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Foreword

Welcome to the fourth edition of Funds Insider, our quarterly publication focusing on hot topics across a wide range of practice areas of particular interest to private capital clients.

This edition covers:

- National Security and Investment Act coming into force and how that affects dealmaking in the UK
- The rise of venture capital in the Middle East
- The demarcation between the Luxembourg Securitisation Law and the Securitisation Regulation
- An overview of stakeholder expectations in resolving COVID-19 rent arrears in the UK in 2022
- The new Spanish financial assistance rules
- Our top tech predictions for 2022
- The current status of the European hospitality industry
- Key aspects of fund finance in Luxembourg - Knowing your borrower

Looking forward to what 2022 will hold, we can see a lot of the key themes and trends continuing from last year. We are increasingly seeing healthy businesses being very focused on seeking to cement the competitive edge gained during the pandemic through digital innovation and use of technology. This focus on technology also extends to M&A with this sector expected to continue to perform strongly in the year ahead. Availability of liquidity in the market remains strong and, as a direct consequence, European restructuring activity is still subdued. Macro challenges such as supply chain issues, tight labour markets, inflation and the fear of further COVID variants affecting recovery continue to be prevalent however, so we would expect this to translate to a level of market turbulence later in the year giving rise to more special situation and distressed opportunities.

In the wake of COP26, ESG remains as topical as ever, and we will continue to support our clients through this transition in every way we can.

We hope you enjoy reading this edition of Funds Insider. Please do get in touch if you have any feedback or if there are any topics that you would like us to cover in future editions.

Funds Insider

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Sea change in National Security Reviews of transactions in the UK

An overview of the Act, which came fully into force on 4 January 2022

By Neil Cuninghame

- Initiatives and investment by governments as part of broader economic diversification goals;
- The deep pools of capital readily available in the region; and
- Characteristics of the region itself, including its demographics and geography.

1. The Act introduces for the first time in the UK a mandatory notification regime covering national security reviews of transactions; relevant transactions must be cleared before they close
2. The scope of the regime is broad, applying to UK as well as non-UK purchasers, as well as intra-group transactions, and over 1,000 notifications are expected annually
3. Accordingly, funds investing in entities or assets in the UK, or with links to the UK, will need to factor the Act into their transaction planning at an early stage

The United Kingdom National Security and Investment Act 2021 (Act) received royal assent on 29 April 2021. It came fully into force on 4 January 2022, although it may be applied retrospectively to transactions completed in November 2020 or later.

The Act very significantly strengthens the Government's powers to investigate and potentially prohibit transactions on national security grounds, and has significant implications for funds and other investors engaging in transactions both in the UK and abroad.

What and who does the Act apply to?

The Act applies to defined "trigger events" in three ways:

1. certain trigger events are subject to **mandatory notification** and transactions may not be closed before clearance;
2. parties to other trigger events may **voluntarily notify** their transaction;
3. the Secretary of State may **call in** trigger events (whether following a notification or not) for a national security assessment.

Note that the regime applies regardless of whether the acquirer is a UK or non-UK person.

A "trigger event" is defined as a person gaining **control** of a **qualifying entity** or a **qualifying asset**. These terms are considered below.

Control of entities will arise:

- typically, where a person acquires more than 25%, more than 50%, or 75% or more of the shares or voting rights in a **qualifying entity**. This means that incremental acquisitions of shares or rights in the same entity can give rise to multiple trigger events;
- where a person acquires voting rights in a **qualifying entity** which enable it to secure or prevent the passage of any class of resolution governing the affairs of the entity (this does not appear to cover veto rights over specific types of matters often found in shareholder agreements);
- where the acquisition enables the acquirer to **materially influence** the policy of a **qualifying entity**. Factors such as the ability to appoint directors, the industry expertise of the acquirer and any agreements with the target will be relevant in considering whether material influence exists, but this is generally unlikely where shareholdings are under 15%.

Control of assets will arise where a person acquires a right or interest in, or in relation to, a qualifying asset and the person is able to use the asset, or direct or control its use, to a greater extent than prior to its acquisition.

"Qualifying entity" is very broad and covers any entity that is not an individual. It covers non-UK entities which have some UK activities or supply goods/services into the UK.

"Qualifying asset" includes land; tangible moveable property; and ideas, information or techniques which have industrial, commercial or other economic value. Non-UK assets are covered if they are used in connection with UK-based activities or the supply of goods/services into the UK.

Note that the Act applies to intra-group transactions/reorganisations, as well as transactions involving third parties.

1. Mandatory notification regime

The Act creates a mandatory notification requirement for certain transactions, called "**notifiable acquisitions**". A notifiable acquisition occurs where a person gains control of a qualifying entity falling within the descriptions set out in the Notifiable Acquisitions Regulations. Acquisitions of material influence or of qualifying assets will not trigger a mandatory notification. The Notifiable Acquisitions Regulations apply to the following 17 sectors, but only entities meeting the descriptions in the Regulations are covered, not all entities in those sectors:

- Advanced Materials
- Advanced Robotics
- Artificial Intelligence
- Civil Nuclear
- Communications

- Computing Hardware
- Critical Suppliers to Government
- Cryptographic Authentication
- Data Infrastructure
- Defence
- Energy
- Military and Dual-Use
- Quantum Technologies
- Satellite and Space Technology
- Suppliers to the Emergency Services
- Synthetic Biology
- Transport

The mandatory regime is suspensory, meaning the acquirer must obtain clearance before closing the transaction. A notifiable acquisition that is completed before approval will be void, and failure to obtain the necessary advance approval is a criminal offence and large civil penalties may also be imposed (see further below).

2. Voluntary notification regime

Parties to transactions that do not meet the criteria for mandatory notification may submit a voluntary notification to the Secretary of State if they consider that their acquisition may constitute a trigger event that could raise national security concerns.

3. Call-in regime

The Secretary of State may review acquisitions in detail by issuing "call-in notices" if they reasonably suspect that a trigger event has given or may give rise to a risk to national security. A call-in can occur following a notification, or if the transaction otherwise comes to their attention.

A call-in notice may:

- be issued **up to five years after a trigger event** has taken place, so long as that five-year period does not begin before 12 November 2020;
- **not be issued more than six months after the day on which the Secretary of State became aware of the trigger event**.

This timing difference creates an incentive to inform the Government of deals (even if no formal notification is made) in order to limit the possibility of any retrospective call-in to six months.

The Government's statement explains the way in which the call-in power will be exercised. When determining whether to call in a transaction, the following three risk factors will be considered:

a. **Target risk –** whether the target entity/asset is or could be used in a way that poses a risk to national security. This is most likely for targets within the scope of the mandatory regime or closely related areas.

b. **Acquirer risk –** whether the acquirer has characteristics that could suggest a risk to national security. The Secretary of State will consider factors such as the acquirer's sectors of activity, existing holdings, its ultimate controller, and whether it has ties or allegiance to a state or organisation which is hostile to the UK. A history of passive or long-term investments may indicate low or no acquirer risk.

c. **Control risk –** whether the amount of control being acquired over the entity poses a risk to national security.

Review process

Notifications may be made to a dedicated Investment Security Unit (ISU) through an online portal.

Once a notification (whether mandatory or voluntary) is accepted, the initial review will take up to 30 working days, following which the Secretary of State must either give a call-in notice or inform the notifying party that no further action will be taken.

If a call-in notice is issued, a new "assessment period" commences. This lasts for an additional 30 working days, but may be extended by a further 45 working days. Additional "voluntary" extensions may also be agreed. Furthermore, if an information request is issued following a call-in notice, the clock stops until the Government confirms that a satisfactory response has been received.

Information-gathering powers and interim measures

The Secretary of State may issue mandatory information requests and require the attendance of witnesses to give evidence. The Secretary of State can also impose interim orders to prevent or reverse "pre-emptive action" such as the integration of the two businesses.

Final decision and remedial powers

At the end of the national security assessment, the Secretary of State will either (i) issue a **final notification** that there is no national security risk; or (ii) issue a **final order**, finding that there is a national security risk and containing remedies to address it.

In its impact assessment published at the time the Bill was introduced to Parliament, the Government indicated that it expected to impose remedies only in around 10 cases per year. Remedies may include conditions on, for example, access to particular sites or to confidential information, or (more rarely) prohibition or divestment/unwinding.

Penalties for non-compliance

Failure to obtain a necessary mandatory approval in advance is a criminal offence, which could result in up to five years' imprisonment of officers of entities where the offence is committed with their consent or due to their neglect. It may also lead to civil penalties for the acquirer of up to 5% of worldwide turnover or £10 million, whichever is greater.

Fines, including daily penalties, may also be imposed for failure to comply with an interim or final order. There are also other offences, such as failure to comply with a requirement of an information request or witness attendance notice.

Impact of the Act

The Government originally stated that it envisaged around 1,000-1,830 notifications being made each year under the regime. Many commentators think that there will be far more than this, at least initially. The Act therefore heralds a fundamental change in the UK Government's approach, as there were historically very few transactions formally assessed under the Government's previous, more limited national security powers.

Funds investing in entities or assets in the UK, or with links to the UK, therefore need to factor the Act into their transaction planning at an early stage, particularly where a mandatory notification may be required.

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The Rise and Rise of Venture Capital in the Middle East

By Stuart James

Venture capital activity in the Middle East is increasing thanks to:

- Initiatives and investment by governments as part of broader economic diversification goals;
- The deep pools of capital readily available in the region; and
- Characteristics of the region itself, including its demographics and geography.

Stepping into Hub-71 feels like entering any other collaborative work space for start-ups and venture capital investors. There's an energy here you don't find in established corporate or fund management environments – an edge, a sense of pushing boundaries, of youthful urgency to destabilise and disrupt existing industries, markets, and thinking. Disrupt anything. This could be in Silicon Valley, Boston, New York or London. Except it's not. It's in the Abu Dhabi Global Market, a financial centre and free zone in the middle of the capital of the United Arab Emirates.

