AIFMD II – New Regime for Loan Origination AIFs

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Revisions[1] to the AIFMD (AIFMD II) introduce a new regime for EU managers (AIFMs) that manage alternative investment funds which originate loans. Below is a summary of the key features of the loan-origination regime. AIFMD II will take effect from 15 April 2024,[2] and the new rules will apply from 15 April 2026, with a partial sunset period until April 2029. A summary of the key provisions under the new regime is set out below.

Scope

Some rules apply to any alternative investment fund (AIF) engaged in originating loans, whereas other rules apply only to AIFs which undertake significant loan-origination activity (Loan-Originating AIFs).

Key Definitions

A Loan-Originating AIF is defined as an AIF "whose investment strategy is mainly to originate loans […] or where the notional value of the AIF's originated loans represents at least 50% of its net asset value".

AIFMD II uses statutory terms 'loan origination' and 'originating a loan', which are both defined to mean:

> "the granting of a loan directly by an AIF as the original lender or indirectly through a third party or special purpose vehicle, which originates a loan for or on behalf of the AIF or AIFM in respect of the AIF, where the AIFM or AIF is involved in structuring the loan, defining or pre-agreeing its characteristics prior to the purchase".

AIFMD II includes no definition of a "loan", and it is expected that the customary distinction between debt securities and loans would be applied also under the new proposals, but this will ultimately be confirmed over time.

The definition does not distinguish between loans made to EU borrowers and non-EU borrowers. As such, all loan-origination activities (irrespective of the jurisdiction of the borrower) should be considered when determining whether an AIF meets the definitional threshold of a Loan-Originating AIF.

Shareholder loans are carved out of the scope of the requirements relating to governance requirements and leverage limits (subject to maximum exposure of 150% of an AIF's capital).

Shareholder loans are defined as "loans made to an undertaking in which the AIF holds at least 5% of capital or voting rights (directly or indirectly) and which cannot be transferred independently of the AIF's holding in the undertaking".

New Requirements Applicable to All AIFMs of AIFs Which Originate Loans

Risk Retention. Echoing the requirements for issuers/managers of securitisations, an AIF which originates loans must retain at least 5% of the notional value of each loan it originates for 8 years or until maturity (with respect to loans with a term shorter than 8 years).[3]

Exemptions are available, for example, in the event of sanctions, on liquidation of the AIF or where it is necessary to sell the loan interest to allow the AIFM to implement the investment strategy of the AIF in the best interests of the investors. Sale of the risk retention interest due to deterioration of the risk profile associated with the loan is permitted, subject to disclosure of the deterioration to a purchaser.

Concentration Limits. An AIFM is required to ensure that, when an AIF it manages originates loans, the notional aggregate value of the loans advanced (directly or indirectly, including through any special purpose vehicles (SPVs)) to any single borrower does not exceed 20% of the AIF's capital if the borrower is an AIF, an Undertaking for Collective Investment in Transferable Securities (UCITS) or a financial undertaking, including, e.g., an insurance company or an investment adviser.[4] The limits may be suspended in some circumstances and must be set to apply under the AIF's constitutional documents no later than 24 months from first close.

Governance and Risk Management Requirements. AIFMs are required to have effective policies, procedures and processes for the granting of loans, assessment and management of credit risk, and administering and monitoring the credit portfolios where AIFs that they manage engage in loan origination, including when those AIFs gain exposure to loans through third parties. Such policies, procedures and processes should be proportionate to the extent of loan origination and should be reviewed at least annually.

As noted above, shareholder loans are carved out of the governance requirements, provided that the notional value of such loans does not exceed 150 % of the capital of the AIF.

Lending Restrictions. AIFMs must ensure that an AIF under its management does not grant loans to the AIFM, its staff, its delegates (or their staff), the AIF's depositary or its delegate(s) or any member of the AIFM's group, subject to limited exemptions. In addition, consumer lending restrictions may apply as specified by each EU member state.

Prohibition on "Originate to Distribute" Strategies. AIFMs will be prohibited from managing AIFs that engage in loan origination and whose investment strategy, in whole or in part, consists of originating loans with the sole purpose of transferring those loans or exposures to third parties.

Proceeds of Loans; Disclosure. The proceeds of loans originated by an AIF must be attributed to the AIF in full, minus any allowable fees for loan administration. All costs and expenses linked to the administration of the loans must disclosed to investors.

New Requirements Applicable to AIFMs of Loan-Originating AIFs

Leverage Limits. Specifically applicable to Loan-Originating AIFs are proposed leverage limits: 175% of net asset value (NAV) for open-ended AIFs and 300% of NAV for closed-ended funds. Leverage should be calculated on the basis of the commitment method but excluding borrowing by the AIF which is fully covered by investor commitments. Inadvertent breaches of the leverage limits must be rectified within an "appropriate period of time", "taking due account of the interests of the investors" in the Loan-Originating AIF.

As noted above, shareholder loans are carved out of the leverage limit, provided that the notional value of those loans does not exceed in aggregate 150 % of the Loan-Originating AIF's capital.

Mandatory Closed-Ended Structure. The new rules mandate that a Loan-Originating AIF must have a closed-ended structure, unless the AIFM can demonstrate to its home member state regulator that the AIF's liquidity risk management system is compatible with its investment strategy and redemption policy. The criteria AIFMs must meet to be able to operate an open-ended structure will be specified in secondary legislation.

Timing

AIFMD II will apply from 15 April 2024 and should be effective in all EU member states at the end of a 2-year implementation period, from 16 April 2026.

Transitional Provisions

AIFMD II provides limited grandfathering with respect to loan portfolios of existing AIFs acquired before AIFMD II concerning compliance with the lending restrictions; risk retention requirements; prohibition on “originate-to-distribute” strategies; requirement for policies, procedures and processes; and requirements in respect of proceeds of loans.

Pre-Existing AIFs. The AIFMD II provides for a 5-year transition period for AIFMs managing Loan-Originating AIFs established before 15 April 2024 to comply with the leverage limits, concentration limits and closed-ended structure requirement described above. During this time, however, the AIFM must not exceed the new limits under AIFMD II or, if the AIF’s existing concentration and leverage levels exceed the new limits, the AIFM must not further increase concentration or leverage.

Further, AIFs that were established before 15 April 2024 and that do not raise additional capital after that date will be deemed comply with the concentration limits, leverage limits and the closed-ended structure requirement described above.

Impact on UK AIFMD

Similar changes have not been contemplated to the United Kingdom’s (UK) version of the AIFMD. Accordingly, UK AIFMs should continue to adhere to the current version of the UK AIFMD. A broader overhaul of the rules applicable to AIFMs is expected in the future, subject to consultation.

Application to Non-EU AIFMs

The new loan origination regime is expected to apply to EU AIFMs. However, it is possible that some or all of the requirements could be extended to non-EU AIFMs that market AIFs that originate loans to EU investors under the national private placement regime.

If you have questions about this client alert, please contact any Akin lawyer or advisor below:

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[1] **https://eur-lex.europa.eu/resource.html?uri=cellar:9025e7c1-4de7-11ec-91ac-01aa75ed71a1.0001.02/DOC_1&format=PDF**

[2] Following the publication of AIFMD II in the Official Journal of the European Union on 26 March 2024.

[3] Consumer loan risk retention stake would need to be held until maturity, regardless of the term.

[4] As defined in Article 13(25) of Solvency II.