

Debt funds, Luxembourg SPVs, and the regulation of lending activities

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The role of debt funds in the global debt market has been steadily increasing since the financial crisis in 2008. In the Grand Duchy of Luxembourg total assets under management of debt funds reached EUR 510 billion by December 2023, with a growth of 21.5% in just six months.⁽¹⁾

After having initially emerged as debt-participants purchasing the debt on the secondary market, the debt funds' role as debt-originators has noticeably increased in recent years: currently, the split between debt-originating and debt-participating funds is approximately 50-50 with a small portion of funds doing both. The activity has also shifted from primarily small and medium enterprises to a variety of areas as fund managers are searching for yields in more diverse investment opportunities.

Luxembourg has become a very popular jurisdiction for the debt funds' SPVs⁽²⁾, in particular in respect of those SPVs meant to originate or hold loan participations. Many large debt funds are based in Luxembourg either *via* their Luxembourg-domiciled (either regulated or unregulated) funds or *via* their Luxembourg-based SPVs acting as direct lenders in a financing transaction. The lending activity may take the form of loan origination by the funds or SPVs or of acquisition of loans on the secondary market.

While it is more common nowadays that credit funds and other lending actors who are not already regulated in Luxembourg are aware of the fact that using Luxembourg SPVs may bring them into the Luxembourg regulated sphere, there are still actors who may not have quite grasped the extent of the scope of such lending license requirement. This article is meant to clarify a few principles that apply when using a Luxembourg lending or loan holding SPV as well as what the current market practice is in this respect.

1. Lending activities requiring a license

Contrary to most other European jurisdictions, lending is, in principle, a regulated activity in Luxembourg pursuant to Article 28-4 of the Luxembourg law of 5 April 1993 on the financial sector, as amended (the LFS). A Luxembourg entity which intends to professionally engage in the business of granting loans to the public for its own account requires a license granted by the *Commission de Surveillance du Secteur Financier* (CSSF).

i. The concept of "lending operations"

The activities potentially requiring a Luxembourg lending license include debt-origination and may cover debt-participation on the secondary market. The relevant CSSF FAQ specifically refers to the acquisition of drawn or undrawn credit lines and to the transfer of loans, where such transfers were contracted simultaneously with or immediately after they were granted by banks.⁽³⁾ "Lending operations" within the meaning of the LFS include loans, but also other financial activities such as financial leasing and factoring operations⁽⁴⁾ as well as other operations that are not specifically mentioned in the applicable legal framework.⁽⁵⁾

ii. Are debt investments "lending operations" subject to a license in Luxembourg?

Debt investments may include loan origination or loan participation or acquisition (e.g., the acquisition of leveraged loans) as well as the acquisition of bonds, asset-backed notes, subordinated notes, or other similar instruments. Whereas lending activities through the granting of loans are clearly in scope of the LFS, the situation is less clear with respect to the acquisition of bonds or similar debt instruments.

Historically, the CSSF considered that the acquisition of bonds, notes, or other loan obligations by an entity, which were not originated by the entity itself, did not constitute a lending activity subject to Article 28-4 of the LFS. However, where loans



were granted or originated by a third party further to an investment decision of the entity and subsequently transferred to the same entity, such entity would be considered as an original lender. Participation in primary syndication was also deemed to be a lending activity. Currently, the regulator's position and market practice seem to be that loan origination is considered clearly in-scope (i.e., potentially subject to a lending license requirement, if no exemption (see point 3. below) were to apply), loan acquisition or participation may be in scope, and acquisitions of debt instruments such as bonds or notes would not typically be considered as constituting a lending activity subject to a license.

iii. The requirements for a Luxembourg lending license

An entity performing a lending activity from or in Luxembourg requires a license as "professional performing lending operations".⁽⁶⁾ To obtain a lending license, a number of requirements have to be met, concerning in particular (i) the entity's central administration and infrastructure (which requires substantial management and other staffing in Luxembourg), (ii) its shareholding, (iii) the professional standing and experience of members of the administrative, management and supervisory bodies and of any shareholders with a qualifying participation into the equity of the Luxembourg entity, (iv) substantial amounts of capital base and own funds, and (v) external auditing.⁽⁷⁾ Obtaining the lending license involves substantial costs (including one-off and annual licensing fees and the costs of staffing of the Luxembourg presence), a significant time investment (up to 12 months from the moment an application is filed) and compliance with ongoing professional obligations, prudential requirements, and rules of conduct.

Being captured by the license requirement is therefore something that credit funds may want to avoid (though we do from time to time come across certain funds who, on the contrary, are looking to be regulated in Luxembourg).