Now home to over 100 start-ups from around the world, Hub-71 is a thriving venture capital environment that is now ranked in the world's top 10 start-up ecosystems. Opened in 2019, it provides non-equity incentives and support to resident start-ups. The shared space fosters collaboration among start-ups, investors, corporates and government, providing a vital link between innovation and investment. Its success is evident. Earlier this year the first unicorn (a start-up valued at more than US$1 billion) joined as part of Hub-71's Value Creation Programme, which specifically targets later stage start-ups.

Hub-71 is no anomaly. Although the majority of start-ups and venture capital investments originate in the United States, the Middle East is an area of rapidly increasing venture capital activity. A rising number of start-ups and VC fund managers domiciled in the region, increasing inbound investment, and increasing activity from Middle Eastern sovereign wealth funds in the sector, both within the region and overseas, are all testament to this. The actions of governments and certain characteristics of the region itself have contributed to this rise.

Government support

MENA-based start-ups attracted more than US$1.2 billion in funding in the first half of 2021, representing 64% year-on-year growth.[1] A look at the countries in the region receiving the most funding – with 71% invested in the UAE (mainly through the various financial centre free zones, such as the Dubai International Finance Centre, and the ADGM), Saudi Arabia and Egypt – reveals why the region is experiencing a venture capital boom.

Both the UAE and Saudi Arabia have led the way for the oil exporting nations in the Middle East in implementing strategies and initiatives to diversify their economies and reduce their reliance on hydrocarbon resources and related industries. With the world currently experiencing the fastest energy transition in human history, these countries, starkly aware of the implications of this shift on their core revenue-generating assets and ultimately on their long-term wealth, have acted decisively. Both countries have aggressive economic diversity and sustainability goals, together with broader modernisation ambitions, to achieve by 2030. Not surprisingly, other Gulf States such as Qatar and Bahrain have similar strategies for the remainder of the decade.

To achieve these goals both the UAE and Saudi Arabia have implemented fiscal reforms and unleashed large-scale programmes to privatise assets, increase public-private partnerships, unlock value by monetising real assets and infrastructure, improve public benefits and services, develop social and human resources, and optimise government operations. These initiatives, together with complementary legal and regulatory reforms and social changes, ultimately make these countries more attractive destinations for foreign capital with more diverse, efficient and sustainable economies.

In this context, both the UAE and Saudi Arabia have recognised the importance of the venture capital sector to achieve these economic aims. Government-led initiatives have therefore been a key driver of growth in the venture capital sector in the region, evidenced by the development of start-up ecosystems.

1 MENA H1 2021 Venture Investment Report, MAGNiTT.

Hub-71 for example is a flagship initiative of Abu Dhabi's US$13.6 billion accelerator programme for business in the city, Ghadan 21. With backing from the likes of Abu Dhabi sovereign wealth fund Mubadala and leading venture capital investors Softbank Vision Fund and Microsoft, it's no surprise that the initiative is going from strength to strength. Dubai has undertaken similar initiatives, with Dtec (Dubai technology entrepreneur campus) in the tech-focused free zone Dubai Silicon Oasis, and DIFC Fintech Hive, which is a similar hub in the DIFC.

But government support for the sector goes beyond simply providing a desk and Wi-Fi. A tax-free environment has long been an attraction of jurisdictions like the ADGM and DIFC, but this is now complemented by an institutionalised support network aimed at attracting start-ups and giving them the best chance to succeed. The Dubai Future District, for example, has been created to promote innovation and is dedicated to developing the new economy. Within this district, made up of three main financial areas including the DIFC, businesses have access to licensing, visa, legal, funding and housing support – an environment designed to attract start-ups and give them the best chance to succeed.

Middle Eastern governments are also increasingly providing regulatory support to start-ups. All of the Gulf States for example either have or are proposing regulatory sandboxes for Fintech, which provide a protected environment for innovators to test Fintech products with oversight by regulators. Following the first Fintech sandbox in the region launched by the ADGM in 2016, ADGM RegLab, both the Dubai Financial Services Authority in the DIFC and the Central Bank of Bahrain followed suit in 2017. The Central Banks of Saudi Arabia and Kuwait launched their sandboxes the following year, and recently Oman and Qatar announced their intention to do the same as part of broader efforts to encourage Fintech investment and innovation in the banking sector.

There is also regulatory support for venture capital funds. The ADGM for example has created a specific regulatory framework for venture capital fund managers. Some of the benefits of this framework are reduced governance and control requirements, eg no requirement to appoint an internal auditor, separate custodian or independent fund administrator, and no minimum capital requirements. Certain requirements must however be met: the fund must invest in equity of unlisted early stage companies and have a closed-end structure, the offering must be made by private placement to professional investors, and fund size is limited to US$100 million, unless otherwise agreed with the regulator, the Financial Services Regulatory Authority.

The availability of capital

Start-ups obviously need funding. The abundance of local capital for this purpose has attracted start-ups to the Middle East and provided the financial firepower to animate the VC ecosystems.

Most of this capital has been provided by the sovereign wealth funds of the Gulf States. These SWFs have become global venture capitalist powerhouses, rivalling the leading private equity firms. Their deep pockets, long investment horizons and gravitas make them the ideal partner. Mubadala alone poured nearly US$3.5 billion into venture capital investments in the first nine months of 2021.[2]

SWF investment in start-ups has mainly been in offshore markets; the US, China and India in particular, and typically in later stage funding rounds where bigger ticket sizes fit better with their traditional investment strategies. Mubadala's US$1.2 billion investment in 2020 in Jio Platforms, an Indian telco and data services company, is an extreme example of that. But now, with experienced in-house VC investment capability, earlier stage investing by the SWFs is becoming commonplace.

Mubadala in particular is becoming more nimble and is shifting towards investment in earlier stage rounds, having launched a $400 million European tech fund in 2018 for that purpose. Just after the UAE and the UK signed a £10 billion sovereign investment partnership earlier this year, its global ventures platform led a £60 million Series B funding investment in Huboo, a UK-based e-commerce fulfilment provider that is expanding in Europe. This was the largest ever Series B raise in the UK.

Middle Eastern SWFs are also now increasingly looking in their own backyard. Armed with learnings from the implementation of their US and European venture strategies, they have recognised that funding high-growth businesses in the region is an important part not only of their investment strategies but also their broader role in achieving their respective state's transformative economic aims. And the VC investment capability and knowhow they have developed, and the profile of their investment activity, particularly in unicorns, have provided a welcome boost to the region's start-up sector.

2 SWF Global, 7 October 2021.

Saudi Arabia's Public Investment Fund has been aggressive on this front, particularly through its VC-focused investment vehicles, the most notable being Softbank Vision Fund. Created five years ago (specifically for technology investment) with Japan's Softbank, other sovereign wealth funds such as Mubadala and corporates such as Apple, its two funds now reportedly have assets under management of around US$150 billion. The firepower it brings to the local start-up scene was evident in July 2021 when Softbank Vision Fund 2 led the US$415 million Series C raise by Kitopi, a Dubai-based cloud kitchen platform and now the region's third homegrown unicorn.

PIF's support of fund managers has also formed a key aspect of its strategy. For the sole purpose of promoting the development of a venture capital ecosystem, two years ago PIF established Jada, a fund of funds company. By funding venture capital funds and private equity focused on the Saudi market, Jada's mandate is to create a self-sustaining growth platform for local SMEs. Look deeper into the funds it has invested in and its ecosystem development strategy becomes clearer. One such fund, VentureSouq, is an ADGM VC fund focusing on MENA Fintech opportunities. Its base? Hub-71.

Fund managers like VentureSouq are also critical for tapping into another prevalent deep pool of capital for regional start-ups – family offices and high-net-worth individuals. Family offices have traditionally played an important role in the economies of Middle Eastern states, and this is now extending to the digital economy. Historically underinvested in technology and generally slow to embrace change, leaders of Middle Eastern family offices are realising that the current pace of change and the extent of digital disruption now leaves their businesses exposed. 75% of those leaders now say that technology, digital and innovation initiatives are a top priority for the next two years.[3] With 58% of family offices intending to expand into new markets or client segments, tech-based start-ups, alongside real estate and private equity, now form one of the main asset classes where these investors are eager to find returns.[4] That's overwhelmingly positive news for start-ups in the region.

Regional characteristics

The drive for economic diversification and ensuing government financial and other support for start-ups is, however, only part of the story. The rise of venture capital in the Middle East is not limited to the Gulf States and their start-up cultivating approach. Why has Egypt for example developed a thriving venture capital ecosystem, becoming a regional start-up powerhouse? Although it too has benefitted from aggressive government policies to support start-ups, the answer also lies in some of the characteristics of the region itself.

3 PwC Middle East Family Business Survey 2021.
4 PwC Middle East Family Business Survey 2021.

The Middle East is an increasingly attractive emerging market. There is both large scope for the development of new goods and services and significant room for new businesses across a wide variety of sectors to grow, and grow rapidly, given the utilisation of technology. And the aggressive reform programmes and diversification initiatives referred to above only enhance the broader economic environment in which new businesses can thrive. For start-ups, it's even more attractive given the start-up sector in the region is still relatively immature.

The financial services sector provides a good example. A high percentage of the adult population in the Middle East is unbanked. It's estimated that 70% of the region's adults lack access to a bank account (up to 80% in the region's developing nations) despite many being active economic citizens.[5] The region, and even the developed nations within it, still rely heavily on cash, and cash on delivery, as a payment method. Fintech, and its application throughout all aspects of the financial services value chain – from payment systems, to digital delivery models and micro banking – has the potential to completely change that.

The Fintech sector in the Middle East has steadily grown over the past years at a compounded annual growth rate of over 30%, up an impressive 49% on a year-on-year basis for H1 2021.[6] Most of this growth is in payments, transfers and remittances, with 85% of Fintech firms in the region operating in this space.[7] This is not surprising given the historical high prevalence of cash transactions, the rapid recent growth of e-commerce, and large expat workforces. In 2017 in the UAE alone, expat remittances (mostly to India, Pakistan and the Philippines) totalled US$44.5 billion.[8]

Facilitating this Fintech rise is the fact that the MENA region is one of the most digitally connected in the world. Smartphone usage is widespread – currently constituting over 60% of all connections and forecast to be 80% by 2025.[9] Internet usage is also high, with over 88% of the population going online daily.

