment strategy?

A Luxembourg AIF that is not subject to the SIF Act or Part II of the UCI Act is not authorised by or directly under the supervision of the CSSF. Such AIFs, which include RAIFs, are not directly regulated by the CSSF. However, their Luxembourg-based AIFM will be subject to the supervision of the CSSF, and a non-Luxembourg AIFM will be subject to certain reporting obligations on the Luxembourg AIF, which will be provided to the CSSF.

Similarly, a Luxembourg credit fund adopting the form of an SCSp is considered as an unregulated vehicle as its formation is not subject to authorisation by the CSSF and will also not be under the ongoing supervision of the CSSF after its formation. Such an SCSp is managed either by a sub-threshold or registered AIFM or by an AIFM authorised in accordance with the AIFMD.

A Luxembourg sub-threshold AIFM is registered with the CSSF and will – on an annual basis – report to the CSSF on the activity of the SCSp managed by the sub-threshold AIFM. Assets under management of a sub-threshold AIFM cannot exceed €100 million. This threshold is increased to €500 million if none of the AIFs managed by the sub-threshold AIFMs are leveraged or grant redemption rights to their investors during a minimum period of five years starting from the date of the first investment.

An AIFM authorised in Luxembourg is authorised by and is under the ongoing supervision of the CSSF and will regularly report to the CSSF on the activity of the SCSp managed by the authorised AIFM. Consequently, even though the credit fund is not directly regulated by the CSSF, there is an indirect supervision of the unregulated credit fund through the registration or supervision of the Luxembourg AIFM of this regulated credit fund.

Formation process

5 What is the process for forming a credit fund vehicle in your jurisdiction? Are there any practical impediments to speed to market, such as account opening or banking and regulatory permissions?

The formation process depends on the type of credit fund. The fund regime and the corporate form must be considered in this context.

Fund regime considerations

Most Luxembourg credit funds are established within the full scope of the AIFMD and managed by an AIFM authorised in Luxembourg or another member state of the EEA. Generally, these credit funds are either SCSps or RAIFs with a variable capital structure and the form of an SA or an SCA. The timeline to establish such credit funds depends primarily on the legal and operational set-up process as the CSSF's involvement is limited to the management and marketing notifications by the Luxembourg AIFM in accordance with the AIFM Act. Regulatory reporting follows Annex IV of Commission Delegated Regulation (EU) No. 231/2013.

If the credit fund is an RAIF, its constitution (irrespective of the RAIF's legal form) must be recorded in a notarial deed within five working days of its constitution. This deed will also confirm the appointment of the AIFM. Furthermore, RAIFs must be recorded on an official list of RAIFs, which is maintained by the Registre de Commerce et des Sociétés, Luxembourg (RCSL), the Luxembourg Trade and Companies House.

Luxembourg credit funds can also be managed by a sub-threshold AIFM. In this case, the credit fund is often formed as an SCSp whereby the general partner is registered with the CSSF as a sub-threshold AIFM under article 3(3) of the AIFM Act. The registration process with the CSSF of the sub-threshold AIFM might take between two and six months. As the registration process is not an authorisation process, the credit fund can be launched before the registration process of its AIFM has been accomplished. The operational set-up process is easier than for credit funds managed within the full scope of the AIFMD because, among other reasons, the number of interferants is lower (eg, there is no obligation to appoint a depositary) and the regulatory obligations are less stringent. However, credit funds managed by a sub-threshold AIFM do not benefit from the marketing passport under the AIFMD. The sub-threshold AIFM must report to the CSSF on its activity on a yearly basis.

For SIFs (irrespective of whether they are managed within the scope of the AIFMD or exempted from the scope of the AIFMD), an authorisation from the CSSF must be obtained before launching the SIF. For this purpose, an application is filed with the CSSF together with a certain number of documents and forms. Forms to be completed must be downloaded from https://www.cssf.lu/en/authorisation-uci/. Among other things, assessing constitutive documents, issuing documents and contractual arrangements in their draft form will be part of the CSSF's review process. The authorisation process will be closed by the registration of the SIF on the official list of SIFs by the CSSF and the provision of the visa stamp electronically on the issuing document of the SIF.

The minimum capital or net assets of SIFs and RAIFs must be €1.25 million within one year after they have been established.

Corporate form considerations

There is no minimum capital for an SCSp or an SCS. They are established by the execution of a limited partnership agreement under private deed. No public notary

is required. An extract of the limited partnership agreement is deposited with the RCSL and published in the official Luxembourg gazette.

The minimum capital for an SA or an SCA is €30,000. They are formed by a notarial deed. The public notary takes care of the deposit and publication requirements. Contrary to the limited partnership agreement of an SCSp or an SCS, the articles of an SA or an SCA will be published in their entirety.

Substance requirements

6 Is a credit fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, a corporate secretary, employees, professional anti-money laundering (AML) officers or other substance? If so, how is that requirement typically satisfied?

The centre of effective management of any Luxembourg credit fund must be located in Luxembourg. Books and records must be available at the registered office of the credit fund. The SIF Act and the RAIF Act explicitly require that the central administration of the SIF and the RAIF, respectively, must be in Luxembourg.

Where the credit fund is managed by an AIFM authorised in the EEA, a Luxembourg-based depositary must be appointed in accordance with article 19 of the AIFM Act.

Luxembourg credit funds fall within the scope of the act of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the AML Act). In this context, a person among the management body (or the management body as a whole) must be designated to be responsible for compliance with the professional obligations in connection with the AML Act (the original French version refers to a '*responsable du respect des obligations*' and thus the acronym 'RR' is used). In addition, a compliance officer at an appropriate hierarchical level (the original French version refers to a '*responsable du contrôle du respect des obligations*' and thus the acronym 'RC' is used) must be designated for the credit fund. The RC can also be a person employed by a third party (eg, the external AIFM or the administrator).

Access to information

7 What access to information about a private credit fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available? What information (in addition to that available to the general public) are shareholders and limited partners able to see? Is it possible to reduce access rights as a matter of contract?

Credit funds formed as a corporate vehicle (eg, an SIF or an RAIF under the form of an SA or an SCA) typically issue registered shares, in which case a register of shares must be kept at the registered office of the credit fund disclosing the identity of the shareholders. Credit funds formed as partnerships (eg, SCSs or SCSps) must also keep a register of limited partners – the limited partnership agreement

can, however, limit the limited partners' access to the register to their own information and insert any other limitations. In addition to the minimum information to be inserted in the register of shares or the register of limited partners under the Companies Act, there is extensive freedom to structure the register of shares and the register of limited partners.

Except in the case of a private limited liability company, a register of shareholders or limited partners will not be published in the RCSL and consequently will not be available to the public.

However, the register of beneficial owners established under the act of 13 January 2019 on the register of beneficial owners, as amended (the RBO Act), is required to disclose any investor owning or controlling, directly or indirectly, more than 25 per cent of the voting rights, the units or interest in a credit fund. Failing to comply with the obligations under the RBO Act is subject to penalties of up to €1.25 million.

Investor liability

8 In what circumstances would the limited liability of investors in a credit fund formed in your jurisdiction not be respected as a matter of local law? Is there a list of actions in which investors can participate without losing their limited liability?

Exposure of a shareholder of a credit fund formed as a corporate vehicle (eg, an SIF or an RAIF under the form of an SA or an SCA) is limited to its contribution to the credit fund represented by the shares issued by the credit fund for its contribution. Shareholders do not have the right to be involved in the conduct of daily management of the credit fund, which is reserved for the board of directors or the management board (for SAs) or the unlimited managing shareholder. The liability of directors is governed by the Companies Act and the general principle of civil liability under the Luxembourg Civil Code. The unlimited shareholder is jointly and severally liable with the credit fund adopting the form of an SCA (and is therefore generally established as a limited liability company).

Exposure of a limited partner of a credit fund formed as a partnership (ie, an SCS or an SCSp) is limited to its contribution to the credit fund, provided that the limited partner is not participating in any action falling within the scope of the external management of the partnership (eg, executing contractual arrangements with third parties on behalf of the partnership). The limited partner may, however, participate in the internal management of the partnership by, for instance, participating in the limited partners' advisory committee. Conduct of daily management, including actions falling within the scope of external management of the partnership, is reserved for the managing general partner, which is jointly and severally liable with the partnership. If a limited partner undertakes an action of external management, the limited partner will also become jointly and severally liable with the partnership.

Fund manager's fiduciary duties

9 What are the fiduciary duties owed to a credit fund formed in your jurisdiction and its third-party investors by that fund's manager, investment adviser or other similar control party or fiduciary? To what extent can those fiduciary duties be modified by agreement of the parties?

Luxembourg credit funds are, in principle, managed by the AIFM. The duties of the AIFM are determined in the contractual arrangement appointing the AIFM and must, for AIFMs authorised in the EEA, comply with the requirements under the AIFMD.

In addition, the Luxembourg Civil Code requires contractual obligations to be assumed to be in good faith.

Gross negligence

10 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'simple negligence') standard of liability applicable to the management of a credit fund? If so, how does this standard differ from a simple negligence standard?

Gross negligence is deemed as intentional fault or fraud. It sustains that, contrary to the liability for simple negligence, the liability for gross negligence can contractually not be excluded or limited.

In Luxembourg civil liability, reference is made to the concept of a prudent salaried agent extensively developed by case law. To determine whether a fault can be recognised within the management of the credit fund, the court will assess whether it might reasonably be considered that the management of any other credit funds put under the same circumstances would have defaulted in the same way.

Other special issues or requirements

11 Are there any other special issues or requirements particular to credit fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling vehicles formed in other jurisdictions into vehicles in your jurisdiction, what are the most material terms that typically must be modified and how common is this process? How long does it typically take?

There are no specific rules applicable for credit funds only – where applicable, the requirements under the AIFM Act, the relevant fund regime and the Companies Act apply irrespective of whether the fund is pursuing an investment strategy focused on debt or lending activity or on other asset classes.

Re-domiciliation of a credit fund to Luxembourg primarily depends on the legal form and the applicable fund regime (eg, if the credit fund will become subject to the SIF Act, an authorisation will be required from the CSSF).

It is also possible to change the fund regime (eg, from an SIF to an RAIF or vice versa) or the legal form whereby a conversion within an SCSp will cause the loss of the legal personality.

Fund sponsor insolvency or change of control

12 With respect to institutional sponsors of credit funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the credit fund and its general partner and investment manager or adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the credit fund's sponsor?

Sponsorship of a credit fund is not a legal concept in Luxembourg law. For credit funds subject to the authorisation of the CSSF (eg, SIFs), the CSSF will require documents and information on the promoter of the credit fund – the promoter is generally defined as the entity or the persons initiating the creation of the credit fund and that is often represented in the management body of the credit fund. White label AIFMs follow a similar approach to the CSSF when onboarding credit funds, irrespective of the applicable fund regime.

Changes affecting the good standing and the ownership of the promoter will have to be reported but do not, in principle, have a direct statutory or contractual impact on the credit fund itself.

REGULATION, LICENSING AND REGISTRATION

Principal legislation and regulatory bodies

13 What principal legislation governs credit funds in your jurisdiction? Which regulatory bodies have authority over credit funds and its managers and investment advisers in your jurisdiction? What are the regulators' audit and inspection rights?

There is no specific fund regime for private credit funds in Luxembourg. Any alternative investment fund (AIF) can originate loans within the scope of its defined investment strategy, provided that the AIF does not grant loans to the public in the meaning of article 28-4 of the Financial Sector Act, which regulates the activity of professionals carrying on a lending activity to the public for their own account (ie, without taking deposits from the public, such as credit institutions).

As most credit funds are structured as specialised investment funds (SIFs), reserved alternative investment funds (RAIFs) or *société en commandite spéciale* (SCSps), the principal legislation governing Luxembourg credit funds is the Specialised Investment Funds Act (SIF Act), the Reserved Alternative Investment Funds Act (RAIF Act) and the Companies Act.

In addition, the Alternative Investment Fund Managers Act (AIFM Act) and item 22 of the Commission de Surveillance du Secteur Financier (CSSF) FAQ on the Alternative Investment Fund Managers Directive (AIFMD) must be considered for the obligations of Luxembourg AIFMs managing credit funds.

Luxembourg AIFMs and SIFs are directly under the supervision of the CSSF. RAIFs and SCSps not subject to the SIF Act are not under the direct supervision of the CSSF but are indirectly supervised through the supervision of the AIFM that manages these types of credit fund.

Because of their specific nature, AIFs do not generally fall within the scope of the Financial Sector Act, which regulates the professional activity of financial service providers but does not regulate the investment activity of AIFs.

'Public' is not defined in the Financial Sector Act. In practice, loans granted alongside equity participation in the same investments are not considered as a lending activity to the public because these loans are granted to a limited circle of previously determined or identifiable borrowers, whereas 'public' generally refers to a multitude of non-identifiable persons.

In the FAQ on statuses of professionals of the financial sector (PFSs), Part II, the CSSF considers that a lending activity shall not be considered as being directed towards the public where the nominal value of the loans amounts to more than €3 million (or the equivalent amount in another currency), and such loans are exclusively granted to professionals as defined in the Luxembourg Consumer Code.

