

Credit lines to Luxembourg funds: to whom should we talk?

Insights - 16/01/2023

Jad Nader and Fabiana Popescu from Ogier's Luxembourg Banking and Finance team clarify the distribution of management roles and powers of representation of Luxembourg funds, and their impact on funds' ability to borrow or grant security. This article first appeared in Chambers Expert Focus 2022.

| Background

In the context of credit lines, lenders require assurance as to the capacity and authority of the fund to borrow and the capacity and authority of its representatives to grant powers of attorney to call capital, and enter into and execute security documents on behalf of the fund. The architecture of Luxembourg funds involving different players, with management functions split between a number of parties, can make it difficult to discern which entity is appropriated with these powers.

Under the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended (the "Collateral Law"), it is generally held that the claim that the fund has towards its investors in the context of a pledge of uncalled commitments is only payable by exercising the right to call capital from investors, therefore it is considered that this right is attached accessorially to the claim (*droit lié à la créance*). Other accessory rights include the right to receive capital from investors, direct capital commitments into a specific bank account and exercise remedies to enforce the payment of capital commitments. These rights along with the capital commitments themselves are the subject of the pledge which, in an enforcement scenario, will be exercised by or under the direction of the lender or agent. In order to create a valid pledge, lenders must have certainty as to which entity is entitled to exercise these rights or to assign, pledge or delegate them.

Corporate powers: the general partner

The Luxembourg law of 10 August 1915 on commercial companies, as amended from time to time (the “Lux Companies Law”) provides the framework for the operation and management of all Luxembourg funds, whatever their legal form. Typically, the corporate management is conducted by a management board or an appointed sole manager. The appointment of a sole manager, named the general partner, is a requirement under the Lux Companies Law for certain types of funds such as those bearing the form of common limited partnerships and special limited partnerships (the forms most commonly used in fund finance). Other types of funds may also choose to act through a general partner. The specific powers of the general partner are detailed under the constitutional documents of the fund (the limited partnership agreement, the articles of association, management regulations or sometimes in the private placement memorandum – depending on the fund structure). Such rights are in addition to those rights of representation of the fund granted by law (which would generally include the rights to enter into borrowing and collateral arrangements). In such cases, parties may want to make the general partner a party in its own right to the credit agreement or security document.

Regulatory powers: the AIFM

Fund vehicles may also have an obligation to appoint an alternative investment fund manager (AIFM), if they qualify as alternative investment funds (AIFs) under the Luxembourg law on alternative investment funds dated 12 July 2013 (the “AIFM Law”), as amended from time to time, transposing Directive 2011/61/EU of the European Parliament and Council of 8 June 2011. Given the wide AIF definition, most funds will be able to fulfil this criterion and therefore have to appoint an AIFM (although exemptions do exist).

Once appointed, the role of the AIFM is to ensure the compliance of the AIF it manages with the AIFM Law. The AIFM exercises a regulatory management position with its most essential duties being portfolio management and risk management. In addition to these duties, the fund or general partner may delegate other rights to the AIFM under the constitutional documents or an AIFM/management agreement. These documents must be carefully reviewed to assess whether the delegation, even partially, concerns the ability to arrange borrowings on behalf of the fund or the rights subject to the capital commitments pledge or requires prior AIFM approval. The AIFM would then be expected to become a party to the relevant agreement or offer alternative comfort, usually by way of a side letter. Moreover, for Luxembourg-based AIFMs, financing documentation may fall within the scope of the AIFM’s portfolio management or risk management function, hence requiring AIFM approval. It may therefore be prudent to request an approval letter from the AIFM in some of these scenarios.

Regulatory powers: the portfolio/investment

manager

The AIFM may sub-delegate some of the functions it holds under the AIFM Law, and any other powers delegated to it by the fund or general partner, to a third party. This sub-delegation is usually granted to a portfolio manager, an investment adviser or an administrator. Typically, the portfolio manager builds, maintains and monitors the investment portfolio, while the investment adviser provides a wider variety of ad hoc financial services, and the administrator will mainly deal with the day-to-day administration of funds. In practice, the lines between these roles may be difficult to discern and it is therefore important to assess their functions based on the delegation agreements and, subsequently, decide whether any of these entities must be a party to the transaction.

Safekeeping and assets oversight: the depositary

If the fund qualifies as an AIF, in most cases the AIFM law will also impose the appointment of a depositary, in charge of the safekeeping of funds' assets, cash flow monitoring and oversight. In order to perform its custodian duties, the depositary agreement may grant the depositary a right of prior consent to pledging fund assets, a right of information or an existing pledge over the assets of the fund. The lender or agent should aim to obtain a waiver of pledge or a second rank of the depositary's pledge, depending on the circumstances. The involvement of the depositary in net asset value or portfolio deals is even more important.

The distribution of roles in the management of Luxembourg funds varies according to fund structure, and regulatory requirements and their powers can be complex and layered. A prudent and tailor-made assessment of the underlying fund documentation is fundamental to ensuring the validity and enforceability of obligations under credit and collateral arrangements.

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