Demographics also play a big part. Home to 7.5% of the world's population, the MENA region has a predominantly young population. Of the nearly 600 million people in the region, more than 50% are under 25 years old. This translates to a customer base unencumbered by traditional service delivery methods and engagement with providers, and a growing culture of entrepreneurship.

Historically, the Middle East has also benefitted from its geographical location, as a gateway to both Africa and Asia. Given that one-third of the world's population lives within a four-hour flight of Dubai (and two-thirds within either hours), the region's proximity to Africa and Asia is an attractive attribute for start-ups looking to capitalise on those vast emerging markets.

New regional cooperation between Israel, the UAE and Bahrain under the Abraham Accords should only further enhance the growth of the venture capital sector in the Middle East. Israel has traditionally been the region's technology and innovation capital, forging close links with Silicon Valley and being a world leader in security, AI and enterprise software development. With the signing of the Abraham Accords in August 2021, the pathway for collaboration, particularly for cross-border investment in tech and other sectors, has become clearer. Indeed, the commercialisation of the Accords from a venture capital perspective has already commenced. In November 2021, Israel's most active VC fund, OurCrowd, became the first Israeli fund manager to be licensed in the ADGM, targeting tech start-ups in the UAE and the broader region.

These factors all make the region a place of opportunity, attractive for start-ups looking for markets, global private equity firms looking for high returns, and corporates hungry for acquisitive growth. In H1 2021, 31% of MENA-based venture capital transactions involved investment from outside the region.[10] Some of the larger acquisitions in the Middle East by foreign investors in recent years have grabbed the headlines and shown the extent of opportunities that exist there. These include Uber's acquisition of MENA ride-hailing business Careem in 2020 for US$3.1 billion, and Amazon's acquisition of MENA online retailer Souk.com in 2017 for US$650 million.

While these high-profile deals catch the eye, they're also indicative of an increasing strength in the underlying M&A market in the Middle East, creating more exit opportunities for both founders and investors alike. The challenge for the region is for local equity markets to mature to the point that listings on local exchanges such as the ADX or DFM become a viable, and commonplace, exit strategy. IPO exits have generally been challenging for regional start-ups – Middle East companies accounted for less than 1% of all IPOs globally in the first half of 2021, and many of those IPOs were of large state-owned enterprises.[11]

The current popularity of "SPACs" – special purpose acquisition companies, which are listed with the sole purpose of making acquisitions within a certain time period – should increase the number of IPO exits for regional start-ups.[12] The imminent listing on NASDAQ of Anghami, the Arab world's leading music streaming business, through its merger with a SPAC, Vista Media Acquisition Company, has led the way, showing the benefit of this structure for start-ups by de-risking the IPO process. The NASDAQ listing of Swvl, a bus ride sharing business that started in Cairo, should soon follow, with Swvl having agreed a merger with a SPAC, Queen's Gambit Growth Capital, in July 2021. And while these transactions stand out as they'll be the Middle East's first tech companies to be listed on NASDAQ, a more impressive story will be regular listings of companies like Anghami and Swvl on Middle Eastern exchanges, either through SPACs or by the traditional listing route.

Conclusion

The rapid rise of venture capital in the Middle East has not happened by accident. Facilitating the development of sustainable venture capital ecosystems, backed by their powerful sovereign wealth funds, has been a key pillar of the economic diversification strategies of the region's oil exporting nations as they discard their historic petrodollar dependency. And the culture of transformation and innovation that this is creating, combined with the Middle East's young, digitally connected population, who are ideally located between two other large emerging markets, looks set to ensure that this rapid rise continues.

5 To the Future and Back: Financial Inclusion in the Arab World by Nadine Shehade, CGAP.
6 MENA H1 2021 Venture Investment Report, MAGNiTT.
7 Ibid.
8 Ibid.
9 Statista Research, 25 March 2021.
10 MENA H1 2021 Venture Investment Report, MAGNiTT.
11 The Many Paths to Exit by Noor Sweid, General Partner, Global Ventures.
12 There were 305 SPAC IPOs globally in the first half of 2021, raising a total of US$98 billion. MENA H1 2021 Venture Investment Report, MAGNiTT.

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Luxembourg law-governed securitisation transactions

The demarcation between the Luxembourg Securitisation Law and the Securitisation Regulation

By Markus Waitschies and Isabelle Lentz

- Luxembourg securitisation transactions continue to be regulated by national law only if tranched securities are not issued.
- Tranching can also occur in single investor scenarios and therefore falls under the Securitisation Regulation.
- The securitisation of one single asset, provided that tranched securities are issued, will also lead to the application of the Securitisation Regulation.

The Securitisation Regulation

The following article is an overview of the main mechanisms with respect to the application of Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the Securitisation Regulation) and the Luxembourg law of 22 March 2004 on securitisation, as amended (the Luxembourg Securitisation Law) in the context of securitisation transactions set up by a Luxembourg-incorporated securitisation special purpose vehicle.

Under the Securitisation Regulation, "securitisation" means a transaction or scheme whereby a credit risk is tranched as follows:

- payments depend on the performance of the underlying exposure;
- the distribution of losses during the ongoing life of the transaction is determined by the subordination of tranches; and
- the transaction does not constitute a specialised lending in order to finance or operate physical assets as defined in Article 147(8) of Regulation (EU) no. 575/2013.

In summary, one can therefore say that the two main criteria of the notion of securitisation under the Securitisation Regulation are the requirements of (i) credit risk and (ii) tranching.

The Luxembourg Securitisation Law

However, under the Luxembourg Securitisation Law the definition of securitisation is broader as it does not require a securitisation undertaking to securitise credit risk by issuing tranched securities.

The Securitisation Regulation versus the Luxembourg Securitisation Law

In the light of these differences regarding the scope of the Securitisation Regulation and the Luxembourg Securitisation Law, a Luxembourg securitisation transaction can primarily be structured in three possible ways:

1. **Securitisation which is subject only to the Luxembourg Securitisation Law**

   It is still possible to structure a Luxembourg securitisation transaction in such a manner that the structure will only have to be compliant with the Luxembourg Securitisation Law and will not be covered by the scope of the Securitisation Regulation. This can generally be achieved either by securitising a risk other than a credit risk or by not tranching the securities to be issued.

2. **Securitisation under the Securitisation Regulation**

   Securitisation transactions which securitise credit risk and issue tranched securities, ie securities that contain different segments, eg senior and subordinated segments, will usually be subject to both the Luxembourg Securitisation Law and the Securitisation Regulation. In other words, this usually means that requirements and rules such as risk retention, transparency and due diligence need to be complied with by the securitisation undertaking in addition to the application of the general framework of the Luxembourg Securitisation Law. Consequently, the provisions set out in both the Luxembourg Securitisation Law and the Securitisation Regulation will have to be respected by a Luxembourg-incorporated securitisation special purpose vehicle in such a case.

3. **STS (simple, transparent and standardised) securitisation**

   The Securitisation Regulation has also introduced a framework for simple, transparent and standardised securitisation transactions which fulfil the definition of STS securitisation as set out in the Securitisation Regulation. Such STS transactions are foremost a specific category of securitisation which needs to be assessed by applying the relevant provisions set out in the Securitisation Regulation (chapter 4 of the Securitisation Regulation). However, given that they would in most instances still fulfil the general definition of securitisation under the Luxembourg Securitisation Law, such transactions must also comply with all relevant requirements imposed by the law. For instance, the general requirement that any securitisation vehicle can offer its securities to the public on a continuous basis (ie more than three times a year on an all-compartment basis) only if it has been authorised by the Luxembourg financial supervisory authority (CSSF) also applies a priori to such STS transactions.

Specific cases of tranching

In the light of the above, one can therefore conclude that the crucial factor in determining whether or not the Securitisation Regulation will be applicable to a Luxembourg-incorporated securitisation vehicle in addition to the Luxembourg Securitisation Law is whether the transaction will entail the issuance of tranched securities. However, in specific cases the topic of tranching can give rise to discussions – the legal treatment of which is not entirely clear.

Pursuant to article 2(6) of the Securitisation Regulation, "tranche" means a contractually established segment of the credit risk associated with an exposure or a pool of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in another segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments.

Such tranches have different risk/return profiles and levels of seniority as well as different degrees of priority with respect to cash flows. Customarily, in case of losses the initial losses are absorbed by the equity or "junior" tranche, followed by the mezzanine tranche, which in turn is followed by the more senior tranches.

1. **Transactions consisting of the issuance of securities and the entering into a loan agreement**

   In this context, the question arises whether, in a situation in which the securitisation undertaking issues securities and subscribes to a loan as part of the same securitisation transaction, the required tranching would already be fulfilled if an analysis of the position of the securities holder and the loan provider (both groups being exposed to the same portfolio of assets) would lead to the conclusion that they do indeed have different, subordinated positions as regards the distribution of losses of the transaction. In other words, can one already speak of tranching if the securities would not entail any specific subordination provisions, as such provisions only arise from the different risk positions under the securities and the loan (comparing the positions of the securities holders and the loan provider)?

   The definition of "tranche" set out in article 2(6) of the Securitisation Regulation is rather wide and does not provide any clear-cut answers. As mentioned, the definition states that "tranche" means a contractually established segment of the credit risk associated with an exposure or pool of exposures, where a position in a segment entails a risk of credit loss greater than or less than a position of the same amount in another segment. It is, however, not clear precisely what would have to be understood by "segment". In other words, the question arises whether "segment" could only be a specific contractual position created by the particular structure of the terms and conditions of the securities issued by the securitisation undertaking or whether one could also have different segments relating to the same exposure or pool of exposures if such segments have been brought about by the co-existence of two completely different tools (ie issuance of securities and the subscription to a loan).

   Strictly speaking, however, the definitions of securitisation and tranche do not contain any such explicit distinction. The only prerequisite seems to be the reference in the definition of "tranche" to the fact that the different risk segments need to be contractually established by the securitisation undertaking. In this respect, it should however not be sufficient to have a different risk segment established by way of the participation of a third entity (ie an entity other than the issuer) providing particular risk insurance in case of losses under the securities.