Article L. 010-1.2) of the Luxembourg Consumer Code defines 'professional' as any legal or natural person, whether public or private, acting for purposes relating to their trade, business, craft or independent profession.

Reporting and disclosure requirements

14 What ongoing reporting and disclosure requirements apply to credit fund managers and investment advisers in your jurisdiction?

There are no specific reporting or disclosure requirements in addition to those that are required under the AIFMD. The CSSF will not be informed of any changes within the investor basis of a Luxembourg credit fund. Under the AIFM Act, however, the CSSF has the right to require from the Luxembourg AIFM information on investors in the AIF managed by the AIFM.

Changes affecting the organisation of a credit fund subject to the SIF Act (eg, a change of a director) must be filed with the CSSF and receive its non-objection.

Fund licensing and registration

15 What governmental approval, licensing or registration requirements apply to credit funds in your jurisdiction?

A Luxembourg credit fund formed under the SIF Act or Part II of the UCI Act must be authorised by the CSSF before starting its investment or lending activities. The approval process will consider, among other things, that the lending activity is not conducted with the public under the meaning of the Financial Sector Act.

Other Luxembourg credit funds, including RAIFs, are not subject to authorisation of the CSSF. The management of these credit funds, however, will be notified by their AIFMs to the competent supervisory authorities of the relevant AIFM.

Registration of investment adviser

16 Is a credit fund's manager or investment adviser (or any of its officers, directors or control persons) required to register as an investment adviser in your jurisdiction? If so, is there a triggering activity for such registration?

Luxembourg-based investment advisers appointed to advise an AIFM of a Luxembourg credit fund do not fall within the scope of the Markets in Financial Instruments Directive (MiFID) if the advice is not in connection with financial instruments as defined under MiFID. In this case, the investment adviser must have a business licence (unless one of the exemptions under the Luxembourg act of 2 September 2011 regulating access to the professions of craftsman, trader, industrialist and certain liberal professions applies).

Luxembourg-based investment fund managers must be regulated either as an investment firm under the Financial Sector Act – in which case they act as a delegate of the AIFM of the credit fund – or as an AIFM.

Fund manager and investment adviser qualifications

17 Are there any specific qualifications or other requirements imposed on a credit fund's manager, investment adviser or any of its officers, directors or control persons in your jurisdiction?

There is no specific licence required for fund managers or investment advisers of credit funds in Luxembourg. Investment fund managers of Luxembourg credit funds are generally undertaking an activity for which they must be registered or authorised as an AIFM. To be authorised as an AIFM, requirements under Article 2 of the AIFM Act and CSSF Circular 18/698 must be fulfilled. The FAQs from the CSSF on the AIFM Act provide additional guidance for a Luxembourg AIFM managing credit funds. Among other things, the AIFM must provide evidence to the CSSF that it is addressing all aspects and risks on the lending activity through the credit funds and that it consists of proper organisational and governance structures and has the necessary expertise and experience in managing credit funds. Appropriate technical

and human resources with a focus on credit and liquidity risk management will be assessed in this context.

Political contributions

18 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a credit fund's manager or investment adviser or their employees?

There are no specific rules in this regard.

Use of intermediaries and lobbyist registration

19 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a credit fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

There are no specific rules in this regard.

Bank participation

20 Are there any legal or regulatory requirements that specifically apply to banks with respect to investing in or sponsoring credit funds?

From a Luxembourg fund regulation perspective (eg, the RAIF Act and the SIF Act) and from the perspective of the AIFM Act, there are no specific requirements on banks when investing in a Luxembourg credit fund. Banks are, however, subject to their own regulations, which might limit or submit their investments in credit funds to certain conditions.

Anti-money laundering rules

21 What anti-money laundering (AML) rules and regulations apply to credit funds formed in your jurisdiction? Are there any requirements for due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a credit fund or the individual members of the sponsor? What AML requirements apply at the level of the fund? What level of scrutiny is required for AML checks regarding investments?

Luxembourg credit funds fall within the scope of the act of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the AML Act). Consequently, credit funds must identify their investors and borrowers in accordance with the requirements of the AML Act and related regulations and guidelines.

A person within the management body (or the management body as a whole) must be designated to be responsible for compliance with the professional obligations regarding the prevention of money laundering and terrorist financing (the original French version refers to a '*responsable du respect des obligations*' and thus the acronym 'RR' is used). In addition, a compliance officer at an appropriate hierarchical level (the original French version refers to a '*responsable du contrôle du respect des obligations*' and thus the acronym 'RC' is used) must be designated. The RC can also be a person employed by a third party (eg, the external AIFM or the administrator).

TAXATION

Tax obligations and exemptions

22 Is a credit fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Are there any applicable tax exemptions?

Luxembourg credit funds formed as specialised investment funds (SIFs) or reserved alternative investment funds (RAIFs) are subject to specific tax regimes established under the Specialised Investment Funds Act (SIF Act) or the Reserved Alternative Investment Funds Act (RAIF Act), respectively. They are subject to subscription tax, which is 1 per cent of the net asset value of the credit fund per year.

Where the credit fund is a corporate vehicle (eg, a *société anonyme* (SA) or a *société en commandite par actions* (SCA)) under the SIF Act or the RAIF Act, the credit fund benefits from an exemption on any taxation of their profits, whether income or gain.

Where the Luxembourg credit fund is formed as a partnership (ie, a *société en commandite simple* (SCS) or a *société en commandite spéciale* (SCSp)), it is, in principle, transparent from a Luxembourg tax perspective (provided that the credit fund is properly structured to avoid losing its tax transparency).

Attention should furthermore be paid on the reverse hybrid rule. To the extent that a tax-transparent partnership would be treated as a taxable entity by a majority of its investors, the partnership may lose its tax transparency. An exemption exists for qualifying collective investment funds, such as funds established as an SIF or an RAIF.

There are no withholding taxes on distributions to investors.

Tax structuring

23 What range of downstream tax structures are available and commonly used in your jurisdiction to mitigate any tax leakage?

The downstream structure mainly depends on where the investments are located.

Credit funds formed as corporates (eg, SAs or SCAs) are generally subject to the RAIF Act or the SIF Act and consequently subject to the specific tax regime under the RAIF Act or the SIF Act. These credit funds benefit more and more from withholding tax exemption based on double tax treaties or from the free movement of capital within the European Union.

In the case of credit funds formed as partnerships (ie, SCSs or SCSps), assets may be held by a dedicated vehicle, that being an ordinary fully taxable Luxembourg company. The company may largely finance itself by debt whereby the interest will then be offset against its interest revenues. These companies would need to retain their own portion of profits determined by transfer pricing analysis in line with Organisation for Economic Co-operation and Development (OECD) standards. In addition, it is important that such companies have an adequate level of local substance and that their board is actively making its own decisions.

As an alternative option, credit funds may also hold their investments through Luxembourg securitisation vehicles, which are, in principle, fully taxable but for which all payments to investors are tax deductible.

It must be noted, however, that the level of deductibility of interests is limited for above-mentioned dedicated vehicles and securitisation vehicles – debit expenses that exceed the interest revenues are deductible only up to the higher of (1) 30 per cent of their earnings before interest, taxes, depreciation and amortization (EBITDA) or (2) €3 million per annum.

These rules may particularly impact the gain realised on a debt portfolio, notably on distressed debt or more generally on debt acquired with a discount.

Finally, the set-up of an asset holding vehicle shall be organised after due consideration of the limitation to treaty abuse under the principal purposes test, and a downstream structure must be justified by serious economic grounds.

Local taxation of non-resident investors

24 Are non-resident investors in a credit fund subject to taxation or return-filing requirements in your jurisdiction?

In principle, there is no taxation for non-resident investors in a Luxembourg credit fund.

There is also no withholding tax on distributions, and a VAT exemption may apply.

In certain cases, if a Luxembourg company is held through a partnership, a potential gain of such a company may be taxable in Luxembourg.

Finally, Luxembourg applies international exchange of information under the Common Reporting Standard and the Foreign Account Tax Compliance Act.

Local tax authority ruling

25 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a credit fund vehicle formed in your jurisdiction, or the services provided by the investment manager or investment adviser? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Obtaining tax rulings is no longer a common practice in Luxembourg.

Special tax considerations for sponsors

26 Are there any special tax considerations for credit fund sponsors?

Luxembourg has limited specific rules on carry mechanisms. The main specification is that capital gains realised through shares or interest in the credit fund with a carry mechanism with a carry holder being an employee of the Luxembourg AIFM are taxed as capital gains and not as salary.

Management fees may benefit from VAT exemption.

Tax treaties

27 Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to the fund vehicle or any downstream structure?

Luxembourg has signed over 99 double tax treaties with several countries. It should be noted that a corporate investment company with variable capital (a *société d'investissement à capital variable* (SICAV)) benefits from several double tax treaties and is generally considered as tax resident in Luxembourg for domestic purposes but not necessarily for all the double tax treaties. The Luxembourg treaty policy is for the corporate form SICAV to benefit from new double tax treaties.

On the contrary, partnerships (ie, SCSs and SCSps) are not considered as tax resident in Luxembourg and benefit from only a limited number of double tax treaties specifically covering instrument funds.

In light of the implementation of the multilateral instrument to avoid treaty abuse as part of the OECD's Base Erosion and Profit Shifting Project, Luxembourg has opted for the principal purpose test. It is therefore necessary when organising the downstream structure to ensure that the structure is implemented for a valid business rationale.

Other significant tax issues

28 Are there any other significant tax issues relating to credit funds organised in your jurisdiction?

Luxembourg has implemented interest deduction limitation rules in accordance with the EU Anti Tax Avoidance Directive (ATAD 1 and ATAD 2).

Debit interests will be deductible only up to an amount equal to the higher of (1) €3 million or (2) 30 per cent of its EBITDA for any tax period. Therefore, borrowing costs are fully deductible only up to the amount of interest revenues and other economically equivalent taxable income of the taxpayer.

The interest limitation rule especially impacts the non-deductibility of gains on debt portfolios.

In addition, ATAD 2 includes several anti-hybrid provisions, which target the situation whereby a payment under the financial instrument, notably on the downstream structure, leads to deduction without any inclusion at the level of the investors due to a hybrid mismatch or due to a diverging treatment of the fund between the investors and the considered entity. The application of the anti-hybrid rules may in this case limit the deductibility.

The last portion of the anti-hybrid rule took effect as from 1 January 2022 and deals with reverse hybrid mismatches. The notion of reverse hybrid covers entities that are Luxembourg partnerships treated as tax transparent in Luxembourg but considered to be fiscally opaque taxable persons in the country of residence of their partners. In such a case, the partnership may be subject to Luxembourg corporate income tax for the portion of its profits that is not subject to tax in the hands of its investors in Luxembourg or abroad.

SIFs and RAIFs are expected to benefit from an exemption from these rules as well as other collective investment vehicles that are (1) widely held, (2) subject to investor protection rules in Luxembourg and (3) hold a diversified portfolio of securities.

Credit funds formed as corporate vehicles (eg, SAs and SCAs) are, in principle, not impacted by these anti-hybrid rules.

OFFERING, SELLING AND INVESTMENT RESTRICTIONS

Offer and sale

29 What principal legal and regulatory restrictions apply to offers and sales of interests in credit funds formed in your jurisdiction, including the type of investors to whom such funds may be offered without registration under applicable securities laws?

Luxembourg credit funds managed by an alternative investment fund manager (AIFM) authorised in the European Economic Area (EEA) can be marketed to professional investors (the Professional Investor) within the EEA under the passport regime of the Alternative Investment Fund Managers Directive (AIFMD) subject to the accomplishment of the required marketing notifications. The definition of 'professional investor' refers to 'professional client' in Directive 2014/65/EU, the Markets in Financial Instruments Directive (MiFID).

As the passport under the AIFMD is denied for credit funds managed by sub-threshold AIFMs, these credit funds can be marketed only within the limits of the applicable national private placement regime.

Types of investor and investment

30 Are there any restrictions on the types of investors that may participate in credit funds or the types of investments that may be held by credit funds formed in your jurisdiction?

There are no specific restrictions on the type of investors that can participate in a Luxembourg credit fund. However, for credit funds that are formed as specialised investment funds (SIFs) or reserved alternative investment funds (RAIFs), only well-informed investors as defined in the Specialised Investment Funds Act (SIF Act) and in the Reserved Alternative Investment Funds Act (RAIF Act), respectively (the Well-Informed Investors), can be admitted. Any Professional Investor qualifies as a Well-Informed Investor. In addition, certain institutional investors that do not qualify as a Professional Investor, such as family estate companies, are considered to be Well-Informed Investors. Finally, any investor that confirms in writing to be a Well-Informed Investor and either invests (or commits to invest) a minimum of €125,000 or obtains a certificate delivered by a credit institution under Directive 2006/48/EC, an investment firm under MiFID or a management company under Directive 2001/107/EC certifying its expertise, experience and knowledge to adequately appraise an investment in the SIF or the RAIF is eligible under the SIF Act or the RAIF Act to invest in the SIF or the RAIF, respectively. For RAIFs, this certificate can also be delivered by an AIFM authorised in the EEA.

