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FUND FINANCE FRIDAY

Getting All Your 'Lux' in a Row – a Lender Checklist!

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Every deal has its quirks but, as anyone who has done a deal with a Lux entity will know, the EU brings its own set of regulatory considerations to the table (primarily AIFMD). In many cases when compared with parallel Delaware and Cayman workstreams, Lux can seem like (and in some cases is) a much more involved process.

We thought the start of the new year might be a good time for a refresher on how the Lux workstream can best be managed, why additional tasks are required (when compared to equivalent Delaware and Cayman vehicles), what these tasks are, and the common deal points that can pop up and give rise to negotiation. In short, how a lender and their counsel can best get their 'Lux' in a row to ensure a deal runs as smoothly as possible.

Why Lux?

Luxembourg is by far the leading EU jurisdiction for the formation of closed-ended fund structures typically seen in fund finance deals. It provides a regulated and familiar jurisdiction for global sponsors and investors alike and has a diverse and well-crafted stable of vehicles to choose from – the most common of which, an SCSp, allows for the creation of a limited partnership with the same concepts as are seen in common-law jurisdictions like Delaware and Cayman. The easiest line to draw is that, although not always the case, U.S. sponsors use U.S. and Cayman vehicles for U.S. limited partners and Lux vehicles for EU and Rest of the World limited partners (benefiting from the cross-border marketing aspects of AIFMD for EU investors).

Security Squared

One aspect that commonly sets Lux apart on U.S.-originated deals is the necessity for Lux-governed security agreements over capital call rights contained in Lux-governed LPAs. Lux has specific and modernized legislation to govern the granting of security interests and provide certain benefits to secured parties (the Collateral Law). In order to benefit from the provisions of the Collateral Law a Lux-governed security agreement which aligns with its provisions must be executed. Accordingly, it is common to have parallel U.S. law-governed security and Lux law-governed security over the same capital call and enforcement rights allowing the secured parties to benefit from both regimes giving the secured parties the right to enforce in the jurisdiction of their choosing in the event of an enforcement.

Where a fund has Lux-based bank accounts that capital contributions are funded into, then Lux law-governed security also needs to be taken over these accounts (and it's always worth checking the IBAN of such accounts to ensure they

are in fact Lux based!). This is not a feature that is specific to Luxembourg. It is a good practice for secured creditors generally to take security in the jurisdiction where collateral is located in order to ensure validity and priority of the security interest in the eyes of the relevant legal regime where the creditor is most likely to enforce its rights in that collateral. In the case of accounts based in Lux, in many cases a Lux-based bank will require their own forms of notice and acknowledgement of security to be used. While this is not problematic in theory, it can be time-consuming and is not in the direct control of the borrower, so early engagement with the bank is important.

By contrast, Cayman is generally thought to be an exception to the regime of taking local security where the collateral is located. Cayman does not have a security interest law and its courts are understood to be friendly to enforcement of security interests that are not under Cayman law, so separate Cayman-governed security over capital call rights is not required, nor is it market practise to obtain it. It's also very rare for Cayman-based bank accounts to be used and so local account security is not a common deal feature.

Given the need for Luxembourg law-governed security documents in a transaction with Lux entities, it is important to know from the outset who is going to draft the Lux security documents. In some cases a protracted negotiation can be avoided by certain forms being used as a base and, given this is the most significant documentation being drafted on the Lux side, time efficiencies here can be considerable. The following is a checklist of sorts of some of the issues that may arise when Lux entities are the security providers in a deal.

The AIFM of the Game

AIFMD primarily regulates *managers* of Lux funds rather than the *funds themselves* but almost every Lux fund that pops up in a fund finance transaction will be required to appoint an "AIFM". While an AIFM is in essence the same role as a 'manager' of a Delaware or Cayman fund may undertake, its obligations under AIFMD are much more wide-ranging and the terms of the AIFM agreement may be much more detailed.

Even if the right to call capital from investors has not been delegated to the AIFM (which would of course necessitate its involvement in the security documents) the AIFM may be required to consent formally to the transaction and if this is the case early attention should be dedicated to ensuring that the AIFM has been provided with sufficient information and a form of consent is agreed in this regard.

A Depositary of Knowledge

For most Lux funds the AIFMD also requires that they appoint a depositary that is independent of the AIFM function. This concept (which is more familiar to the hedge fund world where a custodian often holds assets of a fund) is designed as an investor protection. The depositary plays a key role in safeguarding the assets of the AIF and ensuring compliance with applicable laws and regulations.

For fund finance deals in Lux, this introduces an additional hurdle to closing that would not be required in Cayman or Delaware – being notification to or consent by the depositary to the transaction (depending on the terms of the depositary agreement). Early outreach to the depositary is important in order that it has time to review, comment on and line up a signatory for any applicable consents or acknowledgements.

The Split Opinion

The most common arrangement in Lux deals sees a 'split' opinion approach where the lender's counsel gives an enforceability opinion and the borrower's counsel provides the capacity opinion. While there is no specific reason this has to be the case (either side could and sometimes does provide an opinion covering both points) it leads to a slightly more involved process and so needs to be managed closely.

Fighting for your right to Priority

Perhaps the point that gives rise to most dialog in Lux deals is the question of how the parallel U.S. and Lux security agreements are described when it comes to their priority against each other (which is senior). While both are ultimately in favour of the same party, a number of technical legal arguments arise which sometimes see a divergence of opinion as to how the matter is documented. The scope of those arguments, the risk (if any) attached to the issue in real-world scenarios and which is ultimately correct is worthy of a note in its own right (watch this space!) but when it comes to getting your Lux in a row the main point is for the parties to engage early to ensure alignment so that the issue does not become a drag on timing.

Quelle heure est-il? (What time is it?)

Lastly, it is worth remembering that Lux is usually six hours ahead of the U.S. The main issue this can cause is availability of opinions for early-morning or late-evening U.S. closings and prior agreement on how an opinion can be released can save lots of stress on the day of closing as a wire cutoff approaches!