2. **Transactions consisting of the issuance of both debt and equity securities**

   Furthermore, the question arises whether, in a situation in which in addition to the issuance of debt securities the securitisation undertaking has also issued shares and the proceeds of such equity issuance have been used in the acquisition of the relevant securitisation, underlying tranching also arises. In such a situation one might argue that two different risk segments have been created which have brought about the existence of different categories of investors with regard to their risk exposures. In relation to this question, the Securitisation Regulation does not provide any specific indications as to how such a case must be assessed. However, given the fact that the share position ranking is legally and not contractually defined, if the equity issuance was done for general investment and cash flow generation purposes without there being a specific link to the shares participating in a particular underlying (similar to the position under the debt securities) such context should not be sufficient for the required tranching to arise. However, this might have to be viewed differently in a situation in which the securitisation undertaking has issued different types of shares with different rankings and where specific shares are explicitly linked to a particular underlying and whose dividend payments would only be generated from the proceeds originated by such underlying. Consequently, a case-by-case analysis ought to be carried out in such "equity-to-debt ratio" scenarios.

3. **Single investor contexts**

   In single investor scenarios the question arises whether tranching can also occur if all the different risk segments are held by the same investor. There might be some uncertainty in this respect given that in case of losses under the securities the same investor will always be affected, so that from a practical perspective all losses irrespective of the tranche in question are always absorbed by the same investor. However, the fact that only one investor exists should not be decisive for the question of whether or not tranching has arisen. The definitions of both securitisation and tranche under the Securitisation Regulation do not require an assessment from an investor's point of view. It should therefore ultimately not matter by whom the different risk segments are held. The main criterion is the requirement that different risk segments have been created contractually without focusing on the investor in question.

4. **Losses occurring during the ongoing life of the transaction**

   Furthermore, the definition of securitisation pursuant to article 2(1)(b) of the Securitisation Regulation requires that "the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme". In this respect, one might wonder whether, when only one single type of asset is securitised, tranching could occur. In such a situation one might argue that tranching could never materialise since, should the underlying assets stop performing, the whole structure would default and ultimately have to be terminated. It might therefore not be possible to speak of different risk segments persisting throughout the ongoing life of the transaction as the defaulting situation will affect all risk segments by ending all of them at the same time.

   The Securitisation Regulation contains no specific references or rules (neither in the recitals nor in the main body of the regulation) from which it could undeniably be deduced that single asset securitisations are not to fall under the scope of the Securitisation Regulation.

   From an investor protection perspective, we cannot conclude that the Securitisation Regulation is not applicable since such an approach would lead to the risk retention and transparency requirements set out in chapter 2 not being applicable. This would ultimately lead to a position in which the investors in a single asset securitisation transaction would be less protected than investors which have invested in securities linked to a pool of different assets, although the former, given the higher risk of the transaction being prematurely terminated, would be exposed to even more risk in this respect.

Other topics of discussion under the Securitisation Regulation

1. **Direct lending activities**

   a. Direct lending under the Luxembourg Securitisation Law

      Pursuant to the Luxembourg Securitisation Law, securitisation usually involves the acquisition of one or several claims from an originator. However, it is accepted that under specific circumstances a securitisation undertaking may itself

expressly grant loans instead of their being acquired on the secondary market. The CSSF states in its Frequently Asked Questions on Securitisation (October 2013) that direct lending can be regarded as securitisation provided that the securitisation undertaking does not allocate funds from the public to a credit activity on its own account, and that the documentation relating to the issue either clearly defines the assets on which the service and the repayment of the loans granted by the securitisation will depend, or clearly describes the borrower(s) and/or the criteria according to which the borrowers will be selected, so that investors are adequately informed of the risks. Consequently, in specific circumstances and subject to the conditions mentioned above, direct lending is an accepted securitisation activity within the meaning of the Luxembourg Securitisation Law.

b. Direct lending under the Securitisation Regulation

The Securitisation Regulation does not however expressly confirm whether direct lending transactions qualify as securitisation within the meaning of article 2(1) of the Securitisation Regulation.

However, taking a closer look at the mechanism of the Securitisation Regulation and its definitions, one could conclude that direct lending might not be covered by it as several aspects of the regulation might convey the idea that the securitised risks must have been created by an entity other than the securitisation undertaking itself.

For instance, the definition of "securitisation special purpose entity" clearly states that such an "SSPE" means a corporation, trust or entity other than an originator or sponsor and that the activities of the securitisation undertaking are structured so as to isolate the obligations of such an undertaking from those of the originator. In this respect, the originator is defined as being an entity that was involved in the original agreement and which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised or which purchases a third party's exposures on its own account and then securitises them.

Furthermore, the Securitisation Regulation explicitly refers to two different types of securitisation transactions, ie "traditional securitisation" and "synthetic securitisation".

Traditional securitisation is to be understood as a securitisation involving the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to a securitisation undertaking or through sub-participation by a securitisation undertaking, where the securities issued do not represent payment obligations of the originator. Synthetic securitisation means a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator.

In particular, the concept of traditional securitisation shows that the purpose of the securitisation undertaking is primarily to acquire already existing exposures, which will be transferred from the originator to the securitisation undertaking, instead of the securitisation undertaking itself creating such exposures by direct lending.[1] This idea seems to be corroborated by most of the official European Commission and European Parliament publications with respect to the Securitisation Regulation, as in none of these publications can any explicit reference be found to the notion that direct lending activities engaged in by a securitisation undertaking are to be viewed as securitisation within the meaning of the Securitisation Regulation.

In fact, most of the publications refer to the various parties in a securitisation transaction such as the original lender, the originator, the sponsor, the securitisation undertaking, the underwriter, etc. These entities are all viewed as separate, each having its own distinctive function in the securitisation. Furthermore, the briefing note dated January 2018 from the European Parliament on common rules and new framework for securitisation clearly states that securitisations under the Securitisation Regulation are viewed as either "traditional" or "synthetic".[2]

1 European Parliament, Understanding Securitisation, Background-benefits-risks, October 2015- PE569.017.

2 Briefing EU Legislation in Progress, January 2018, PE 608.777.

However, in both definitions the risks to be securitised are transferred to the securitisation undertaking and therefore could not be created by it by direct lending activities. The aforementioned briefing note further states that in the context of traditional securitisations the assets are effectively transferred to the securitisation undertaking and removed from the originator's balance sheet. This means that the assets must have been existing assets which were acquired by the securitisation undertaking from the originator. In a direct lending scenario, such subsequent transfer of an existing exposure could not occur since it would have been the securitisation undertaking itself which created the underlying obligations. Therefore, unlike the position taken in Luxembourg as regards the Luxembourg Securitisation Law, direct lending activities do not seem to qualify as securitisation under the

Securitisation Regulation. However, on the other hand, such an assessment would lead to the result that in a direct lending scenario in particular the risk retention and transparency obligations, which are foremost a mechanism to protect the investors, would not be applicable. From a mere investor protection perspective it does not seem to make sense to distinguish between scenarios in which existing assets were acquired by the securitisation undertaking and those in which the securitisation proceeded to create them itself. It is therefore advisable to assess any context containing a direct lending component on a case-by-case basis, to follow closely any publication of circulars or statements of the CSSF on securitisation and, in situations where the non-compliance risk might be very high, to address the CSSF for clearance on an individual basis.

2. Borrowing activities by a securitisation undertaking

a. Implications under the Luxembourg Securitisation Law

Usually, the securitisation undertaking is financed by the issuance of securities whose value or yield depends on the risks assumed by the securitisation undertaking pursuant to article 1(1) of the Luxembourg Securitisation Law. In specific instances it is however accepted that the securitisation undertaking uses borrowing or intra-group financing on a temporary basis in order to pre-finance the acquisition of the risks to be securitised while it proceeds to the issuance of securities to investors at a later stage (warehousing).

Furthermore, it is accepted that borrowing can be done on a lasting but limited basis. In this respect, it is however important to note that such borrowing can only be done on an ancillary basis while the main and determining purpose of the transaction must always be securitisation, ie the economic transformation of risks into securities. In other words, borrowing can only be viewed as acceptable if the transaction as a whole also includes the issuance of securities for a proportionately substantial amount (see question 9 of the CSSF Frequently Asked Questions on Securitisation, October 2013).

b. Implications under the Securitisation Regulation

As far as the Securitisation Regulation is concerned, it seems unclear whether a securitisation undertaking falling under the scope of the Securitisation Regulation would also be permitted to engage in borrowing activities. The official EU Commission and EU Parliament publications are silent on this point. However, the definition of "traditional securitisation" set out in article 2(9) of the Securitisation Regulation refers to the fact that the securities issued do not represent payment obligations of the originator. From this reference one might have to conclude that a securitisation transaction under the Securitisation Regulation must also primarily entail the issuance of securities by the securitisation undertaking. Furthermore, the explanatory memorandum regarding the official proposal for the Securitisation Regulation of the European Parliament and of the Council (2015/0226 (COD)) dated 30 September 2015 states on page 2 that securitisation refers to transactions that enable a lender or other originator of assets to refinance a set of loans or assets by converting them into securities.[3] This aspect is also reflected in recital 19 of the Securitisation Regulation, which refers to the acquisition of risks to be securitised and which in this context states that such risks are transformed into tradable securities. However, despite these indications it still seems unclear whether, at least to a certain extent and as an ancillary activity to the issuance of securities, the securitisation undertaking could engage in borrowing by entering into loan agreements rather than by issuing securities only. Should one come to the conclusion that mixed issuing and borrowing structures would not be covered by the Securitisation Regulation, it might unduly provide a possibility to circumvent the obligations of the Securitisation Regulation, which again from an investor protection perspective might not be convincing. It is therefore advisable that market participants follow closely any developments in terms of publications or statements made by the CSSF or ESMA in this respect.