In the absence of any specific statutory provisions, the administrative practice of the supervisory authority for the financial sector in Luxembourg, the Commission de Surveillance du Secteur Financier, considers that only Professional Investors can be admitted to Luxembourg credit funds under the form of an SCSp or an SCS that

does not qualify as an SIF or an RAIF. This administrative practice applies to credit funds managed by registered AIFMs and authorised AIFMs.

EXCHANGE LISTING AND SECONDARIES

Listing

31 Are credit funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing? Are there any restrictions on the type of vehicle or the terms of the credit fund that is seeking a listing?

As for other types of funds, credit funds may be listed on the Luxembourg Stock Exchange (LuxSE). The LuxSE operates in two markets: (1) the Bourse de Luxembourg (BdL) market, which qualifies as a regulated market under the Markets in Financial Instruments Directive, and (2) the Euro MTF, which is the multilateral trading facility of LuxSE. Both trading platforms are accessible to credit funds, provided that they fulfil the conditions for listing and trading.

Listing on LuxSE may be sought for various reasons, including for liquidity purposes (although there is no guarantee that the secondary market will develop) or to allow certain investors to invest in the credit fund as the securities will be listed in line with their specific investment criteria.

Listing on BdL requires the submission of a listing prospectus to the Commission de Surveillance du Secteur Financier (CSSF), which is the competent authority to review and approve the listing prospectus. LuxSE is the competent authority to review and approve the prospectus that will be required for listing on Euro MTF. Once the listing prospectus has been approved by the CSSF or the LuxSE, respectively, the credit fund will be listed and admitted to trading on the relevant market.

To be listed on BdL or Euro MTF, shares or units of the credit fund must be active and have a net asset value. They must furthermore be eligible for clearing and settlement (eg, Clearstream or Euroclear) and they must be freely transferable.

Listed credit funds will have to comply with certain reporting obligations under their applicable sectorial laws, EU transparency requirements, and specific rules and regulations of LuxSE. These ongoing obligations will differ depending on whether they are listed on the BdL or the Euro MTF.

Restriction on transfers of interests

32 To what extent can a listed fund restrict transfers of its interests?

One of the main conditions for shares or units of a credit fund to be listed on LuxSE is that the shares or units are freely transferable and consequently the transfer of these shares and units after they have been listed can, in principle, not be restricted.

Transferring listed shares or units to a person not authorised to hold them under the terms of the fund (eg, a non-professional investor) shall be effective. To avoid the violation of any restrictions in the fund documents, the fund documents should include a mechanism providing that shares or units held by non-eligible investors shall be compulsorily redeemed by the fund.

It should be noted, however, that LuxSE has established professional segments for the trading of securities between professional investors only, in relation to both the BdL and the Euro MTF. Securities that are admitted for trading in these segments will not be accessible to retail investors.

Secondary transactions

33 Can interests in a private credit fund established in your jurisdiction be transferred between investors? If so, are these typically subject to any contractual or regulatory conditions?

Luxembourg credit funds documents may include specific provisions to organise the transfer of shares, units or interest of the credit fund between its investors. In practice, however, documents include general provisions on the transfer, including to third parties, and on submitting the transfer for the consent of the board (for SAs), to the unlimited managing shareholder (for SCAs) or to the managing general partner (for SCSs and SCSps).

PARTICIPATION IN PRIVATE CREDIT TRANSACTIONS

Legal and regulatory restrictions

34 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private credit transactions or otherwise affect the structuring of private credit transactions completed inside or outside your jurisdiction? Can a private credit fund hold non-loan or non-debt investments and, if so, are such holdings subject to any restrictions? Is a private credit fund established in your jurisdiction subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrowers?

Luxembourg credit funds are not subject to specific legal or regulatory restrictions limiting their participation in private credit transactions, provided that they do not undertake any lending to the public within the meaning of the Financial Sector Act.

The investment policy of any Luxembourg credit fund may include the possibility to hold non-loan or non-debt investments.

Where the credit fund is a reserved alternative investment fund (RAIF) or a specialised investment fund (SIF), its investments are subject to risk spreading. Generally, the exposure to a single loan or borrower shall not exceed 30 per cent of the assets of the credit fund after a ramp-up period to be determined in the issuing document.

A credit fund is not prevented from participating in any creditors' committee, provided that such participation is in relation to its investments.

Use of leverage

35 Are there any legal or practical restrictions on funds formed in your jurisdiction having a subscription line (and providing security over investor interests) or having true leverage (and asset level security) in the fund?

There are no legal or regulatory constraints for a credit fund to use subscription lines. It should be noted that sub-threshold alternative investment fund managers (AIFMs) benefiting from the threshold of assets under management of €500 million are not permitted to use any leverage that is not temporary in nature and that cannot be covered by undrawn commitments from investors.

There are no specific legal or regulatory constraints for a credit fund to use leverage, provided that the combination of borrowing and lending by the credit fund falls within the activity of a credit institution under the Financial Sector Act. In practice, fund documents of Luxembourg credit funds limit leverage on 30 per cent of the assets under management following the administrative practice of the supervisory authority for the financial sector in Luxembourg, the Commission de Surveillance du Secteur Financier (CSSF), for credit funds formed as SIFs.

Compensation and profit sharing

36 Are there any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund? Is there anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund?

Determination of management fees, transaction fees and carried interest arrangements is a contractual matter and can be implemented in any type of Luxembourg credit fund. There are no specific legal or regulatory constraints other than those that are required for AIFMs and their delegates in the context of the remuneration policy under the Alternative Investment Fund Managers Directive. For regulated AIFs (eg, SIFs), the CSSF will review fees and carried interest arrangements in the approval process on a case-by-case basis.

UPDATE AND TRENDS

Key developments of the past year

37 What are the most significant recent trends and developments relating to credit funds in your jurisdiction? What impact do you expect such trends and developments will have on global credit fundraising and on credit funds generally?

In 2021, the supervisory authority for the financial sector in Luxembourg, the Commission de Surveillance du Secteur Financier (CSSF), further clarified its interpretation of lending to the public under the meaning of the Financial Sector Act, providing further regulatory certainty on lending activities of Luxembourg credit funds.

Other key developments affecting Luxembourg credit funds are recent tax developments (eg, the Anti Tax Avoidance Directive), even though those developments also affect Luxembourg alternative investments funds (AIFs) following strategies in other asset classes for private debt and non-Luxembourg AIFs with a focus on private debt strategies.

Finally, the Luxembourg securitisation regime was reformed by the adoption of the act of 25 February 2022 amending the act of 22 March 2004 on securitisation. The intention was to increase the appeal of Luxembourg securitisation vehicles that may also be used in combination with a credit fund.

Luxembourg will continue to be one of the major locations of credit funds.

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MARKET AND POLICY CLIMATE

Market snapshot

1 How would you generally describe the state of the market for private credit funds in your jurisdiction?

Although the United Kingdom is a key location for fund sponsors, it has not been a key jurisdiction for the establishment of private credit funds. This is in part due to other similarly situated jurisdictions, notably Luxembourg, offering more favourable tax treatment for fund structures (including, in particular, a VAT exemption for management fees) and, perhaps, in part due to other jurisdictions historically having more heavily promoted their local fund regimes overseas.

More commonly, UK feeder funds are established specifically to target UK investors (generally pension funds) to access private credit strategies through master funds established in a different jurisdiction.

Although the UK has not previously been the go-to jurisdiction for establishing private credit funds, a large number of fund sponsors (including credit fund sponsors) are located in the UK. The UK asset management industry is the largest in Europe and the second largest globally with around £11 trillion of assets under management. In terms of private credit specifically, the UK ranks second behind the United States in terms of the proportion of the 100 largest credit managers that it houses. London is also the second-ranked city globally for fundraising in the private debt space and the first in Europe. Following Brexit, the UK government is now assessing how it can make the UK a more attractive jurisdiction for funds going forwards.

Government and regulatory policy

2 How would you describe the general government and regulatory policy towards credit funds in your jurisdiction?

The UK government is seeking to strengthen the international competitiveness of the UK funds regime while upholding the UK's current high standards of regulation, and it is anticipated that private credit, as well as other asset classes, will

benefit from this initiative. At the 2020 budget, the UK government announced a wide-ranging review of the UK funds regime covering tax and regulation aimed at making the UK a more attractive location in which to set up, manage and administer funds. Following feedback from key industry stakeholders, the government has stated its aim to (1) make the taxation of UK funds simpler and more efficient and (2) explore the opportunity to support the wider funds environment, including promoting the UK funds regime abroad. Further consideration has also been given to the VAT treatment of fund management fees, which is currently a barrier to the establishment of UK private funds, and a consultation on this will be published in the coming months. This is not expected to result in a VAT zero rate for management fees but will explore other options to improve and simplify the UK VAT regime.

To date, the UK has not sought to regulate commercial lending activities (although consumer credit and home finance lending activities are generally subject to regulation in the UK). However, the operation of credit fund structures in or from the UK would be subject to ordinary UK funds regulation depending on the type of fund structure. For example, a UK firm managing an unregulated credit fund in or from the UK would normally be required to be regulated by the Financial Conduct Authority as an alternative investment fund manager.

FORMATION AND MANAGEMENT

Forms of vehicle

3 What legal form of vehicle is typically used for credit funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? Is it possible to create umbrella structures that permit the creation of sub-funds? What are the legal consequences for investors, managers and investment advisers in respect of each of these structures?

The form of vehicle used to establish credit funds in the UK depends on whether the fund is intended to be marketed on a private placement basis, where a limited partnership is generally used, or whether the intention is to list the vehicle on the London Stock Exchange (LSE), where a corporate vehicle (eg, a public limited company or an investment trust) is used (see the separate section below on listing).

The dominant fund vehicle in the UK for private investment funds, including credit funds, is the limited partnership. Limited partnerships are governed by the Limited Partnerships Act 1907 (the 1907 Act), the Partnership Act 1890 (the 1890 Act) and common law. Since 2017, a limited partnership may also be designated as a private fund limited partnership (PFLP) pursuant to the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514) (the PFLP Order).

The PFLP, as the name suggests, was introduced to make the limited partnership more attractive to fund sponsors and to better compete with similar vehicles in other jurisdictions. A limited partnership may be designated as a PFLP only if satisfies the private fund conditions – that is, it is both constituted by an agreement

in writing and a collective investment scheme, as defined in section 235 of the Financial Services and Markets Act 2000, as amended (the FSMA). Most investment funds will meet the above criteria and the PFLP is now the preferred form of limited partnership for fund sponsors.

Limited partnerships can be established in both England and Scotland. English limited partnerships are generally used to establish investment funds, whereas Scottish limited partnerships are often used as carry vehicles. Unlike an English limited partnership, which has no legal personality and must therefore act by its general partner (GP) or manager, a Scottish limited partnership does have legal personality and can act in its own right.

Any limited partnership in the UK requires a GP and at least one limited partner (LP). The GP is responsible for the management of the limited partnership and the LPs are the passive investors.

A PFLP's structure differs from the ordinary limited partnership structure in the following areas:

- certain duties applicable to partners under the 1890 Act have been disapplied – for example, an LP in a PFLP does not have a duty to render accounts and information to other partners or a duty to account for profits made in competing businesses;
- the PFLP Order includes a non-exhaustive list of activities that an LP may be allowed to undertake without being considered as taking part in management; and
- some of the outdated administrative requirements have been removed, including those in respect of the following:

    - notice of assignment: the requirement to publish a notice in the London Gazette where an LP assigns its interest to another party has been removed. However, notice of the removal of a GP or a GP becoming an LP will still need to be published; and
    - winding up: LPs may agree among themselves as to who will wind up the PFLP without the time and expense of seeking a court order (other UK limited partnerships require a court order where a GP is not able to effect the winding up).

A GP has unlimited liability and is liable for the debts and obligations of the limited partnership. Due to the GP's unlimited liability, a separate GP is usually established for each limited partnership to ring-fence any potential liabilities. An LP's liability is limited to its capital contribution, provided that the LP is 'not taking part in the management of the partnership business'.

Currently, there is no legal or regulatory requirement for a limited partnership to maintain its principal place of business in the UK, and this may be migrated offshore through the GP transferring its interest to a GP located in a different jurisdiction. Such GP migration is commonly seen where the fund sponsor wishes to move the fund outside of the UK for VAT reasons. Once the GP has been migrated outside of the UK, the limited partnership will no longer be classed as a UK fund, and many

of the provisions relating to UK funds will no longer apply (eg, the appointment of a UK alternative investment fund manager (AIFM) as noted below).

UK private credit funds will be alternative investment funds (AIFs) for the purposes of the Alternative Investment Fund Managers Regulations 2013 (SI 2013/1773) as amended by the Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/328) (the UK AIFM Regulations) and must appoint a UK authorised AIFM. The UK GP could apply to the Financial Conduct Authority (FCA) to become an AIFM in order to manage the limited partnership. However, due to the costs and time involved and the fact that the GP usually acts for one fund only, this is rare and the GP usually appoints either an AIFM from the sponsor group or an external (third-party) AIFM to manage the fund.

Unlike some jurisdictions, it is not currently possible to structure a PFLP as an umbrella structure.

It is also not possible to structure a private credit fund as a UK authorised fund.

Unregulated fund vehicles

4 Can the fund vehicle be unregulated? If so, does this affect the ability to originate loans or otherwise execute its investment strategy?