2. Are funds in or out of scope of a lending license requirement?

The key question is whether investment funds intending to originate loans or otherwise invest in debt are potentially caught by the lending license requirement.

i. Statutory exclusions

Certain entities are excluded from the scope of application of the LFS, including certain types of investment funds. In particular, undertakings for collective investment in transferable securities (UCITS) authorized under Part I of the law of 17 December 2010 relating to undertakings for collective investments, as amended (the 2010 Law), undertakings for collective investment authorized under Part II of the 2010 Law (Part II UCIs), specialized investment funds (SIFs) governed by the law of 13 February 2007 relating to specialized investment funds, as amended (the 2007 Law), certain pension funds, and investment companies in risk capital (SICARs) governed by the law of 15 June 2004 relating to SICARs are excluded from the LFS and are therefore not subject to a license requirement for lending activities.⁽⁸⁾

ii. Regulatory permissions

European long-term investment funds (ELTIFs), European social entrepreneurship funds (EuSEFs), and European venture capital funds (EuVECFs) are expressly permitted to grant loans, subject

to specific conditions set out in their respective EU regulations.⁽⁹⁾

iii. The case of unregulated AIFs

Some alternative investment funds (AIFs) as defined by the law of 12 July 2013 on alternative investment fund managers, as amended (the AIFM Law), may however be captured by the LFS. Although all Part II UCIs qualify as AIFs by virtue of Article 88-1 of the 2010 Law, not all AIFs necessarily qualify as Part II UCIs. This is the case for certain unregulated funds, including many funds taking the form of a Luxembourg special limited partnership (*société en commandite spéciale* or "SCSp").

Certain funds which are not covered by the product-specific laws and regulations mentioned above may therefore, in theory, be caught by the license requirement for lending activities. As mentioned under paragraph 1(a)(ii) above, this would be an issue mostly for loan origination and participation/acquisition, but not for the investment in bonds, notes, or similar instruments.

iv. Supervisory tolerance

Although certain AIFs are theoretically in scope of the license requirement set out by the LFS, the CSSF has provided some guidance on lending activities exercised by AIFs in its FAQ on the AIFM Law (the AIFM FAQ).⁽¹⁰⁾ According to this FAQ, loan origination, loan participation and loan acquisition are permitted activities for AIFs in Luxembourg, mainly because such activity is not prohibited by the AIFM Law or other product laws and regulations applicable to AIFs.⁽¹¹⁾

The CSSF expects alternative investment fund managers (AIFMs) and AIFs to comply with all applicable requirements, including those stemming from specific product laws or regulations, and also requires AIFMs and AIFs to ensure they manage risks appropriately and have appropriate organizational and governance structures in place in order to be able to perform the lending activities.⁽¹²⁾ Despite the CSSF's position in the AIFM FAQ, it remains unclear however whether unregulated AIFs are completely exempt from the licensing requirement set out in the LFS if they engage into lending activities. It is likely however that most loan originating funds would be able to benefit from the professional exemption described in paragraph 3 below.

v. What about SPVs held by funds?

As mentioned above, funds often use SPVs they own or control as vehicles to perform lending activities. The CSSF considers that where an SPV granting loans is held at 100% or directly or indirectly controlled by a regulated entity that is itself exempted from the provisions of the LFS, that SPV is also exempted from the LFS.⁽¹³⁾ In other words, if a UCITS, a Part II UCI, a SIF, a pension fund, or a SICAR for instance grants loans through a SPV it owns at 100% or controls, that SPV will not be subject to the authorization requirement set out in the LFS. If the SPV is however owned or controlled by an AIF for which the applicability of the LFS is unclear, the risk remains that such SPV should obtain the appropriate license.

vi. The case of NPLs

The law of 15 July 2024 on the transfer of non-performing loans (NPLs), which transposes Directive (EU) 2021/2167 of 24 November 2021 on credit servicers and credit purchasers (the NPL Law), introduced an amendment to Article 28-4 of the

The CSSF does not detail what a "limited circle of previously determined persons" means; in practice, such a "limited circle" is generally composed of borrowers that share a certain number of characteristics which makes them clearly identifiable before the granting of the relevant loans.

Concerning the Professional Exemption, a "professional" within the meaning of the Consumer Code is a natural or legal person, public or private, which acts for purposes relating to his/her/its professional activity.⁽¹⁴⁾ Where the loans granted (or acquired) by a debt fund are made to companies, there should therefore be no issue for this exemption to apply to the extent the nominal value of the loans amounts to at least EUR 3,000,000 (or the equivalent amount in another currency).

Conclusion

Credit and other funds using Luxembourg SPVs for originating or holding loans should consider their structure and planned investment strategy and whether it leads to regulatory impacts in Luxembourg. Assuming a fund intends to invest in debt, they should ensure that they can benefit from existing exclusions or exemptions prior to investing.

Note that, generally, it is not only advisable for the board of managers/directors of the relevant Luxembourg SPV to consider the lending license criteria and exemptions at board level (and ensure a traceability of the reasoning followed or relevant facts) but also, where the application of an exemption may not be obvious, to submit a demand to the CSSF for a negative clearance letter.

Finally, the exemptions hearted in the CSSF Q&A are subject to change as they have in the past, often without much notification or prior consultation so it is also advisable to double check whether they are still in place when relevant.