3 European Commission COM (2015) 472 final.

Summary

- The application of the Securitisation Regulation rests on two main components: the securitisation of credit risk and the occurrence of tranching.
- Securitisation transactions set up by a Luxembourg-incorporated securitisation undertaking which do not securitise credit risk and where no tranched securities are issued usually fall under the scope of the Luxembourg Securitisation Law only.
- Tranching should also arise out of a combination of the issuance of securities and the granting of a loan, as tranching should occur whenever different risk segments are contractually established.
- The ordinary share capital of the securitisation undertaking may not be sufficient for tranching given that the ranking of shareholders of the securitisation undertaking is legally established and does not arise by way of contractual relationship.
- Single investor scenarios should not automatically lead to the conclusion that tranching has not occurred as single investor status should be irrelevant if two different risk segments are held by the same investor.
- The securitisation of one single asset should usually also qualify as tranching and can therefore constitute a securitisation under the Securitisation Regulation irrespective of the fact that in case of a default of such asset the transaction will automatically come to an end.
- Whether direct lending and borrowing activities carried out by a securitisation undertaking and which are acceptable under the Luxembourg Securitisation Law would also fall under the scope of the Securitisation Regulation is unclear. Arguments from an investor protection perspective might however lead to the conclusion that such transactions, provided credit risk is securitised and the securities in question are indeed tranched, would need to comply with the Securitisation Regulation.

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Resolving COVID-19 rent arrears in the UK

What can stakeholders expect in 2022?

By Richard Bulmore and George Bland

- The substantial rent arrears that have built up during the pandemic are likely to mean that restructurings of landlord liabilities continue to be a focus through 2022.
- The introduction of restructuring plans offers companies a powerful alternative to the more established CVA, but challenges to the use of CVAs and restructuring plans are also likely to continue. Recent decisions have reinforced the use of these procedures as a means for compromising rent liabilities.
- The Government's long-awaited commercial rent arrears scheme is due to be introduced in March 2022, which may alter the dynamics for stakeholders, but it remains to be seen how popular the scheme will be in practice.

It is estimated that at least £7 billion in commercial rent arrears is outstanding in the UK market. Restructurings of companies with rent liabilities therefore continue to be on the horizon in 2022, with implications for stakeholders. We look at some themes that may affect those restructurings: the use of CVAs and the Part 26A restructuring plan; the persistence of challenges to those processes; and the backdrop to the proposals for commercial rent arbitration.

The restructuring options – CVA or restructuring plan

Company voluntary arrangements (or CVAs) have long been used by companies as a means of restructuring leasehold liabilities. However, the Part 26A restructuring plan introduced in 2020 offers an alternative, much more powerful tool for binding creditors, since it allows for one or more dissenting classes of creditors or shareholders to be bound by a plan where those classes would be no worse off in the 'relevant alternative' to the plan (known as 'cross-class cramdown'). It has also been tested: the Virgin Active restructuring plan decision involved the English High Court approving a compromise forced on dissenting landlords by the votes of secured creditors.

We expect Part 26A restructuring plans to continue to be used for larger, more complex restructurings dealing with both financial and operational liabilities. They may also be the only option for companies effecting an operational restructuring where their creditor breakdown means that the landlords' voting power could block a CVA (in which case the 'cramdown' power of a restructuring plan is required). CVAs will still have their place, and we expect they will continue to be used by SMEs and mid-market companies looking to compromise leasehold portfolios.

Why might a company with leasehold liabilities consider using a restructuring plan, rather than a CVA?

	Restructuring Plan	CVA
Approval	Requires (i) 75% by value of at least one in-the-money voting class; (ii) court sanction. Dissenting classes (including landlords) can be "crammed down".	Requires 75% by value of creditors entitled to vote. No court sanction required. No cross-class cramdown possible.
Voting discount to landlords	None seen so far.	Pre-2020, typically 75%. Currently 0%-50% (frequently 25%).
Termination rights	Crucial that compromised landlords have termination rights.	
Wider Restructuring	Financial creditors may be compromised within the same restructuring plan as landlords.	Financial creditors are more commonly addressed through a parallel scheme, restructuring plan or other amendments or refinancing.
'In' or 'out of' the money	Creditors who are out of the money can be excluded from voting and can also be relatively easily crammed down.	Every creditor who has been given notice of the voting procedure is entitled to vote. Irrelevant whether 'in' or 'out of' the money.
Challenges	Challenge process is 'baked-in'. Creditors may challenge the plan at the convening or sanction hearings.	A compromised creditor can only challenge the CVA after it has been approved, and within 28 days.

Challenges to rent liability restructurings: what are the key takeaways?

On the face of it, it has been a disappointing year for landlords. In May, we saw the High Court hand down three important decisions concerning the restructuring of landlord liabilities – *New Look, Regis* and *Virgin Active*. Despite winning in *Regis*, it was a mostly pyrrhic victory for the landlords, and the landlords were defeated in both *New Look* and *Virgin Active*, where their legal challenges failed to gain any real traction. A few months later, the *Caffè Nero* CVA challenge was also unsuccessful, with the High Court rejecting allegations of unfair prejudice and material irregularity.

However, there are some positives for landlords too. The *New Look* decision should bring an end to landlord CVAs reliant upon the votes of a large group of truly unimpaired creditors to get them through. And, while many of the landlords' challenges to the *Regis* CVA failed, the CVA was ultimately revoked because the treatment of its shareholders under the CVA was found to be unfairly prejudicial to the landlords as creditors of the company.

CVAs have to some extent been allowed to develop relatively unchecked for more than a decade, but the *Regis* case comes as an important reminder that the court can, and will, strike down a CVA in an appropriate case. Aside from formal challenges by landlords, the attempted restructuring plan by *National Car Parks*, which was suspended following receipt of an improved offer for the company, also shows that companies considering a restructuring plan will need to provide robust evidence regarding the 'relevant alternative' to the plan.

The increased court scrutiny of CVAs, and now restructuring plans, is to be welcomed as it provides legal rigour to a process that has been allowed to develop relatively unchallenged over the last decade. However, for the most part, recent decisions sweep away much of the landlords' unfairness arguments and vindicate the use of CVAs and restructuring plans by companies. In particular:

- In *New Look*, it was held that a CVA which allows a company to remain in possession on a reduced future rent is not necessarily unfair.
- Generally, the answer to landlords' complaints about their treatment under a CVA is provided by the landlords' rights to terminate.
- *New Look* also confirms that, while a CVA cannot force a surrender on a landlord, a CVA can achieve substantially the same result through a carefully drafted 'termination right', by which a company can offer to give up any right of occupation in return for a release from its liabilities.
- Allegations of material irregularity (including in relation to voting procedures) will be challenging to substantiate following the failure of the *Caffè Nero* challenge.

However, the judgments provide some warnings for those preparing restructurings of rent liabilities:

- In *New Look*, the judge commented that there will be strong grounds to conclude that a CVA is unfair where it relies upon the votes of a large swathe of genuinely unimpaired creditors to compromise the claims of a sub-group of creditors, even if there is an objective justification for the treatment of the unimpaired creditors.
- In *Regis*, it was clear that the courts will closely analyse the treatment of shareholders as part of the restructuring, and any preferential treatment will need to be adequately justified.
- After *Regis*, a blanket 75% discount on landlords' future rent claims – for so long an arbitrary feature of such CVAs – will not generally be justified.

The context: the new commercial rent arrears Bill

In November 2021, the Government announced that it expects to introduce an arbitration scheme for rent arrears accrued as a result of pandemic-related closures, together with a new voluntary code of conduct for resolving all COVID-19 rent arrears. It is expected to come into force in March 2022.

The proposed legislation will extend the current moratorium on landlord enforcement (such as the restrictions on the use of winding-up petitions and the Commercial Rent Arrears Recovery Process), which has been in existence since April 2020, for a further six months after the legislation is enacted.

The proposed arbitration scheme is intended to be a last resort when a consensual agreement cannot be reached and will involve the parties applying to an arbitrator who will have power to make a binding decision with respect to the parties' proposals.

As a final thought, as currently proposed the arbitration scheme will also affect a company's ability to propose an alternative restructuring, since the appointment of an arbitrator will prevent a CVA, scheme of arrangement or restructuring plan from being proposed until 12 months after an arbitration award is made. It may therefore be possible for landlords to make an arbitration referral as a means of preventing a disputed debt from being compromised through a CVA or restructuring plan prior to such a process being initiated. This potentially gives landlords some negotiating leverage when attempting to agree a consensual deal.

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Spanish Financial Assistance Rules

The main aspects to consider under Spanish law

By Francisco Vázquez Oteo and Jorge Vázquez

- Spanish Companies law provides for a very strict and broad prohibition on financial assistance, which affects both public limited companies and limited liability companies. There is also a special procedure for the validation of leveraged mergers post-LBOs.
- The prohibition on financial assistance extends to financing provided before, simultaneously with, or after the acquisition, provided that the financing was given to assist the buyer in the acquisition of the shares.
- The consequences of breaching the financial assistance rules could lead to the nullity of the financial assistance agreement and to the liability of the directors involved in the financial assistance transaction.

Spanish corporate law (*Ley de Sociedades de Capital*, or "LSC") foresees a general prohibition regarding financial assistance, which prohibits a company from financially assisting another person (natural or legal) in order to enable that person to acquire the shares of the assisting company or of the parent company of the assisting company. In the case of limited liability companies, it is also prohibited to provide financial assistance for the acquisition of shares in any company of the assisting company's group.

This financial assistance prohibition works for both public limited companies (*sociedades anónimas*) (S.A. Companies) and limited liability companies (*sociedades de responsabilidad limitada*) (S.L. Companies). This is a surprising difference between Spain and other European jurisdictions, as Spain is one of the few European jurisdictions prohibiting financial assistance by limited liability companies.

As seen below, the financial assistance prohibition under Spanish law is very strict and is defined in very broad terms. This prohibition applies to "any kind of financial assistance" and extends to financing provided before, simultaneously with or after the acquisition, provided that the financing was given in order to assist the buyer in the acquisition of the shares.

The consequences of breaching the financial assistance rules are severe, not only in terms of the potential nullity of the financial assistance agreement, but also for the directors involved in the financial assistance transaction.