Private credit funds are not required to be authorised by the FCA. However, to the extent that the GP has not been migrated offshore, the fund must be managed by a UK AIFM, which is regulated by the FCA.

Formation process

5 What is the process for forming a credit fund vehicle in your jurisdiction? Are there any practical impediments to speed to market, such as account opening or banking and regulatory permissions?

Establishing a limited partnership in the UK is a fairly quick process.

A GP and at least one LP are required to form a limited partnership by filing with Companies House either (1) a Form LP5 to establish an ordinary limited partnership or (2) a Form LP7 to establish a PFLP. The Form LP7 sets out the name of the fund and its proposed principal place of business and the names of the GP and the LP(s). The Form LP5 captures additional information (eg, GP and LP capital contributions). The limited partnership comes into existence on registration of an acceptable Form LP5 or LP7 and the issuance of a certificate of limited partnership. If a limited partnership is designated as a PFLP on the date of its registration, a combined certificate of registration and designation will be issued. The certificate is conclusive evidence that a limited partnership came into existence on the date of registration and, if applicable, designated as a PFLP on such a date. A registration fee of £20 applies and Companies House will usually register a limited partnership within five days of receipt of the application. As of August 2022, same-day registration remains suspended but typically incurs a fee of £100. If the limited partnership

is established as a PFLP, then, once designated as a PFLP, it cannot opt out of the regime.

To be a PFLP the limited partnership must be constituted in writing and a limited partnership agreement (LPA) is entered into by the GP and the LP(s) setting out the terms of the partnership, although the LPA itself does not need to be filed with Companies House and is not a public record. An LPA is also entered into for an ordinary limited partnership to agree the terms of its operation and to override any default provisions under the 1890 Act that would otherwise apply.

Any changes to the information submitted on the Form LP5 or Form LP7 must be notified to Companies House within seven days of the change taking place by filing a Form LP6. There is no filing fee relating to the filing of Form LP6. However, a late notification fine may be levied against the GP of £1 per day from the deadline for making the notification until the notification of such a change is reported.

As is noted above, the limited partnership will be classified as an AIF under the UK AIFM Regulations and, for as long as the GP remains in the UK, a depositary, an auditor and a UK AIFM will need to be appointed by the GP.

The AIFM will need to notify the FCA that it has a new AIF under management and include details on any outsourcing arrangement (eg, those services that would be provided by an AIFM pursuant to Annex I of the Alternative Investment Fund Managers Directive, Directive 2011/61/EU (AIFMD) that have been delegated to a third party, such as a portfolio manager or an administrator). The notification should be submitted to the FCA at least one month prior to the AIFM commencing management of the AIF.

A limited partnership does not have a minimum capital requirement. However, the AIFM will need to comply with its own capital requirements set out in the Collective Portfolio Management Firms and Collective Portfolio Management Investment Firms (IPRU-INV) section of the FCA's handbook of rules and guidance (the FCA Handbook). A full-scope UK AIFM is required to have initial capital of (1) €125,000 plus (2) 0.02 per cent of the assets under management (AUM) of the AIFs it manages in excess of €250 million, subject to a cap of €10 million. An AIFM must also hold own funds of at least one quarter of the fixed overheads of the preceding year. In addition, full-scope AIFMs must either (1) have professional indemnity insurance or (2) have additional own funds appropriate to cover risks arising from professional negligence (being at least 0.01 per cent of the AUM of AIFs managed). To the extent that the AIFM also carries out services subject to Directive 2014/65/EU on the markets in financial instruments (MiFID II) and as such is a collective portfolio management investment firm for FCA purposes, it is required to comply with the MIFIDPRU section in the FCA Handbook in parallel with its requirements under IPRU-INV 11. This means that a capital instrument or liquid asset may be used to meet either or both sets of requirements provided that it meets the conditions set out in the relevant sourcebook.

Substance requirements

6 Is a credit fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, a corporate secretary, employees, professional anti-money laundering (AML) officers or other substance? If so, how is that requirement typically satisfied?

At the time of its formation, a limited partnership is required to have its principal place of business in the UK, which will be the place from which the central control and management of the firm are carried on (ie, where the GP is located). The books and records are kept at the principal place of business, unless otherwise agreed between the partners. However, as is noted above, the GP can be migrated offshore.

As a credit fund will be an AIF, for as long as the GP remains in the UK it will be required to appoint a UK depositary that is authorised by the Prudential Regulation Authority or the FCA. There is no requirement to appoint a UK-based administrator.

An anti-money laundering officer is not required to be appointed to the fund itself. However, as is noted below, a UK AIFM will be required to appoint a money laundering reporting officer who is required to maintain oversight of the AIFM's anti-money laundering responsibilities, including any funds managed by the AIFM.

Access to information

7 What access to information about a private credit fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available? What information (in addition to that available to the general public) are shareholders and limited partners able to see? Is it possible to reduce access rights as a matter of contract?

Limited partnerships are required to be registered with Companies House, which maintains the register of limited partnerships. The names of the LPs are required to be included on Companies House filing records (ie, Form LP5/LP6 or LP7). For a PFLP, it is not required to include the capital contribution of each LP. However, this is still required for an ordinary limited partnership. Companies House filings are public records and can be obtained from the Companies House website. In addition, for an ordinary limited partnership, any changes to the limited partners (eg, through a transfer of interest or an increase in capital contribution) is required to be published in the London Gazette.

There is no legal requirement to maintain a separate register of a limited partnership, although, in practice, the GP or the administrator will maintain these on behalf of the limited partnership.

LPs do have a statutory right to inspect the books of the firm and examine the state and prospects of the partnership business. The GP should maintain full and accurate books of the partnership to fulfil this requirement. However, there is no

specific form or set of documents that is prescribed to be maintained. If a GP does not maintain sufficient information for an LP to examine the state and prospects of the partnership, then an LP may inspect the primary documents in the possession of the GP (or its delegate) from which such partnership books and records ought to have been created.

If a limited partnership falls within the definition of a 'qualifying partnership' pursuant to the Partnerships (Accounts) Regulations 2008, as amended by the Companies and Partnerships (Accounts and Audit) Regulations 2013, this will require the accounts of the limited partnership to be made publicly available. As such, if the limited partnership has a GP that has been established as a limited company, it will be a qualifying partnership. For a GP established in the UK, the GP will be required to append the accounts of the limited partnership to its own accounts and file these with Companies House on the public record (unless the accounts of the qualifying partnership have been dealt with on a consolidated basis in the audited financial statements of a parent undertaking incorporated in a European Economic Area member state). If, however, the GP has been migrated offshore, the accounts must be made publicly available at either the UK place of business of the GP or, if no such place exists, a nominated UK address. To fall outside the definition of a qualifying partnership and not make the accounts publicly available, it might be possible to introduce a second GP established as a UK limited liability partnership. However, this adds further complexity and costs to the fund structure.

Investor liability

8 In what circumstances would the limited liability of investors in a credit fund formed in your jurisdiction not be respected as a matter of local law? Is there a list of actions in which investors can participate without losing their limited liability?

An LP retains its limited liability provided that it does not take part in the management of the partnership business; otherwise, the LP will be liable for all debts and obligations of the firm incurred for as long as the LP takes part in the management as though it were a GP.

To provide LPs with guidance as to what are permissible activities in respect of a PFLP, the PFLP Order introduces a list of activities that LPs in a PFLP can undertake without losing their limited liability status (provided that such activities are allowed under the relevant LPA). The list is non-exhaustive and covers many of the activities commonly undertaken by LPs under an LPA (eg, taking part in a decision about whether the partnership should end or whether the term of the partnership should be extended, taking part in a decision regarding changes in the persons responsible for the day-to-day management of the partnership, serving on an LP advisory committee or taking part in a decision about varying the terms of the LPA). The list also introduces a safe harbour for members and employees of a manager who are themselves investing in a PFLP as part of the GP commitment (or similar arrangement).

There is no specific guidance as to what constitutes taking part in management for an ordinary limited partnership, and the list of permitted activities provided in the PFLP Order cannot be relied on to provide similar comfort for LPs in a limited partnership that is not a PFLP.

Fund manager's fiduciary duties

9 What are the fiduciary duties owed to a credit fund formed in your jurisdiction and its third-party investors by that fund's manager, investment adviser or other similar control party or fiduciary? To what extent can those fiduciary duties be modified by agreement of the parties?

Each of the partners in a limited partnership owes to the others a duty of honesty and good faith in relation to the partnership business. Accordingly, a GP must exercise its duty to manage the limited partnership's business with the utmost good faith. In addition, the AIFMD imposes a fiduciary duty on the UK AIFM and the depositary to act honestly, fairly, professionally, independently and in the interest of the AIF and the investors of the AIF. Under English law, it is possible to contractually agree on the scope of fiduciary duties. However, any limitation of such fiduciary duties must be within the limits imposed by the common law and cannot exclude liability for such things as a deliberate breach of fiduciary duty, fraud or bad faith.

Gross negligence

10 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'simple negligence') standard of liability applicable to the management of a credit fund? If so, how does this standard differ from a simple negligence standard?

There is no concept of 'gross negligence' under English contract law. However, the courts will interpret the relevant contractual arrangement to give effect to the intentions of the parties. As such, gross negligence may be interpreted as being more serious than simple negligence, although it will be determined on a case-by-case basis.

Other special issues or requirements

11 Are there any other special issues or requirements particular to credit fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling vehicles formed in other jurisdictions into vehicles in your jurisdiction, what are the most material terms that typically must be modified and how common is this process? How long does it typically take?

There are no special issues particular to credit funds formed in the UK.

It is not currently possible to redomicile funds from other jurisdictions into a limited partnership in the UK.

Fund sponsor insolvency or change of control

12 With respect to institutional sponsors of credit funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the credit fund and its general partner and investment manager or adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the credit fund's sponsor?

A limited partnership cannot exist without a GP. Therefore, upon the insolvency of the GP, unless replaced, the limited partnership must be dissolved. An LPA will generally include contractual provisions relating to the circumstances in which the limited partnership may be continued or dissolved in such circumstances.

Also, as long as the GP remains in the UK, as a UK AIF, the limited partnership must have a UK AIFM. If the UK AIFM becomes insolvent, the GP must appoint a replacement UK AIFM.

The 1907 Act allows the assignment of a GP's share without the consent of the LPs. However, it is common to include a contractual provision in the LPA to constrain the GP from transferring its rights and obligations as a GP in certain circumstances (eg, if the GP is no longer part of the sponsor group).

A UK AIFM, as an entity regulated by the FCA, will be subject to the FCA's change in control provisions. Any entity with a holding of 20 per cent or more of the shares or voting rights in the AIFM or any of its parent undertakings will be deemed to be a controller and must be pre-approved by the FCA.

REGULATION, LICENSING AND REGISTRATION

Principal legislation and regulatory bodies

13 What principal legislation governs credit funds in your jurisdiction? Which regulatory bodies have authority over credit funds and its managers and investment advisers in your jurisdiction? What are the regulators' audit and inspection rights?

Credit funds and alternative investment fund managers (AIFMs) in the UK are governed by the Financial Services and Markets Act 2000 (the FSMA), the Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/328) (the UK AIFM Regulations) and the FCA Handbook. The Financial Conduct Authority (FCA) is the regulatory conduct body for financial services firms in the UK.

The FSMA requires the FCA to maintain arrangements for supervising authorised persons, which includes AIFMs. The FCA's audit and inspection rights are set out in the supervision (SUP) section of the FCA Handbook and include:

- access to business premises (with or without notice);

- access to documents (which includes information recorded in any form), records, files, tapes or computer systems that are within the firm's possession or control; and
- access to personnel (including employees, agents and other members from within the firm's group).

In addition to the above, the FCA also expects firms to regularly report to it through the filing of certain prescribed information, including an annual controllers report, annual close links report and annual report and accounts, among other things.

Reporting and disclosure requirements

14 What ongoing reporting and disclosure requirements apply to credit fund managers and investment advisers in your jurisdiction?

As an alternative investment fund (AIF), the AIFM is required to provide certain information set out in Article 23 of the AFMD to investors before they invest in the AIF. The AIFM is also required to update that information when it is changed to a material extent. This information is usually contained in the offering memorandum of the fund, although it is common to see a separate document that sets out where the relevant information can be found.

The AIFM must disclose certain information periodically to investors (eg, the percentage of the AIF's assets that are subject to special arrangements arising from their illiquid nature, any new arrangements for managing the liquidity of an AIF, and the current risk profile of the AIF and risk management systems employed by the AIFM to manage those risks). The FCA also has specific rules in relation to the disclosure of leverage. In particular, an AIFM must disclose on a 'regular basis' any changes to the maximum level of leverage that the AIFM may employ on behalf of the AIF and any right of reuse of collateral or any guarantee granted under the leveraging arrangements, and the total amount of leverage employed by that AIF.

The AIFM must also include certain disclosures in the annual report of the AIF, including any material changes to the information that is required to be disclosed to the investors and information on remuneration paid to the AIFM.