Finally, on 26 March 2024, Directive (EU) 2024/927 amending Directives 2011/61/EU and 2009/65/EC (AIFMD 2) was published in the Official Journal of the European Union.⁽²⁰⁾ One of the objectives of the proposal for AIFMD 2 was to create an internal market for loan-originating funds in order to increase the availability of alternative sources of funding for the real economy.⁽²¹⁾ As a result, AIFMD 2 now allows loan origination by AIFs, subject to compliance with certain requirements and restrictions. Transposition of AIFMD 2 into the laws of EU Member States must occur by 16 April 2026.

In addition, it is important to note that the recently adopted Directive (EU) 2024/1619 (CRD VI)⁽²²⁾ introduces a restriction on the provision of certain banking services – including lending – by third-country undertakings into the EU on a cross-border basis. The restriction on lending activities however only applies to third-country undertakings that would qualify as a credit institution or a certain type of investment firm if they were established in the EU, meaning that cross-border lending activities by third-country funds are unaffected.⁽²³⁾

Please have a look at the following articles if you are looking for more details on the setting up of a Luxembourg debt- or credit fund, and information about capital-raising in Europe.

LFS, which now states that it does not apply to the activities of credit purchasers that are subject to the NPL Law.

A "credit purchaser" within the meaning of the NPL Law means "any natural or legal person, other than a credit institution, that purchases a creditor's rights under a non-performing credit agreement, or the non-performing credit agreement itself, in the course of its trade, business or profession."⁽¹⁴⁾

As a result, debt funds, including those AIFs that are potentially in scope of Article 28-4 LFS as described above, would be out of scope of the licensing requirement to the extent their loan acquisitions are limited to the acquisition of NPLs (although they would, in such case, be subject to the obligations imposed on credit purchasers under the NPL Law).

3. Available exemptions to a Luxembourg lending license

Despite the position expressed by the CSSF in the AIFM FAQ, a doubt remains as to whether unregulated AIFs are completely exempt from the LFS. In this respect it is important to note that there are a number of exemptions from the licensing requirement for lending activities that entities subject to the LFS may avail of, and that those AIFs may therefore rely on in order to avoid the need for a license.

A lending license under Article 28-4 of the LFS is not needed if:

- (i) the loans are provided on a "one-off" basis and not as a repetitive activity;⁽¹⁵⁾
- (ii) the loans are granted intra-group (the notion of group for these purposes being however interpreted very strictly);⁽¹⁶⁾
- (iii) the loans are provided to a limited circle of previously determined persons;⁽¹⁷⁾ or
- (iv) the nominal value of the loans amounts to at least EUR 3,000,000 and the loans are granted exclusively to professionals as defined in the Luxembourg Consumer Code (*Code de la consommation*) (the "Professional Exemption").⁽¹⁸⁾

It is important to consider that lenders without a license relying on one or more of these exceptions need to evaluate that each individual loan granted by the entity falls into one of the exceptions. An entity is not exempted by itself, instead each act of lending requires a reevaluation of the previously relied on exemption.

It is unlikely that debt funds, whose activity by definition is to invest in debt, would be able to benefit from the first two exemptions. The "limited circle" and the Professional Exemption are therefore the most relevant, assuming a licensing risk exists.

1) ALFI/KPMG Private Debt Fund Survey 2024. <https://lc.cx/Lm-YI>
 2) Special Purpose Vehicle.
 3) CSSF, Questions and Answers on the Statutes of "PFS" – Part II (version of 15 June 2021), Q52, p. 46, para. d.
 4) Art. 28-4 LFS.
 5) CSSF, Questions and Answers on the Statutes of "PFS" – Part II (version of 15 June 2021), Q52, p. 47, para. e.
 6) Art. 14 and Art. 28-4 LFS.
 7) Art. 17-22 LFS.
 8) Art. 1-1(2) LFS.
 9) Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds, Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds, and Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds.
 10) CSSF, Luxembourg law of 12 July 2013 on alternative investment fund managers – FAQ, version 19, June 2021.
 11) CSSF, Luxembourg law of 12 July 2013 on alternative investment fund managers – FAQ, version 19, June 2021, Q22, p. 79-79.
 12) *Ibid.*
 13) CSSF, Questions and Answers on the Statutes of "PFS" – Part II (version of 15 June 2021), Q52, p. 46, para. c.
 14) Art. 1(2) NPL Law.
 15) CSSF, Questions and Answers on the Statutes of "PFS" – Part II (version of 15 June 2021), Q52, p. 46, para. c.
 16) Art. 1-1(2)(c) LFS.
 17) CSSF, Questions and Answers on the Statutes of "PFS" – Part II (version of 15 June 2021), Q52, p. 46, para. c.
 18) *Ibid.*
 19) Luxembourg Consumer Code (*Code de la consommation*), Art. L. 010-1. (2).
 20) Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds.
 21) COM(2021) 721 final, p. 5.
 22) Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024 amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks.
 23) Art. 1(13) CRD VI (future Art. 47(1) of Directive 2013/36/EU, as amended by CRD VI).