Key elements of the financial assistance prohibition under Spanish law

Parties involved in the prohibited financial assistance

On the side of the party granting the assistance, the financial assistance prohibition under Spanish law applies to both S.A. Companies and S.L. Companies. Nevertheless, there are two differences between the regimes applicable to each of these two types of companies:

- S.A. Companies are exempt from the application of the financial assistance prohibition in two cases, and these exemptions do not apply to S.L. Companies. The exemptions are:
  - Transactions aimed at facilitating the acquisition by the company's employees of shares in the company itself or of shares in any other company belonging to the same group. Some legal authors question why this exception has not been included in the regime applicable to S.L. Companies.
  - Transactions entered into by banks or other credit institutions (which, according to Spanish law, must operate in the form of S.A. Companies), within the scope of their ordinary course of business, which are financed with disposable assets of the company.
- The scope of the prohibition on financial assistance is broader for S.L. Companies since it extends not only to the acquisition of its own shares and those of its parent company, but also to the acquisition of shares in any group company.

On the recipient's side, the LSC states that the party acquiring the shares with financial assistance must be a "third party". The general reference to a "third party" in the LSC leads to a wide interpretation of this term, to include any individual or legal person, other than the assisting company. The concept of "third party" would not exclude the actual shareholders and directors of the assisting company.

The acts which are forbidden by the financial assistance prohibition

The prohibition is drafted in very broad terms in the LSC and it includes "advancing funds, granting credits or loans, giving guarantees or providing any kind of financial assistance to third parties for the acquisition of its own shares" (remember that in case of S.A. Companies this also includes the shares of its parent company and for S.L. Companies the shares of any group company, whether upstream or downstream).

Therefore, we can distinguish between two related behaviours in the financial assistance prohibition:

- On the financing side, the advancing of funds, granting of credits or loans, provision of guarantees or any kind of financial assistance to third parties. The existence of financial assistance needs to be looked at broadly since the legislator has chosen to include a catch-all mention of "any kind of financial assistance"; and
- The reference to the acquisition by third parties of shares of the assisting company through such financial assistance does not mean that the assisting company needs to directly provide the financing to the third party acquiring the shares. Provided that the final purpose is to facilitate the purchase of the shares, it may well be that the financial assistance is structured in other ways, such as the provision by the assisting company of: (i) a guarantee regarding any deferred payment for the purchase price of its own shares; or (ii) financial assistance to a "fourth entity", which, in turn, financially assists the third party to acquire the shares of the assisting company.

Existence of a causal link between the financial assistance and the acquisition of the shares

For prohibited financial assistance to exist under Spanish law, there must be a causal link between the provision of financial assistance and the acquisition of the shares, or, in other words, the financing must have been provided in order to assist in the acquisition of the shares.

The main problem is to evidence that the financing has been provided by the assisting company in order to assist in the acquisition of its own shares, especially when such purpose is not explicitly stated in the financing documents. In this regard, a wider purpose of the financing does not discard the existence of prohibited financial assistance. Such further purpose does not prevent the financial assistance from causing potential damage to the shareholders and creditors, which the LSC tries to avoid.

Timing of the financial assistance

The prohibition on financial assistance extends to financing provided before, simultaneously with or after the acquisition, provided that the financing was given in order to assist the buyer in the acquisition of the shares. Nevertheless, the more time that elapses from completion of the transaction, the more difficult it becomes to evidence the link between the financial assistance and the acquisition of the shares.

Although Spanish legislation includes a very specific and absolute prohibition on financial assistance, it also includes a special procedure for carrying out leveraged mergers post-LBOs (merger by absorption of a company previously acquired by the absorbing company using debt) whereby these are validated once three years have passed from the time the debt materialised.

Consequences of infringement of the financial assistance prohibition

Administrative sanctions on the directors

Financial assistance prohibition could lead to a fine being imposed on the directors of the assisting company and, where applicable, on the directors of the controlling company who induced the controlled company to provide the financial assistance. For these purposes, directors, executives and attorneys with broad representation faculties shall be deemed "directors". The fine would be an amount up to the face value of the shares acquired by the third party with the financial assistance provided by the assisting company.

The statutory limitation period for imposing this fine is three years.

Civil liability of the directors

As expressly stated by the Spanish Supreme Court, directors approving a financing which constitutes a breach of the financial assistance provisions under the LSC would be presumed liable for any damages caused to the company, the shareholders and the company's creditors by such illegal financing approved by them.

The Spanish Supreme Court has also recently considered that the directors of a company who agreed to a prohibited financial assistance transaction (which took place 14 years before the initiation of the bankruptcy proceedings) in favour of the parent company aggravated the insolvency situation of the assisting company and are therefore liable for the payment of those debts that cannot be satisfied with the company's assets.

Nullity of the financial assistance agreement

The majority of the legal authors and the Spanish Supreme Court have traditionally deemed that the breach of the financial assistance provision entails the nullity of the financial assistance agreement. Nevertheless, in recent years, there has been a tendency in the case law to (i) seek alternatives to nullity, when possible, and, (ii) when nullity is upheld, limit it to the strict business of financial assistance (the loan, guarantee, etc.) and not to the related transaction (the sale and purchaser, merger, etc.). At the same time, the case law has also stated that nullity does not exclude the parallel imposition of the administrative sanction on directors or their civil liability as detailed above.

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Our top tech predictions for 2022

What we expect in the year ahead

By David Futter and Renée Green

It is no surprise that we have seen a surge of investment in tech over the past year. Venture capital investment in the UK tech sector reached £13.5bn in the first half of 2021, three times higher than the same period in 2020. It's a similar story in Europe, with more venture capital investment in tech in the first six months of 2021 than the whole of 2020.

Much of this investment has been driven by the pandemic, and the move to digitalise almost every aspect of the way that we work and interact. Globally, there has been a realisation that the initial move to remote and hybrid working is steadily becoming the new norm. We have also seen a continued focus on innovation, and a move towards the use of tech to drive sustainability.

As we begin the new year, we take stock of the year that has been and look towards 2022: a year likely to be punctuated by innovation, sustainable tech and the continued rise of the 'demand for digital'.

Increased connectivity will drive more transformation

On the back of strong investment, we are seeing convergence driven by digital transformation. There is already a push for 5G, with 6G development on the horizon. Investment in 5G, and the digital infrastructure required to support it, will propel emerging technologies that rely on fast and effective connectivity such as AI, IoT, virtual and augmented reality.

5G is already here, backed by the UK government's commitment to providing the majority of the population with 5G coverage by 2027. With digital transformation now a key strategic focus for business, many organisations will be looking to hyperautomation - the process of identifying, assessing and automating as many business and IT processes as possible with the benefit of multiple technologies.

War on talent will rage on

Talent shortages are a rising and significant challenge for successful adoption of emerging technologies. According to a recent Gartner survey, IT executives consider the current tech talent shortage as the most significant adoption barrier to 64% of emerging technologies.

The war on talent is likely to continue during the year ahead, particularly in sourcing skills that enable cloud and edge, automation and continuous delivery.

Demand for simple solutions will increase

The rapid evolution of technology is increasing competition across many markets globally. Highly-connected consumers demand instant mobile access to products and services. User experience is key, and organisations are feeling the pressure to digitally transform. This leaves the issue of what to do with slow, complex and outdated IT systems.

In the past, organisations often elected to go down the costly, time consuming and disruptive path of 'rip and replace', the process of replacing outdated legacy systems with ones that are modern, fully functional, flexible and responsive to changing business needs. However as noted above, the chronic shortage of IT talent is driving a marked shift away from rip and replace in favour of simpler no-code and low-code solutions.

Organisations are increasingly choosing to leverage their existing IT assets, for example by using APIs and web services to integrate existing systems, providing the user with a seamless experience at a fraction of the cost. We expect to see this trend continue throughout 2022, as organisations embrace these simple, cost effective tools to rapidly deliver agile solutions.

Data's status as a key strategic asset will be set, as data becomes increasingly democratised

With the exponential growth of data, organisations are increasingly recognising data to be one of their most valuable strategic assets. Cost effective data storage, transfer and processing capabilities, together with the increased adoption of predictive analytics and emerging technologies such as AI and IoT, are driving greater efficiencies in the way that data is being harnessed and monetised by organisations.

Data is now routinely being used by organisations to identify business process efficiencies, better understand their customers and operations, improve marketing and create targeted products. Exploiting connected data for competitive advantage will become a key battleground for business.

Add to this the growing trend of the democratisation of data. Releasing data to make it available to more users, a trend which has largely been driven by widescale adoption of cloud storage solutions. We now have the tools available to not only store and share data more widely, but to better manipulate and understand data through the use of data virtualisation tools.

Take for example Open Banking, where data holders have for some time been required to make available the data that they hold through regulation for the greater benefit of consumers. We are just beginning to see the impact of this trend, which will no doubt be transformative in the longer term.

AI adoption will grow exponentially

AI has already become a key tool in the global response to the pandemic, and we are likely to see significant increased adoption throughout 2022.

One of the key challenges of implementing AI or machine learning is the need for large amounts of training data. Gathering datasets can pose security, privacy and data protection risks, particularly in use cases involving personal or sensitive data (for example in the healthcare sector). Federated learning, which trains a machine learning model on user data without the need to transfer that data to cloud servers, is increasingly being used to mitigate these risks.

As more organisations recognise the value being delivered by their AI investments, further investment is likely across multiple sectors, particularly in the areas of product development, marketing, sales and service operations. The dramatic shift towards online working and e-commerce will also continue to drive AI adoption as businesses explore automation, behavioural analytics and personalisation.

Throughout 2022, we expect that AI will increasingly be used by organisations to optimise business processes, reduce risks/costs and enhance efficiencies. A crucial tool for businesses to strengthen their position in an increasingly competitive global market.

IoT will come of age

IoT continues to explode in popularity. Enabled by 5G, we are finally witnessing the unleashing of IoT's full potential. Reliable and fast connectivity is key to a successful IoT project. The previous deficiencies in connectivity technology has often been an inhibitor to the deployment of large scale IoT networks.

Edge computing has also enabled faster and more comprehensive data analysis, creating rapid response times while supporting resilience to network disconnection. This is critical to the deployment of IoT in some safety critical industries. We will also see small data and TinyML play an increasingly key role in product development in many areas, such as autonomous vehicles.