In addition to the annual report and investor information disclosures, an AIFM must also regularly report to the FCA on behalf of the AIFs they manage (commonly known as Annex IV reporting). The frequency of this reporting is dependent on the assets under management of the AIFs managed and can be required on a quarterly, semi-annual or annual basis. Although information about the AIFs is submitted to the FCA, the identity of the investors does not need to be reported.

The AIFM must also inform the FCA if there any material changes to the AIF, including a change in the AIFM itself, the depositary and any outsourcing or delegation arrangement. Such information is submitted to the FCA through a material change notification.

To the extent that the general partner (GP) has been migrated offshore and the limited partnership is no longer classed as a UK fund for the purposes of the UK AIFM Regulations, the above would also apply should the limited partnership be qualified for marketing in the UK pursuant to the Alternative Investment Fund Managers Directive national private placement regime. In such cases, the AIFM would be the entity responsible for the portfolio and risk management for the fund, which could be the offshore GP or the investment manager.

Fund licensing and registration

15 What governmental approval, licensing or registration requirements apply to credit funds in your jurisdiction?

There are no specific registration requirements that apply to a credit fund; it is the UK AIFM that is subject to regulatory authorisation.

Registration of investment adviser

16 Is a credit fund's manager or investment adviser (or any of its officers, directors or control persons) required to register as an investment adviser in your jurisdiction? If so, is there a triggering activity for such registration?

Managing an AIF is a regulated activity in the UK and, if the GP appoints a UK AIFM, that AIFM needs to be authorised by the FCA.

The type of AIFM authorisation depends on the amount of assets under management, with an AIFM that manages portfolios of AIFs whose assets under management, including any assets acquired through use of leverage, in total exceed a threshold of €100 million, or that manages AIFs whose assets under management in total exceed a threshold of €500 million when the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF, is required to be authorised as a full-scope UK AIFM. AIFM's managing AIFs below the above thresholds can also opt to become a full-scope UK AIFM. Full-scope AIFMs are subject to the full requirements of the UK AIFM Regulations.

Fund manager and investment adviser qualifications

17 Are there any specific qualifications or other requirements imposed on a credit fund's manager, investment adviser or any of its officers, directors or control persons in your jurisdiction?

All FCA-authorised firms are subject to the Senior Managers and Certification Regime (SM&CR). The SM&CR sets a standard of conduct to ensure (1) greater personal accountability at all levels within the firm, (2) minimum standards of conduct and (3) that staff in key jobs are fit and proper to perform their roles.

Under the SM&CR, 'senior managers' are individuals who perform one of the senior management functions designated by the FCA (eg, chief executive, partner, money laundering reporting officer or compliance oversight). Each senior manager must be approved by the FCA to perform senior management functions, and it is the responsibility of the firm making the application to satisfy the FCA that the candidate is a fit and proper person to perform the relevant function. Firms are required to have regard, in particular, to whether the applicant has obtained a qualification, has undergone or is undergoing training, possesses a level of competence or has the personal characteristics (eg, experience) to perform the relevant function.

Each senior manager is subject to a statutory 'duty of responsibility', such that if a firm breaches any FCA requirement, the senior manager responsible for a prescribed function could be held personally accountable if they did not take 'reasonable steps' to prevent or stop the breach.

Political contributions

18 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a credit fund's manager or investment adviser or their employees?

There are no specific 'pay to play' rules or restrictions in the UK that would require a fund sponsor to disclose political contributions made by it or its employees in relation to the credit fund's business. However, the UK does have general rules in respect of the making of political contributions.

Use of intermediaries and lobbyist registration

19 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a credit fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

There are no UK rules specifically related to marketing of credit funds to public pension plans and other governmental entities.

Bank participation

20 Are there any legal or regulatory requirements that specifically apply to banks with respect to investing in or sponsoring credit funds?

There are no legal or regulatory requirements that specifically apply to banks in respect of investing in or sponsoring credit funds.

Anti-money laundering rules

21 What anti-money laundering (AML) rules and regulations apply to credit funds formed in your jurisdiction? Are there any requirements for due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a credit fund or the individual members of the sponsor? What AML requirements apply at the level of the fund? What level of scrutiny is required for AML checks regarding investments?

The FCA has responsibility under the FSMA for taking regulatory action to counter financial crime. All UK FCA-authorised firms, including AIFMs, are subject to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2017/692) as amended by the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 (SI 2019/1511) (the MLRs). The amended MLRs incorporate international standards set by the Financial Action Task Force and transpose the European Union's 5th Money Laundering Directive into UK law.

The MLRs form part of the UK's anti-money laundering (AML) and counterterrorist financing (CTF) regime. The MLRs place a general obligation on firms to establish and maintain appropriate and proportionate risk-based policies and procedures to prevent and detect situations where their systems might be at risk of being used in connection with money laundering or terrorist financing. In addition to the MLRs, UK firms must also comply with the Proceeds of Crime Act 2002, which includes any dealing in criminal property; the Terrorism Act 2000 (as amended by the Anti-terrorism, Crime and Security Act 2001), which includes specific obligations to combat terrorist financing; and certain FCA requirements, which are set out in the FCA Handbook.

The MLRs specify customer due diligence (CDD) measures that are required to be carried out, timing of CDD and actions required if these measures are not performed. The MLRs also set out the circumstances in which limited CDD measures are permitted (referred to as 'Simplified Due Diligence'), and those customers and circumstances where enhanced due diligence is required.

As is noted above, one of the senior management functions is that of the money laundering reporting officer, who is responsible for the firm's compliance with the MLRs. The firm may outsource its CDD to a third party (eg, the credit fund's administrator). However, the AIFM remains liable for any failure to apply such measures. As such, the AIFM will need to be satisfied that the administration has in place satisfactory AML and CTF systems, controls and procedures, and that those policies and procedures are kept up to date to reflect changes with UK requirements.

The Joint Money Laundering Steering Group issues guidance to enable firms to comply with their AML and CTF obligations. As the guidance is issued by a private sector body, it is not legally binding. However, it does receive approval from the UK HM Treasury, meaning that firms follow this guidance.

To the extent that the GP is migrated offshore, the AML laws and regulations applicable to the fund in that jurisdiction would apply.

TAXATION

Tax obligations and exemptions

22 Is a credit fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Are there any applicable tax exemptions?

Private credit funds aimed at international investors are not usually established in the UK. The English limited partnership is sometimes used as a feeder vehicle into a master fund or specifically for UK-resident institutional investors on occasion. The limited partnership is tax transparent from a UK tax perspective so that profits arising to the fund are referrable directly to the limited partners and investors in the limited partnership and are not assessable on the limited partnership itself. There are no UK withholding taxes on distributions to investors in the limited partnership except that a limited partnership might be required to withhold UK tax from payments of interest to an investor in respect of a loan made by that investor to the limited partnership. The qualifying asset holding company (QAHC) was launched on 1 April 2022 as a vehicle to be used to hold assets typically as a subsidiary entity of a fund. It is generally not subject to UK corporation tax, except on a small transfer priced amount referable to the limited services it provides and assuming also that it meets the various qualifying conditions. There is a wide exemption from UK withholding tax applicable to the QAHC in respect of interest payments that it might make, and no withholding tax applies to dividend payments.

Tax structuring

23 What range of downstream tax structures are available and commonly used in your jurisdiction to mitigate any tax leakage?

The QAHC has recently become available as a potential downstream vehicle for funds to use to mitigate tax leakage (eg, in relation to withholding taxes that might otherwise arise on interest payments from an underlying debt portfolio). It is eligible to take advantage of the UK's wide range of double taxation treaties provided that the QAHC is the beneficial owner of the interest payments (within the double tax treaty meaning of that term) and relevant anti-avoidance provisions contained within the double tax treaty can be satisfied. Minimal tax leakage should be incurred within the QAHC, limited to a transfer priced amount for the services it provides. The QAHC must meet certain conditions in order to be eligible for the tax advantaged regime, including conditions as to its ownership and its activities (in particular, these should be investment in nature), which may mean that it is not suitable for all credit fund strategies.

Certain funds have held investments through a UK securitisation vehicle within the definition of the Taxation of Securitisation Companies Regulations 2006, which is also entitled to benefit from the UK's double taxation treaty network. Furthermore, such a securitisation vehicle need pay only a minimal amount of UK corporation tax on a specified residual amount of profits as it receives a tax deduction for all payments made by it. However, various conditions need to be fulfilled to qualify as a UK securitisation vehicle within the regulations, and it would typically need to issue funding instruments as part of a capital markets arrangement mainly to independent investors, which usually makes this option either more expensive or inappropriate for many scenarios. Given the new QAHC option, we would expect this to be preferred in most cases.

Local taxation of non-resident investors

24 Are non-resident investors in a credit fund subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors investing into a tax-transparent credit fund would usually be liable to tax in the UK only if they are considered to be trading in the UK through a permanent establishment, which is unlikely to be the case with most credit funds. UK withholding tax would also generally not be applicable in relation to underlying UK credit assets provided that the fund or an underlying downstream entity holds the asset and is either a UK corporate entity or a treaty-entitled entity subject to a full exemption under the treaty. To the extent that any UK source income (such as interest) is subject to UK tax at source, an investor in a limited partnership might be entitled to the benefit of a double taxation treaty between their country and the UK to reduce or eliminate such liability.

Non-resident investors in a limited partnership would not normally be required to file a UK tax return, although the limited partnership itself will usually be required to file a UK partnership return that will include details of income and gains (or losses) allocable to each investor. This may require a non-resident investor to obtain a unique taxpayer reference number from HM Revenue & Customs (HMRC) except where the limited partnership is already providing information about that investor to HMRC through Foreign Account Tax Compliance Act or Common Reporting Standard reporting.

Local tax authority ruling

25 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a credit fund vehicle formed in your jurisdiction, or the services provided by the investment manager or investment adviser? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It would not be usual to obtain a ruling from HMRC in respect of the tax treatment of a credit fund, although it is recognised that there could be situations where seeking confirmation that relevant conditions are satisfied would be advisable if a QAHC is to be used.

Special tax rules may be of relevance to certain institutional UK investors, such as pension funds or charities that might make certain types of funds unattractive or require special structuring. For example, UK pension funds and charities that are usually exempt from UK tax might become liable to tax on any receipts considered to be trading income. In addition, various anti-avoidance rules could be applicable to UK-resident investors in a limited partnership to the extent that it invests in underlying non-UK companies or funds such as the controlled foreign company, offshore fund, attribution of gains (section 3 of the Taxation of Chargeable Gains Act 1992) or attribution of income rules (transfer of assets abroad) and could potentially render such investors liable to tax on undistributed income or gains in certain circumstances.

Special tax considerations for sponsors

26 | Are there any special tax considerations for credit fund sponsors?

UK executives of sponsors might want to consider whether it is possible or appropriate to structure incentive or performance arrangements as carried interest rather than performance fees because rates of taxes on earned income are generally higher than those on investment income or capital gains. This would usually be structured using a carry limited partnership that is admitted as a limited partner of the limited partnership. Each participant's share of the carried interest is delivered through an interest in the carry limited partnership. Given that the returns from the limited partnership will likely be largely income based, it might be difficult to achieve returns in the form of capital gains. In addition, the UK tax rules relating to carried interest have become more complex in recent years, so it will be important to assess whether capital gains treatment can be achieved for any returns that are not in the form of income. It can sometimes be easier to achieve this if the fund is in the form of a partnership and the executive is an employee rather than a partner, although the specifics of each arrangement should be considered carefully. This is because the special income-based carried interest (IBCI) rules contain an exemption for interests held by employees or directors.

The IBCI rules are a set of anti-avoidance rules designed to prevent capital gains treatment applying to executives in respect of funds that (broadly speaking) are not considered to invest on a medium- to long-term basis. If the rules apply, carried interest that is otherwise taxable as a capital gain is instead taxed as deemed trading income. In general, this can apply where the weighted average holding period of fund assets is less than 36 months, although part can also be taxed as income if the period is less than 40 months. There are also special additional rules for loan origination funds that can also lead to the IBCI rules applying.

Although carry participants who are employees or directors enjoy an exemption from the IBCI rules, they will be subject to the special employment-related securities rules and, in this regard, care should be taken to avoid charges by reference to acquisitions of carried interest at an undervalue by complying as far as possible with the British Venture Capital Association and HMRC Memorandum of Understanding and its various conditions and also by making any appropriate section 431 of the Income Tax (Earnings and Pensions) Act 2003 elections.

Care also needs to be taken in relation to co-investment arrangements, which could also lead to inadvertent taxation at income rates under the general disguised investment management fee anti-avoidance rules. However, there is a specific exemption in the rules for genuine arm's-length co-investment arrangements that are essentially on the same terms (with limited exceptions) as other investors in the fund.

Tax treaties

27 Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to the fund vehicle or any downstream structure?

The UK has negotiated a very wide range of double taxation treaties with other countries. Typically, it is difficult to rely on such treaties where the fund is in partnership form, except in limited circumstances. Accordingly, it is more usual for a downstream corporate entity to be formed as a vehicle to hold debt-related assets and it would seek to rely on the UK double tax treaty network to avoid foreign withholding tax (where applicable). This is of course subject to the requirement that the downstream entity is regarded as the beneficial owner of the interest returns (within the meaning of that term for double taxation treaty purposes) and also satisfies any anti-avoidance provisions in the relevant treaty. In addition, an investor in the limited partnership might be able to rely on a treaty between the UK and their home jurisdiction to the extent that they are allocated a share of UK source income or gains (and a UK investor might be able to rely on a UK treaty in relation to underlying non-UK source income or gains).

Other significant tax issues

28 Are there any other significant tax issues relating to credit funds organised in your jurisdiction?

An ongoing concern in relation to the use of limited partnerships is VAT. Typically, any management fees charged to the limited partnership would attract VAT, which would not be recoverable. To the extent that this is a relevant concern in any given structure (as it might be that fees are charged elsewhere in the overall structure if the limited partnership is a feeder fund), consideration could be given to VAT grouping the general partner (GP) of the limited partnership with the investment manager, and having the limited partnership allocate a profit share to the GP to pay the fees. In this way, VAT would not need to be charged on the management fees, although it would likely lead to a loss of VAT recovery for the investment manager. Consideration might also be given to migrating the GP outside the UK as an alternative. The whole topic of VAT in relation to investment management fees is the subject of a consultation exercise as part of the UK funds review process, and it might be that change emerges as a result of this consultation exercise to alleviate this issue.

OFFERING, SELLING AND INVESTMENT RESTRICTIONS

Offer and sale

29 What principal legal and regulatory restrictions apply to offers and sales of interests in credit funds formed in your jurisdiction, including the type of investors to whom such funds may be offered without registration under applicable securities laws?

Marketing of credit funds in the UK needs to comply with two main sets of restrictions: (1) those relating to the marketing of alternative investment funds (AIFs) set out in the Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/328) (the UK AIFM Regulations) (which implement the Alternative Investment Fund Managers Directive (AIFMD) in the UK) and (2) those relating to communications of financial promotion set out in section 21 of the Financial Services and Markets Act 2000 (the FSMA).

Under the UK AIFM Regulations, an AIF may not be marketed in the UK unless the Financial Conduct Authority (FCA) has been notified about its marketing. For a UK AIFM marketing a UK AIF, this notification may be made to the FCA at the same time that it notifies the FCA about the AIF being subject to its management. If a UK AIFM wishes to market a non-UK AIF or a non-UK AIFM wishes to market a non-UK AIF in the UK, then a notification must be submitted to the FCA under the AIFMD national private placement regime.

Marketing under the AIFM Regulations is defined as 'the direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the United Kingdom or Gibraltar'.

Marketing of AIFs under the UK AIFM Regulations is restricted to professional investors or investors that can opt to be professional investors. However, provided that the fund documents permit such marketing, it is possible to market a private credit fund as an AIF to other types of investors in the UK if effected by a person who is an authorised person under the FSMA (eg, the UK AIFM), pursuant to the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 or the rules in section 4.12 of the Conduct of Business Sourcebook of the FCA, or by a person who is not an authorised person under the FSMA pursuant to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. Such persons include (1) persons having professional experience of participating in unregulated collective investment schemes and (2) high net worth bodies corporate, partnerships, unincorporated associations and trusts, etc. If a credit fund is marketed to investors who do not qualify as professional investors and are therefore classed as retail investors within the meaning of the Packaged Retail and Insurance-Based Investment Products (Amendment) (EU Exit) Regulations 2019 in the UK, then a key investor information document will need to be provided to those investors.

Types of investor and investment

30 Are there any restrictions on the types of investors that may participate in credit funds or the types of investments that may be held by credit funds formed in your jurisdiction?

All UK authorised firms, including UK AIFMs, are required to comply with the UK's financial sanctions regime, and part of the FCA's role is to ensure that the firms it supervises have adequate systems and controls to do so. A UK AIFM should screen against the UK Sanction List and the Office of Financial Sanctions Implementation (OFSI) listfor financial sanctions obligations. AIFMs are legally obliged to report to OFSI if they know or suspect that a breach of financial sanctions has occurred, if a person they are dealing with directly or indirectly is a designated person, if they hold any frozen assets or if knowledge or suspicion of these occurs while conducting business.

EXCHANGE LISTING AND SECONDARIES

Listing

31 Are credit funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing? Are there any restrictions on the type of vehicle or the terms of the credit fund that is seeking a listing?

Although it is more common to establish a credit fund as a non-listed entity that is subject to few regulatory requirements, a credit fund can be structured as a permanent capital vehicle that would be admitted to trading on either the Premium Segment or the Specialist Fund Segment of the Main Market of the London Stock Exchange plc (LSE). Such vehicles are formed using corporate structures (eg, investment trusts) that have legal personality.

For a fund's securities to be admitted to trading on the LSE's Premium Segment of the Main Market, an application will first need to be made to the FCA for the securities to be admitted to the Official List and for the prospectus to be approved, and an application will need to be made to the LSE to be admitted to trading. A fund seeking to be admitted to the Specialist Fund Segment does not have its securities admitted to the Official List and is not subject to the FCA's listing rules.

One of the key advantages of admission to the LSE is to increase the available investor base. The Premium Segment offers funds access to the widest possible investor base from institutional to general retail investors and, as such, funds are subject to stricter rules governing admission and ongoing levels of shareholder engagement and transparency. The Specialist Fund Segment offers funds access to institutional, professional, professionally advised and knowledgeable investors and is subject to less stringent rules.

Permanent capital vehicles offer investment managers the advantages of managing a long-term portfolio and provide investors with liquidity options through the sale of their shares on the LSE, although the market price might, in certain circumstances, be at a significant discount to net asset value (NAV). In contrast, investors in non-listed, private fund vehicles do not have access to on-market liquidity for their investments but, where redemptions are permitted, they would generally be at NAV.

Some of the mechanics that are used within a private fund vehicle cannot be used within a permanent capital vehicle. For example, (1) it will not be possible to operate a commitment and drawdown structure, meaning that there will be some initial inefficiencies when cash is invested in temporary, liquid investments pending the execution of long-term investments, and (2) the manager or adviser will be required to take a performance fee (which will be taxed in the hands of the members as income) and not a carried interest.

Restriction on transfers of interests

32 To what extent can a listed fund restrict transfers of its interests?

To be listed, securities must be freely transferable. However, in exceptional circumstances (eg, to comply with US securities law requirements), certain restrictions may be imposed.

Secondary transactions

33 Can interests in a private credit fund established in your jurisdiction be transferred between investors? If so, are these typically subject to any contractual or regulatory conditions?

Interests in a limited partnership can be transferred subject to the contractual obligations pursuant to the limited partnership agreement, which generally relate to the eligibility requirements of investors. General partner consent to a transfer is generally required.

PARTICIPATION IN PRIVATE CREDIT TRANSACTIONS

Legal and regulatory restrictions

34 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private credit transactions or otherwise affect the structuring of private credit transactions completed inside or outside your jurisdiction? Can a private credit fund hold non-loan or non-debt investments and, if so, are such holdings subject to any restrictions? Is a private credit fund established in your jurisdiction subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrowers?

There are no legal or regulatory restrictions that affect the participation of a UK credit fund in private credit transactions. A credit fund established in the UK can also hold debt and non-debt investments without regulatory restrictions being placed on the composition of the holdings, which is driven by the investment strategy of the fund itself. Participation in creditor meetings or taking actions in respect of underlying borrowers is also permitted.

Use of leverage

35 Are there any legal or practical restrictions on funds formed in your jurisdiction having a subscription line (and providing security over investor interests) or having true leverage (and asset level security) in the fund?

There are no legal restrictions relating to the use of leverage for UK credit funds. However, to the extent that the general partner has not been migrated offshore, as a UK alternative investment fund (AIF), the alternative investment fund manager (AIFM) will be required to disclose in the offering documents how leverage will be used, the maximum amount of leverage that may be employed, any right of reuse of collateral or any guarantee granted under any leveraging arrangements, and the total amount of leverage employed.

Compensation and profit sharing

36 Are there any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund? Is there anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund?

There are no legal or regulatory issues affecting the sponsor's compensation and profit-sharing arrangements. However, if the sponsor is a UK full-scope AIFM, it will need to comply with the AIFM Remuneration Code (SYSC 19B) (the Remuneration Code) set out in the FCA Handbook. The Remuneration Code sets out the standards and policies that full-scope UK AIFMs must meet when setting pay and bonus awards for their staff.

The general principle is that an AIFM must implement and maintain remuneration policies and practices for AIFM Remuneration Code staff that are consistent with effective risk management and do not encourage risk-taking that is inconsistent with the relevant fund documentation. AIFM Remuneration Code staff include:

- members of the AIFM's governing body (ie, the directors or management committee members);
- senior management;
- control functions: staff responsible for risk, compliance and internal audit;
- heads of certain business lines: portfolio management, human resources, marketing and administration;
- other risk-takers who individually or together can assert material influence of the AIFM or AIF's risk profile (examples include individual traders or trading desks); and
- any other employees who have a material impact on the risk profile of the AIFM or AIF and their total remuneration takes them into the same bracket as senior managers.

UPDATE AND TRENDS

Key developments of the past year

37 What are the most significant recent trends and developments relating to credit funds in your jurisdiction? What impact do you expect such trends and developments will have on global credit fundraising and on credit funds generally?

In the government's budget for 2020, it announced that it would carry out a review of the UK funds regime, covering tax and relevant areas of regulation. The call for input set out the scope and objectives of the review and invited stakeholders to provide views on which reforms should be taken forward and how these should be prioritised. The UK government has since published a summary of responses, outlining the feedback the government received for each area and which measures will be progressed.

As part of the wider UK funds regime review, the Financial Conduct Authority (FCA) has introduced rules for long-term asset funds (LTAFs), a new FCA-authorised fund vehicle designed to support investor access to longer-term, less liquid assets such as private credit, infrastructure, venture capital, private equity and real estate. LTAFs are open to investment by certain qualified investors (similar to the existing qualified investor scheme category) and may not be distributed to the general public in the UK. The government has included legislation for a new tax regime for asset holding companies in the Finance Bill 2021-22.

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MARKET AND POLICY CLIMATE

Market snapshot

1 How would you generally describe the state of the market for private credit funds in your jurisdiction?

Private credit market assets under management reached approximately US$1.245 trillion by the end of the third quarter of 2021, up nearly 19 per cent from December 2020. Dry powder, in respect of private credit market assets, increased to US$405.7 billion by the end of 2021, representing a gain of over 11 per cent. In addition, private credit fundraising amounted to just over US$213 billion in 2021, which represents the strongest fundraising year in history for the private credit industry. Credit funds generally performed well during the pandemic, and the current demand for credit assets remains strong. Although the US economy could be facing a recession in the near future, some industry participants believe that private credit fund sponsors are well equipped to navigate future challenges such as inflationary pressures, rising interest rates and geopolitical disruptions.

Government and regulatory policy

2 How would you describe the general government and regulatory policy towards credit funds in your jurisdiction?

Private funds (including credit funds) should be prepared for continued enhanced oversight from the Securities and Exchange Commission (SEC). The SEC Division of Examinations remained active during 2021, despite the ongoing coronavirus pandemic. In particular, in 2021, the SEC Division of Examinations completed 3,040 examinations (representing a 3 per cent increase from the prior year) and made 190 referrals to the Division of Enforcement.

In addition, the SEC on 9 February 2022 voted three-to-one to propose a set of new rules and rule amendments under the Investment Advisers Act of 1940 (Advisers Act) that collectively, if adopted, would represent the most significant changes to the regulation of private funds (including credit funds) and their investment advisers since the Dodd–Frank Act. The proposed rules and related rule amendments, if adopted as proposed, are likely to result in significant burdens on the credit industry

and disrupt the traditional relationship between credit fund advisers and credit fund investors.

FORMATION AND MANAGEMENT

Forms of vehicle

3 What legal form of vehicle is typically used for credit funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? Is it possible to create umbrella structures that permit the creation of sub-funds? What are the legal consequences for investors, managers and investment advisers in respect of each of these structures?

Credit funds are most commonly organised under US state law as a limited partnership (LP) or a limited liability company (LLC). In particular, fund sponsors primarily organise credit funds in the state of Delaware because this jurisdiction is deemed by many industry participants to have pro-management laws, a sophisticated Court of Chancery in respect of corporate matters, and a well-established related body of statutory and case law. A Delaware LP is the traditional and most common vehicle for establishing a credit fund.

Delaware law permits LPs and LLCs to have multiple 'series' and to segregate assets and liabilities into particular series.

Under Delaware law, as long as a limited partner is not actively involved in the management or operations of a credit fund, such a limited partner has limited liability. Typically, the limited partnership agreement of a credit fund provides that limited partners do not have any rights over the day-to-day management or operations of the fund. Accordingly, the personal liability of a limited partner is generally limited to the amount of the capital contributed or that has been agreed to be contributed by the limited partner. The general partner of a credit fund has general liability for the obligations of the partnership.

Unregulated fund vehicles

4 Can the fund vehicle be unregulated? If so, does this affect the ability to originate loans or otherwise execute its investment strategy?