We will continue to see a range of novel consumer IoT initiatives, particular in those sectors where a heavy reliance on physical human-to-human interactions currently limits user experience or efficiencies. Examples include continued adoption in the healthcare industry (for example, a patient using a smart wearable to report on health conditions), the use of IoT to facilitate digital twin technologies, and the increased use of IoT in everyday settings to reduce manual interactions such as purchases made via connected devices using voice commands.

2022 will also see an acceleration of the adoption of IoT in an industrial setting as a result of both Brexit and Covid-19. Manufacturers and other similar businesses have felt keenly the impact of staff shortages on their ability to monitor and safely maintain key infrastructure required for their businesses. As a result, the implementation of remote monitoring capabilities using IoT are likely to increase at a considerable rate.

The Metaverse will be transformative

While there is unlikely to be an immediate impact on business, it is hard to ignore Mark Zuckerberg's "Metaverse" announcement. The development of an augmented and virtual reality world focused on connecting people, the merging of the physical and virtual worlds using a broad range of machine perception and AI capabilities that empower developers to build reality presence platforms, is an exciting proposition.

In the longer term this is likely to shape not only how we work, but also how we socialise and even how we do business. If the Metaverse becomes a reality it will likely transform society radically, with Morgan Stanley valuing the Metaverse as an $8trn addressable market.

Quantum will start a new race to innovate

Whilst we are discussing the drive to innovate, Boris Johnson has also now outlined his ambition for the UK to become the pre-eminent force in the global quantum computing market by 2040.

The race is now on to accelerate development of quantum computing hardware and software. Quantum computing is predicted to grow to a $1trn industry in the next three decades, and is expected to drive improvements in technologies that rely on heavy computational power, such as AI and advanced data processing tools.

Although still in its early stages of development, Amazon and Google are already using their platforms to accelerate the development of Quantum computing. Eagle, a 127 qubit quantum processor, has just been unveiled by IBM as the first processor of its type which can't be simulated by a classical supercomputer. A team at Cambridge has also recently created a quantum computing desktop operating system – a major step forward in adopting quantum technologies for mainstream consumers.

Focus will sharpen on regulation and risk

Investing in, and implementing, emerging technologies can be complex. It is critical that organisations understand that they are often operating in an uncertain and rapidly changing regulatory environment. Understanding and managing the regulatory obligations relating to both the technology, and the data which underpins it, is key.

As the pace of technological change intensifies, so too will regulators' and policy makers' scrutiny on how complex technologies are governed. 2022 is likely to be the year that we will achieve clarity on the future regulation of AI.

Cybersecurity is also a risk that comes with the deployment of any emerging technology. Organisations will need to be aware of not only the very real operational and reputational risk associated with cybersecurity breaches, but the significant penalties which can arise from associated regulatory breaches.

The year that lies ahead

It goes without saying that the pandemic has brought about a tremendous technological shift across almost every industry globally. We have seen an increased uptick in investment in tech, innovation and sustainability, with tech being harnessed to tackle our response to the pandemic and to develop sustainable solutions across all industries.

With the further deployment of 5G, investment is likely to continue at pace as organisations harness the value of their data, and exploit the benefits of emerging tech to meet the challenges of tomorrow.

Many thanks to Emily Jones and Eleanor Zhao for their contributions to this article.

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Has the hospitality sector in Europe turned the corner?

A look at the European hospitality industry

By Richard Vernon and Cristina Calvo

- The hotel sector has been extremely hard-hit but remains of strong interest to investors who will drive the recovery, with transaction volumes increasing as COVID-related government aid ends.
- Countries with strong domestic leisure demand for staycations will lead the recovery.
- Easing of international travel restrictions will trigger the results of latent demand, and drive renewed growth.

In this issue, we take a look at the European hospitality industry and explore its prospects for growth in the face of the continued impact of the COVID-19 pandemic. The sector has been particularly hard-hit, with hotel performance declining significantly throughout 2020 and 2021. Recovery is not expected until 2024, with continuing uncertainty facing the sector as nations take steps to put their national economies on a sustainable footing in the face of continued challenges from the pandemic.

The scale of the challenge facing the hospitality industry has been enormous. In the UK, Whitbread, the UK's largest hotel group, reported that total accommodation sales were down by 70.4% in the 2020/21 financial year. PwC's forecast is that, by the end of 2022, revenue per available room in London will return to between 43% and 86% of pre-pandemic levels. Regionally, this figure is higher – the forecast being between 64% and 100% of pre-pandemic levels.

With travel only viable for parts of the year in 2020 and 2021, those countries with a more accessible domestic tourism market saw average occupancy surpass the regional average. As a result, France, Germany and the UK all exceeded the European occupancy average of 26.6%, while Spain and Italy – being more directly dependent on overseas demand – saw occupancy fall far short of the regional average.

This decline is in stark contrast to the period of high sector growth and strong market performance that characterised the sector prior to the pandemic. In the period 2016-2019 the hotels share of total commercial real estate investment across Europe increased, driven by the strong market performance and increasing popularity of the asset class among investors seeking to diversify their portfolios. We saw a significant drop in hotel investment in 2020, resulting from a lack of stock on the market and a significant delta in buyer and seller pricing expectations.

However, it is clear that the hospitality sector remains of strong interest to a range of investors. Significant additional capital was raised in 2020 to target hotel opportunities, and although European hotel investment volumes in Q1 2021 remained historically low – reaching €2.16 billion, down -49.7% year-on-year – this does represent the least severe quarterly year-on-year decline since the onset of the pandemic.

The outlook for recovery and challenges

Domestic demand will drive the initial phase of recovery for the sector. This became clear in the months of 2020 and 2021 when restrictions were lifted. Further recovery will depend on the pace and size of the return of tourism, international and domestic business events and easing of government restrictions on travel.

Those countries that have typically strong domestic leisure demand and less exposure to inbound travel markets (particularly long-haul) are likely to bounce back sooner. Germany and the UK, for example, have a huge domestic source-base coupled with historic demand for the population to travel. Of the largest tourism markets in Europe, Germany and the UK boast the highest share of domestic travellers as a proportion of total visitation, at 79.3% and 74.4% respectively. As the two largest suppliers of outbound travellers in

Europe as well, both markets therefore also have the potential to further boost domestic demand through the conversion of typical outbound travel towards their domestic markets.

The boom in the staycation market in the UK is supported by research from Barclays Corporate Banking, which forecasts a growth in the UK staycation market next year, with 45% of consumers choosing UK holidays over holidays abroad. Some regional areas have seen occupancy and average daily rates actually exceeding pre-Covid highs. Hoteliers currently focusing on the business market should therefore consider trying to capture a stronger domestic tourism market, particularly considering many businesses have publicly stated their ambition to cut business travel.

A challenge for the UK is labour shortages and costs. Staff shortages threaten to significantly stunt growth for the UK hotel industry. One in four hospitality businesses has been forced to reduce opening times or close venues due to an inability to service the volume of business. The impact of Brexit is evident: as of October, almost 300,000 hospitality workers have already left their jobs. Inflationary pressures will also see labour costs increasingly adding to the challenge.

Green shoots ahead

According to the latest research by Cushman & Wakefield, more than one-third of real estate investors want more hotel investments in Europe. Despite the disruption to the travel and tourism industry caused by the COVID-19 pandemic, only 21% of investors plan to scale down hotel investments and only 10% have suspended their acquisition plans.

Looking forward, any increase in investor transactions in the hospitality sector is likely to be driven by sellers revising their pricing based on further pressure on working capital, and investors taking a more aggressive stance based on greater clarity on recovery. Given the challenging short-to-medium-term performance outlook and the reduction and increased cost of debt, capital values are expected to remain lower compared with 2019. However, the 'discount' will vary depending on the physical and operational characteristics of each hotel, with limited-service hotels and aparthotels predicted to be the least volatile.

In terms of development, with over 100,000 new rooms planned for this year, many countries in Europe have a material development pipeline of hotels already under construction.

Looking at the speed of recovery and the market outlook we have to take account of the fact that, in many countries, government initiatives have provided a degree of support to the industry. In the UK, furlough schemes and rates relief have perhaps delayed widespread distress, although this may change since support has been withdrawn.

The UK saw the highest investment volumes by country in Q1 2021, totalling €746.5 million and accounting for a 34.6% share of total European volumes. The UK and Ireland top the list of target regions for investors, followed by Germany, the Iberian Peninsula, France and Benelux. For urban hotel investments, the top five locations are dominated by Barcelona, closely followed by London, Paris, Amsterdam and Munich. These European geographic regions and cities are seen as safe investment markets. In particular, Barcelona remains an important European location that benefits from its popularity among tourists, and the current moratorium on hotel developments in this city is pushing it to the top position in the rankings.

It starts with cities

In terms of recovery, the Cushman & Wakefield research shows an expectation that the performance of tourism-oriented cities will be fully back to pre-Covid levels by 2023. Regional cities are expected to follow, with recovery to pre-Covid levels expected between 2023 and 2024. Europe's top cities – which tend to rely more on international travel – are expected to recover more slowly. This is a more optimistic picture of the recovery than in 2008/2009 after the global financial crisis when it took on average more than five years for hotels in major European cities to recover to pre-crisis levels.

While prime trophy assets continue to dominate investment volumes, it is smaller deals (sub-€10 million) that are driving the bulk of sales in terms of deal count. This is largely steered by private buyers seeking investment opportunities on assets boasting a relatively positive operational outlook, in key coastal and country staycation markets. Confidence in this segment has also sparked interest among bigger players, with Blackstone acquiring Butlin's parent company, Bourne Leisure, in February, driven largely by confidence in the British staycation market. Although the hospitality sector remains challenged, the continued easing of travel restrictions and the latent demand for travel and leisure opportunities among the world's population will drive renewed growth in the industry over the next two to three years.

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Fund finance in Luxembourg

Knowing your borrower

By Fabien Debroise

In this article you will:

- Find a glossary of investment fund acronyms and terminology.
- Understand why the fund has been set up this way.
- Get key points to consider when lending to a Luxembourg investment fund.