Yes. Credit funds that are privately offered in the Unites States typically rely on section 3(c)(1) or section 3(c)(7) of the US Investment Company Act of 1940 (Company Act), each of which provides an exemption from registration as an investment company with the Securities and Exchange Commission (SEC) under the Company Act. Sections 3(c)(1) and 3(c)(7) require that the fund must not conduct a public offering of its securities in the United States. Section 3(c)(1) limits the number of beneficial owners in a fund to no more than 100. Section 3(c)(7) does not impose any limits on the number of beneficial owners, but it limits investors to those meeting the definition of a 'qualified purchaser'. The unregulated status of a credit fund does not

prevent such a fund from originating loans; such credit funds might need to comply with applicable state lending rules and regulations.

Formation process

5 What is the process for forming a credit fund vehicle in your jurisdiction? Are there any practical impediments to speed to market, such as account opening or banking and regulatory permissions?

Credit funds may be formed in Delaware by filing a certificate of formation with the state of Delaware. The certificate of formation lists the business address of the fund, among other things. Incorporation typically takes 24 hours and costs approximately US$90. However, for certain additional fees, the fund may be formed on an expedited basis. A fund is required to appoint an agent for service of process in Delaware, but otherwise has no obligation to appoint any other service provider and has no minimum capital requirements.

Typically, a credit fund will need to open a bank account in order for investors to wire their respective capital contributions to the fund. Accordingly, a credit fund will need to comply with any due diligence requirements of the bank.

Substance requirements

6 Is a credit fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, a corporate secretary, employees, professional anti-money laundering (AML) officers or other substance? If so, how is that requirement typically satisfied?

No, but Delaware LPs and LLCs must appoint an agent for service of process in Delaware and must make the necessary local tax filings. In addition, applicable state law may require such a manager or adviser to be qualified in the state in which the fund is domiciled or has its principal place of business. At the US federal level, Rule 206(4)-2 under the Advisers Act requires an adviser that has custody of client assets to maintain those assets with a 'qualified custodian' such as a bank, broker-dealer or futures commission merchant, and to have a reasonable basis for believing that the custodian sends quarterly account statements directly to the clients.

Access to information

7 What access to information about a private credit fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available? What information (in addition to that available to the general public) are shareholders and limited partners able to see? Is it possible to reduce access rights as a matter of contract?

Under Delaware law, limited partners (but not the general public) of a given credit fund are generally permitted to request a list of the names, addresses and

commitment amounts of the other limited partners, provided that the partnership agreement may restrict this right.

In addition, certain limited partners may be required under the US Freedom of Information Act or similar laws to disclose certain fund-level information relating to the credit fund.

Investor liability

8 In what circumstances would the limited liability of investors in a credit fund formed in your jurisdiction not be respected as a matter of local law? Is there a list of actions in which investors can participate without losing their limited liability?

Under Delaware law, as long as an investor is not actively involved in the management or operations of a credit fund, such an investor has limited liability. Typically, the governing agreement of a fund provides that investors do not have any rights over the day-to-day management or operations of a credit fund. Exercising certain voting rights does not negate limited liability. Accordingly, the most that a passive investor of a credit fund can lose is the total amount of its investment in a credit fund.

Fund manager's fiduciary duties

9 What are the fiduciary duties owed to a credit fund formed in your jurisdiction and its third-party investors by that fund's manager, investment adviser or other similar control party or fiduciary? To what extent can those fiduciary duties be modified by agreement of the parties?

Under Delaware law, a general partner of an LP owes a fiduciary duty to the partnership and the limited partners. Such a duty may be modified pursuant to the partnership agreement, provided that the implied contractual covenant of good faith and fair dealing may not be eliminated. In addition, under the Advisers Act, an investment adviser is deemed to owe a fiduciary duty to its clients, which would include a credit fund for which it manages. This fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty.

Gross negligence

10 Does your jurisdiction recognise a 'gross negligence' (as opposed to 'simple negligence') standard of liability applicable to the management of a credit fund? If so, how does this standard differ from a simple negligence standard?

The partnership agreement for a credit fund typically provides that the fund sponsor is entitled to exculpation and indemnification by the fund, subject to certain carve-outs, including acts or omissions constituting gross negligence. Delaware recognises a 'gross negligence' standard of liability in this context. Gross negligence has been defined by Delaware courts as a 'higher level of negligence representing an extreme departure from the ordinary standard of care'. (*Capital v Law Office of*

Krug, No. 2018-0240-JRS (Del. Ch. Feb. 8, 2019)). Furthermore, in order to establish gross negligence, Delaware courts have noted that a plaintiff must assert that the defendant was recklessly uninformed or acted 'outside the bounds of reason'.

Other special issues or requirements

11 Are there any other special issues or requirements particular to credit fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling vehicles formed in other jurisdictions into vehicles in your jurisdiction, what are the most material terms that typically must be modified and how common is this process? How long does it typically take?

The particular provisions of a given credit fund's partnership agreement will address numerous special issues or requirements, including special investor governance rights on matters such as removal of the general partner, early termination of the investment period or early dissolution of the fund. It is permissible under Delaware law to convert or redomicile a non-Delaware entity into a Delaware LP. Upon conversion or redomiciling, the pre-existing governing agreement of the non-Delaware entity should be reviewed to ensure consistency with Delaware law. The tax consequences of such a conversion or redomiciling should also be analysed.

Fund sponsor insolvency or change of control

12 With respect to institutional sponsors of credit funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the credit fund and its general partner and investment manager or adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the credit fund's sponsor?

It is common for a partnership agreement of a credit fund to provide that the bankruptcy or insolvency of the general partner may result in the early termination of the investment period, the removal of the general partner or the dissolution of the fund, or all three. In addition, in the event that the general partner becomes unable to fund its capital commitment (to the extent that it has made one), such a failure could trigger certain 'for cause' remedies made available to limited partners. Under the Advisers Act, each investment advisory contract of an SEC-registered investment adviser must include a provision that such a contract may not be assigned without the consent of the client. A change of control of such an investment adviser would generally trigger the foregoing requirement.

REGULATION, LICENSING AND REGISTRATION

Principal legislation and regulatory bodies

13 What principal legislation governs credit funds in your jurisdiction? Which regulatory bodies have authority over credit funds and its managers and investment advisers in your jurisdiction? What are the regulators' audit and inspection rights?

The principal legislation governing credit funds are the US Securities Act of 1933 (Securities Act) and the Company Act and regulations promulgated thereunder. Typically, interests in a credit fund are privately offered and sold pursuant to Regulation D of the Securities Act, and such a credit fund relies on an exclusion from the definition of an investment company under the Company Act pursuant to section 3(c)(1) or section 3(c)(7) thereof. Investment advisers are subject to the provisions of the Advisers Act. Investment advisers to credit funds typically either are registered with the Securities and Exchange Commission (SEC) as an investment adviser or rely on an exemption from such registration as an exempt reporting adviser. The SEC examines registered investment advisers pursuant to its routine examination programme. The SEC also has the legal authority to examine an exempt reporting adviser's books and records.

Reporting and disclosure requirements

14 What ongoing reporting and disclosure requirements apply to credit fund managers and investment advisers in your jurisdiction?

Under the Advisers Act, SEC-registered investment advisers are required to complete and file Part 1A and Part 2A with the SEC. Exempt reporting advisers are required to complete and file certain sections of Part 1A. In the event of any changes regarding individuals employed by or associated with the investment adviser, such changes must be promptly reflected in an amendment to Part 1A.

In addition, under the Advisers Act, a registered investment adviser with more than US$150 million of private fund regulatory assets under management is required to file Form PF with the SEC, which requires disclosure of certain basic identifying information regarding each 'private fund' an investment adviser advises.

If the general partner of a Delaware limited partnership is replaced or otherwise substituted with a successor general partner, an amended certificate of limited partnership is required to be filed in Delaware. Under the Advisers Act, each investment advisory contract of an SEC-registered investment adviser must include a provision that such a contract may not be 'assigned' (which includes a change of control of the investment adviser) without the consent of the client.

Fund licensing and registration

15 What governmental approval, licensing or registration requirements apply to credit funds in your jurisdiction?

A credit fund typically relies on an exclusion from the definition of an investment company under the Company Act pursuant to section 3(c)(1) or section 3(c)(7) thereof. Certain state lending laws require that a credit fund engaged in the business of lending in the state be licensed as a lender unless otherwise exempt therefrom. Some credit funds may avoid having to become a licensed lender by acquiring debt on the secondary market, rather than engaging in direct lending practices.

Registration of investment adviser

16 Is a credit fund's manager or investment adviser (or any of its officers, directors or control persons) required to register as an investment adviser in your jurisdiction? If so, is there a triggering activity for such registration?

The SEC has the authority to regulate investment advisers to credit funds pursuant to the Advisers Act. In addition, investment advisers may be subject to state regulatory requirements.

Under the Advisers Act, investment advisers to credit funds are generally required to be registered with the SEC under the Advisers Act unless they meet an exemption from such registration. Two exemptions in particular are useful to advisers that wish to manage credit funds marketed in the United States.

Foreign private adviser exemption

Under section 202(a)(30), a 'foreign private adviser' is defined as an investment adviser that (1) has no place of business in the United States; (2) has, in total, fewer than 15 US clients and US investors in private funds advised by the investment adviser (such clients and investors, 'US Persons'); (3) has aggregate assets under management attributable to US Persons of less than US$25 million; and (4) neither (a) holds itself out generally to the public in the United States as an investment adviser nor (b) advises registered investment companies or business development companies.

Private fund adviser exemption

An exemption exists for investment advisers that solely manage 'private funds' with assets under management in the United States of less than US$150 million. In applying this exemption, Rule 203(m)-1 under the Advisers Act requires non-US advisers to count only private fund assets that are managed from a 'place of business' within the United States towards the US$150 million threshold. Investment advisers that rely on the 'private fund adviser' exemption are called 'exempt reporting advisers' under SEC rules, and are required to submit to the SEC, and update at least annually, certain reports on Part 1 of Form ADV. These advisers are subject to a limited subset of rules and regulations under the Advisers Act.

Fund manager and investment adviser qualifications

17 Are there any specific qualifications or other requirements imposed on a credit fund's manager, investment adviser or any of its officers, directors or control persons in your jurisdiction?

Under the Advisers Act, no particular educational or experience requirements are imposed on investment advisers. However, an SEC-registered investment adviser must appoint a chief compliance officer to be responsible for administering a firm's compliance programme. Such a chief compliance officer should be competent and knowledgeable regarding the Advisers Act. From a practical perspective, fundraising for a given credit fund will be dependent on the experience level of the investment adviser's investment team (among other criteria).

Political contributions

18 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a credit fund's manager or investment adviser or their employees?

Under Rule 206(4)-5 of the Advisers Act, covered investment advisers are generally prohibited from providing advice for compensation to any US government entity within two years after the adviser or its covered associates has made a political contribution to an elected official or candidate whose public office would offer such a person the ability to influence an investment by the government entity in a fund advised by such an investment adviser. In addition, investment advisers must monitor and maintain records relating to political contributions made by their employees. Certain US states have passed similar rules and regulations and certain US public pension plans have adopted policies that similarly restrict political contributions to state officials by investment advisers and covered associates.

Use of intermediaries and lobbyist registration

19 Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a credit fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

Under Rule 206(4)-5 of the Advisers Act, covered investment advisers are generally prohibited from making any payment to a third party for securing an investment from a US government entity to a fund advised by the investment adviser unless such a third party is registered as a broker-dealer and subject to pay-to-play rules. In addition, certain US states passed similar rules and regulations regarding payments

made by an investment adviser to a placement agent regarding an investment in such an adviser's fund by such a state's pension plan.

Bank participation

20 Are there any legal or regulatory requirements that specifically apply to banks with respect to investing in or sponsoring credit funds?

Yes, section 13 of the US Bank Holding Company Act and its implementing regulations (collectively referred to as the 'Volcker Rule') prohibit banking entities (ie, banks and their affiliates) from acquiring or retaining an ownership interest in, or sponsoring, a covered fund. A covered fund is any investment fund that relies on section 3(c)(1) or section 3(c)(7) under the Company Act to avoid registration as an investment company. There are certain exclusions and exemptions that permit banking entities to nevertheless invest in or sponsor a covered fund. In 2020, the US banking agencies the SEC and the Commodity Futures Trading Commission adopted revisions to the Volcker Rule regulations that exclude 'credit funds' from the definition of covered fund. For a fund to qualify as a credit fund, it must meet certain asset and activity requirements. Specifically, the fund's assets must be limited to loans, debt instruments, rights and assets related to or incidental to acquiring, holding, servicing or selling loans or debt instruments; and certain interest rate or foreign exchange derivatives that relate to reducing the interest rate of foreign exchange risks of the other assets held by the fund. In addition, the fund cannot engage in proprietary trading (ie, short-term trading as principal) and it may not issue asset-backed securities. If a banking entity wishes to sponsor a credit fund, it must also provide certain disclosures, it cannot guarantee the performance of the fund, and its ownership interest must remain below 3 per cent of the fund's outstanding ownership interests (among other limits).

Anti-money laundering rules

21 What anti-money laundering (AML) rules and regulations apply to credit funds formed in your jurisdiction? Are there any requirements for due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a credit fund or the individual members of the sponsor? What AML requirements apply at the level of the fund? What level of scrutiny is required for AML checks regarding investments?

Under current US anti-money laundering (AML) laws and regulations, private credit funds do not have AML obligations. The US Bank Secrecy Act (BSA), as amended by the USA PATRIOT ACT, and regulations promulgated by the Financial Crimes Enforcement Network (FinCEN), a bureau within the US Department of Treasury, currently require financial institutions to have in place an AML programme that includes, at a minimum:

- developing internal policies, procedures and controls;
- designating an AML compliance officer;
- provide ongoing training for appropriate personnel;
- having an independent audit function to test the programme; and

- implement appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:
    - understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and
    - conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

The term 'financial institution' is defined to include, among other entities, investment companies and broker-dealers in securities. However, FinCEN has exempted from the AML programme requirements under the BSA all investment companies except open-end mutual funds. Accordingly, private funds are not required to have an AML programme in place. In this same vein, investment advisers are not financial institutions under the BSA and likewise are not required to have an AML programme (although some may voluntarily implement one). A private fund's placement agent is, however, required to have in place an AML programme and will request certain information in connection with a private fund investor's subscription document. However, there are generally no ongoing AML obligations on the placement agent in connection with placing private fund interests with a subscriber unless the subscriber has an account with the placement agent for purposes other than holding interests in the private fund.

TAXATION

Tax obligations and exemptions

22 Is a credit fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Are there any applicable tax exemptions?

Credit funds formed in the United States typically are tax transparent and generally not subject to income taxation. If tax opaque, such funds generally seek to qualify for a special regime that allows them to operate without incurring fund-level taxation through reliance on a dividends-paid deduction. Tax-opaque credit funds are required to 'backup withhold' tax from taxable distributions paid to certain categories of US investors that fail to report investment income on their tax returns or make certain required tax certifications. Whether tax transparent or tax opaque, a credit fund that is formed in the United States must withhold tax on the gross amount of certain categories of US source income (including dividends, certain dividend-equivalent payments and interest) that are paid or allocated to a non-US investor. Exceptions apply to a non-US investor that is eligible for an exemption pursuant to an applicable treaty or, in the case of US source interest, a statutory 'portfolio interest' exemption. The portfolio interest exemption is subject to certain conditions, including that the beneficial owner not be deemed a '10 per cent shareholder' of the obligor. A tax transparent credit fund also must withhold tax on net income that is 'effectively connected' with a US trade or business (including US-based loan origination activity) and allocable to a non-US investor. Certain

trading safe harbours enable non-US investors and tax transparent funds through which they invest (but not dealers) to trade in securities (including debt obligations acquired in the secondary market) for their own account without being deemed to be engaged in a US trade or business. The conduct of financing activity from within the United States does not fall within the safe harbours.

Tax structuring

23 What range of downstream tax structures are available and commonly used in your jurisdiction to mitigate any tax leakage?

Certain asset-specific structures that can avoid entity-level taxation if various conditions are satisfied include real estate investment trusts, real estate mortgage investment conduits and regulated investment companies. US taxable entities that are treated as corporations for US tax purposes are also used to shield non-US investors from direct taxation. US taxable entities that are treated as corporations for US tax purposes are subject to federal income taxation at a maximum rate of 21 per cent. Additional state and local taxes may apply. Subject to certain limitations, such entities can be capitalised in part with debt to reduce entity-level corporate taxation. Payments of US source dividends and interest made by a US taxable corporate entity to a non-US investor generally will be subject to gross withholding at source at a rate of 30 per cent, unless a reduced treaty rate or other exemption applies.

Local taxation of non-resident investors

24 Are non-resident investors in a credit fund subject to taxation or return-filing requirements in your jurisdiction?

Non-US investors that are deemed to be engaged in a US trade or business either directly or through investment in a tax transparent entity that is so engaged are subject to US return filing obligations. Non-US investors are taxable at the same rates applicable to US taxpayers in respect of income that is 'effectively connected' with a US trade or business (including income from US-based loan origination activity and certain US real property disposition gains derived either directly or through a tax transparent fund vehicle). The maximum federal income tax rate currently is 37 per cent (in the case of individual US citizens and residents) and 21 per cent (in the case of US entities that are treated as corporations for US tax purposes). Additional state and local taxes and return filing obligations may also apply. Non-US corporate taxpayers that are engaged in a US trade or business are subject to an additional branch profits tax (at a 30 per cent or lower treaty rate) on effectively connected earnings deemed repatriated from the United States. Certain categories of US source income (including dividends, dividend-equivalent payments and interest) that are not effectively connected with a US trade or business and are paid or allocable to a non-US investor are subject to withholding at source on a gross basis at a rate of 30 per cent, unless a lower treaty rate or exemption applies.

Local tax authority ruling

25 Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a credit fund vehicle formed in your jurisdiction, or the services provided by the investment manager or investment adviser? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Generally, rulings are not necessary or feasible given the time, expense and inability to obtain rulings on certain highly factual topics (such as whether a non-US investor is deemed to be engaged in a US trade or business). Entity classification elections may be desirable. US investors (including US citizens and residents) are subject to US taxation on worldwide income. Long-term capital gains (in general, from the disposition of capital assets having a holding period of more than one year) and certain 'qualified dividends' of individual taxpayers generally are subject to a maximum federal income tax rate of 20 per cent, rather than the maximum 37 per cent rate applicable to ordinary income. An additional 3.8 per cent tax applies to certain investment income of non-corporate taxpayers having income levels that exceed certain thresholds. US tax-exempt investors generally are taxable only on income derived from (1) a business that is unrelated to their exempt purpose (with certain exclusions) or (2) debt-financed property. Non-corporate US investors are unable to deduct certain investment expenses (including management and performance fees) incurred directly or through a tax transparent fund unless attributable to active trade or business activity and allowable as an ordinary and reasonable business deduction.

Special tax considerations for sponsors

26 Are there any special tax considerations for credit fund sponsors?

Fund sponsors generally seek to structure carried interest as a profit share, rather than a fee. A profit share allows the character of any long-term capital gain to flow through to the carry recipient. Also, in contrast to a fee, a profit share does not carry the same risk of being taxable to investors with no offsetting deduction for non-corporate investors. In the case of a carry recipient, the holding period required for disposition gains to qualify for reduced long-term capital gain rates for individual taxpayers is increased to more than three years (as opposed to the general long-term holding period of more than one year).

Tax treaties

27 Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to the fund vehicle or any downstream structure?

The United States has income tax treaties in force with many jurisdictions. Such treaties generally include stringent anti-treaty shopping provisions and provide relief only for otherwise eligible residents. For this purpose, a tax transparent US fund would not be considered an eligible treaty resident, though otherwise

treaty-eligible investors could claim relief in respect of income derived through a tax transparent US fund, provided that their jurisdiction of residence (if other than the United States) also views the US fund as fiscally transparent.

Other significant tax issues

28 Are there any other significant tax issues relating to credit funds organised in your jurisdiction?

Generally, no.

OFFERING, SELLING AND INVESTMENT RESTRICTIONS

Offer and sale

29 What principal legal and regulatory restrictions apply to offers and sales of interests in credit funds formed in your jurisdiction, including the type of investors to whom such funds may be offered without registration under applicable securities laws?

A credit fund is typically offered and sold pursuant to a private placement in order for its securities to be exempt from registration under the Securities Act. Private placements issued by credit funds are typically made under Rule 506(b) safe harbour of Regulation D, which permits sales to an unlimited number of 'accredited investors' and up to 35 non-accredited investors (although the sale to non-accredited investors triggers additional disclosure requirements). To rely on this safe harbour, (1) no general solicitation or advertising may occur and (2) reasonable resale restrictions must be imposed. Private placements issued by credit funds are much less commonly made under Rule 506(c) safe harbour of Regulation D, which permits general solicitation and general advertising. To rely on this safe harbour (among other requirements), reasonable steps must be taken to verify that the purchasers are accredited investors. In addition, Regulation D also technically requires a credit fund to file a short notice (a Form D) with the Securities and Exchange Commission within 15 days of the first sale of interests to US investors.

Types of investor and investment

30 Are there any restrictions on the types of investors that may participate in credit funds or the types of investments that may be held by credit funds formed in your jurisdiction?

US credit fund sponsors must comply with certain aspects of the anti-money laundering provisions of the USA PATRIOT Act. In addition, from a legal, tax and Employee Retirement Income Security Act perspective, credit fund sponsors may prohibit or restrict investments from certain investors.

EXCHANGE LISTING AND SECONDARIES

Listing

31 Are credit funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing? Are there any restrictions on the type of vehicle or the terms of the credit fund that is seeking a listing?

Credit funds are not typically listed on a securities exchange in the United States.

Restriction on transfers of interests

32 To what extent can a listed fund restrict transfers of its interests?

Credit funds are not typically listed on a securities exchange in the United States.

Secondary transactions

33 Can interests in a private credit fund established in your jurisdiction be transferred between investors? If so, are these typically subject to any contractual or regulatory conditions?

Credit funds are typically offered and sold pursuant to Regulation D of the Securities Act. Under Rule 502(d) of Regulation D, securities acquired by an investor pursuant to a Regulation D offering cannot be resold by such an investor unless the securities are registered or exempt from registration. In addition, Rule 502(d) requires that the credit fund exercise reasonable care to assure that investors are not underwriters. Accordingly, the partnership agreement of a credit fund typically provides that no transfers may be made without approval of the sponsor.

PARTICIPATION IN PRIVATE CREDIT TRANSACTIONS

Legal and regulatory restrictions

34 Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private credit transactions or otherwise affect the structuring of private credit transactions completed inside or outside your jurisdiction? Can a private credit fund hold non-loan or non-debt investments and, if so, are such holdings subject to any restrictions? Is a private credit fund established in your jurisdiction subject to any restrictions on participating in any creditor committees or taking other actions in respect of its credit investments or borrowers?

A credit fund's partnership agreement and certain investor side letters may include certain investment guidelines or restrictions regarding the particular type of

investments that it may acquire. Such investment guidelines or restrictions could restrict the ability of a credit fund to hold non-credit investments.

Use of leverage

35 Are there any legal or practical restrictions on funds formed in your jurisdiction having a subscription line (and providing security over investor interests) or having true leverage (and asset level security) in the fund?

Subscription lines are commonly utilised by credit fund sponsors. Borrowed funds under a subscription line typically can be drawn down within a day, whereas, under a typical partnership agreement for a credit fund, capital calls may take 10 business days or more. Some investors may object to certain terms of the related provision in a partnership agreement required by lenders, such as financial disclosure, restrictions on transfers of limited partnership interests and waivers of defences. It is also common for credit funds to utilise true leverage in respect of its investment strategy, provided that the partnership agreement permits such use of leverage. One practical consideration is whether the lender will have approval rights regarding each loan's eligibility as collateral, whereby an advance rate will then be assigned based on the underlying risk, or whether a fund sponsor can contribute a loan at a defined advance rate as long as the loan meets certain specific characteristics.

Compensation and profit sharing

36 Are there any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund? Is there anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund?

Credit fund sponsors may be able to utilise certain tax benefits by separately forming a carried interest recipient and a management fee recipient in respect of the credit fund. Fund sponsors that are located in New York City typically utilise the foregoing approach. In addition, pursuant to the Tax Reform Bill, a given asset held by the credit fund must be subject to a three-year holding period in order for carried interest distributions to be eligible for long-term capital gain treatment. In the event that transaction fees could be received by the investment adviser in connection with managing a credit fund, investors may seek to require the investment adviser to offset such fees against the management fee charged to the credit fund.

UPDATE AND TRENDS

Key developments of the past year

37 What are the most significant recent trends and developments relating to credit funds in your jurisdiction? What impact do you expect such trends and developments will have on global credit fundraising and on credit funds generally?

The Securities and Exchange Commission (SEC) continues to signal increased SEC scrutiny of private funds (including credit funds) and their investment advisers. In particular, the SEC has noted the significant expansion and importance of private funds to capital markets. On 30 March 2022, the SEC's Division of Examinations released its examination priorities for 2022, which highlighted private funds as a 'significant focus area'. Therefore, it is anticipated that the SEC will continue to prioritise its focus on investment advisers to private funds (including credit funds), and that SEC examinations will review issues relating to perennial focus areas, such as conflicts of interest, fees and expenses, and valuations.

In addition, the SEC on 9 February 2022 voted three-to-one to propose a set of new rules and rule amendments under the Advisers Act that collectively, if adopted, would represent the most significant changes to the regulation of private funds (including credit funds) and their investment advisers since the Dodd–Frank Act. The proposed rules and related rule amendments, if adopted as proposed, are likely to result in significant burdens on the credit industry and disrupt the traditional relationship between credit fund advisers and credit fund investors. It remains unclear to what extent the foregoing proposed rules would negatively impact credit fund fundraising.

Investment advisers to credit funds face increasing pressure from limited partners to integrate environmental, social and governance (ESG) factors into their investment process. The recently released SEC examination priorities for 2022 highlighted ESG investing as a 'significant focus area'. Accordingly, consistent with previous SEC pronouncements, it is expected that the SEC will focus on ESG-related investment management, including in respect of credit funds and whether such funds' offering documents are accurately disclosing ESG investing approaches.

* *The authors would like to thank the following contributors: Adrienne Baker (tax), Bobby Rhatigan, Josh Anifowoshe, Sarah Sennett and David Peters.*

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