Q We are considering making a subscription facility available to our client, a Luxembourg fund called XYZ Private Market SCSp SICAV-RAIF – Sub-fund 1. What does "SCSp SICAV-RAIF – Sub-fund 1" stand for please?

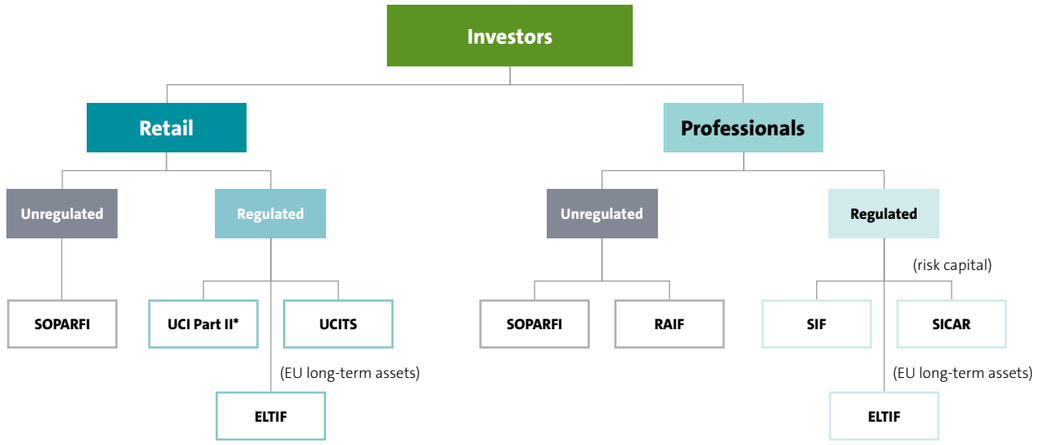
A A RAIF is an unregulated fund vehicle. It can be structured as an FCP or a SICAV with multiple compartments. It will usually take the form of an S.A., a S.à r.l. or a SCSp. Unlike a SIF, a RAIF is not authorised by the CSSF. It cannot be structured as a non-AIF and must be managed by an external AIFM.

While legally correct, is this answer really helpful?

Let's take a step back. Who are we dealing with?

1. What were the factors determining the choice of structure?

Luxembourg offers a wide range of investment vehicles which combine separate legal forms (corporate or contractual forms), tax qualifications (transparent or opaque) and regulatory regimes (regulated or unregulated) depending on the targeted investors, the investment strategy and the marketing strategy of the proposed fund.



* But restricted in other EU countries to professional investors only

2. Overview of the fund vehicles

Decoding fund names

It is easy to be overwhelmed by the number of acronyms associated with investment fund vehicles available in Luxembourg. To help you navigate the "alphabet soup" of acronyms, some of the key terms are defined below.

Corporate forms	**SA**	public limited liability company (managed by a board of directors)
	SARL	private limited liability company (managed by a board of managers)
	SCA	partnership limited by shares (managed by a general partner)
	SCS	common limited partnership (managed by a general partner)
	SCSp	special limited partnership (managed by a general partner)
Legal form	**SICAV**	investment company with variable capital (similar to an open-ended fund. The share capital of a SICAV is equal to its total NAV, making the subscription and redemption procedures easier)
	SICAF	investment company with fixed capital (similar to a closed-ended fund)
	FCP	common fund (co-ownership of assets managed by a management company. Due to its contractual form, an FCP is not subject to company law requirements)
Fund vehicles	**AIF**	alternative investment fund (generic term), ie vehicle which raises 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 and which does not require authorisation
	SOPARFI	*Société de Participations Financières* (unregulated commercial company – the most common vehicle dedicated to holding and financing activities in Luxembourg)
	RAIF	Reserved Alternative Investment Fund (unregulated AIF managed by an authorised AIFM)
	Part II UCI	Undertakings for Collective Investment (regulated fund that can be sold to retail investors subject to certain conditions)
	SICAR	Risk Capital Investment Company (regulated venture capital fund – limited to the direct or indirect contribution of funds to entities in view of their launch, development or listing on a stock exchange)
	SIF	Specialised Investment Fund (regulated multipurpose vehicle for alternative investments)
	UCITS	Undertakings for the collective investment in transferable securities (regulated retail funds)

Main features

An (non-exhaustive) overview of the various types of regulated and unregulated Luxembourg alternative fund vehicles can be found here.

	UNREGULATED VEHICLES		REGULATED VEHICLES		
		AIF			
	SOPARFI	**RAIF**	**SICAR**	**SIF**	**Part II UCI**
Most frequently used corporate forms	SA SARL SCA SCS SCSp	SA SARL SCA SCS SCSp FCP	SA SARL SCA SCS SCSp	SA SARL SCA SCS SCSp FCP	SA SARL SCA SCS SCSp FCP
Authorisation and supervision by the CSSF	No (or indirect supervision if an AIFM is appointed)	No (indirect supervision through the authorised AIFM)	Yes	Yes	Yes
Eligible investors	Unrestricted	Restricted to well-informed investors	Restricted to well-informed investors	Restricted to well-informed investors	Unrestricted
Eligible assets	Unrestricted	Unrestricted	Restricted to investments in risk capital	Unrestricted	Unrestricted
Umbrella structure	No	Yes	Yes	Yes	Yes
Fixed/Variable capital	No	Yes	Yes	Yes	Yes
Net asset value calculation frequency	Not required	At least once a year	Not required on a regular basis	At least once a year	At least once a month
Financial reports	• Annual accounts to be approved within 6 months of the end of the period to which they relate (audited annual accounts may be required if certain thresholds are met) • Not required for SCSp	• Audited annual report within 6 months of the end of the period to which it relates • Where several compartments have been created, each will have to be separately referred to and detailed in the audited annual report of the RAIF	• Audited annual report within 6 months of the end of the period to which it relates • Where several compartments have been created, each will have to be separately referred to and detailed in the audited annual report of the SICAR	• Audited annual report within 6 months of the end of the period to which it relates • Where several compartments have been created, each will have to be separately referred to and detailed in the audited annual report of the SIF	• Audited annual report within 6 months of the end of the period to which it relates + unaudited half-yearly report • Where several compartments have been created, each will have to be separately referred to and detailed in the audited annual report of the Part II UCI
AIFM requirements	Yes, if set up as an AIF (internal AIFM if the legal form permits internal management or external authorised AIFM or registered AIFM)	Yes (external authorised AIFM required)	Yes (internal AIFM if the legal form permits internal management or external (authorised or registered) AIFM)	Yes (internal AIFM if the legal form permits internal management or external (authorised or registered) AIFM)	Yes (internal AIFM if the legal form permits internal management or external (authorised or registered) AIFM)
Required service providers	• Statutory auditor (*commissaire aux comptes*) required for SA, SAS and SCA • Independent auditor (*réviseur d'entreprises agréé*) required if certain thresholds are met	• Luxembourg depositary or Luxembourg branch of a depositary registered in the EU • Central administration, registrar and transfer agency services provider based in Luxembourg • Independent auditor	• Luxembourg depositary or Luxembourg branch of a depositary registered in the EU • Central administration, registrar and transfer agency services provider based in Luxembourg • Independent auditor	• Luxembourg depositary or Luxembourg branch of a depositary registered in the EU • Central administration, registrar and transfer agency services provider based in Luxembourg • Independent auditor	• Luxembourg depositary or Luxembourg branch of a depositary registered in the EU • Central administration, registrar and transfer agency services provider based in Luxembourg • Independent auditor

3. Umbrella structure – who is my borrower?

Luxembourg law provides for the possibility for regulated investment funds and RAIFs to have ring-fenced compartments/sub-funds. Each compartment shall be treated as a separate entity. The rights/claims of investors/creditors relating to a specific compartment will be limited to the assets of such compartment.

As a result, if several compartments are set up within one fund, a loan taken by one compartment does not in principle trigger cross-obligations towards any other compartment of the same umbrella fund. Both the facility agreement and the security documents are then entered into on a limited recourse basis. In our example, only Sub-fund 1 of XYZ Private Market SCSp SICAV-RAIF will be the borrower.

4. Are there any issues with AIFs taking on indebtedness, or granting security/guarantees, in respect of both their own obligations and supporting the obligations of parallel vehicles?

Depending on the type of investment vehicle involved, certain regulatory restrictions on borrowing (eg bridge/warehousing loans only) or on the ability to grant security or guarantees may apply.

Restrictions on borrowing

Generally, Luxembourg law does not impose specific restrictions on a fund's ability to borrow.

However, a UCITS may only borrow the equivalent of (i) in the case of an investment company, not more than 10% of its net assets or, in case of a common investment fund (*Fonds commun de placement* – FCP), not more than 10% of the value of the fund, provided in each case that the borrowing is on a temporary basis; and (ii) not more than 10% of its net assets in the case of an investment company, provided that the borrowing is to make possible the acquisition of immovable property essential for the direct pursuit of its business.

Subject to exemptions, a Part II UCI may borrow the equivalent of up to 25% of its assets.

Restrictions on the granting of security/ guarantees

Except for UCITS and securitisation vehicles (SV), Luxembourg law does not impose specific restrictions on a fund's ability to grant security/ guarantees.

UCITS are prohibited from acting as a guarantor on behalf of third parties.

SV may only grant security interests over their assets or guarantees in order to secure the obligations they have assumed in view of the securitisation or in favour of their investors (and not creditors). Security interests, guarantees and other similar arrangements created in violation of this restriction are void by operation of law. A reform is under discussion.

Conclusion

Based on the above, we are now in a position to answer our initial question:

XYZ Private Market SCSp SICAV-RAIF – Sub-fund 1 is:

- a segregated sub-fund of the umbrella fund XYZ Private Market SCSp SICAV-RAIF.

XYZ Private Market SCSp SICAV-RAIF is:

- a reserved alternative investment fund, ie an unregulated entity (or indirectly regulated through its AIFM) reserved for professional investors;
- established as an investment company with variable capital (open-ended); and
- in the form of a special limited partnership, ie transparent from both a corporate and fiscal perspective and represented by its general partner and/or AIFM (depending on the terms of the fund documents).

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