Loan Origination under AIFMD 2.0

July 2024

The directive amending the Alternative Investment Fund Managers Directive ("**AIFMD 2.0**") must be transposed into the national law of European Union ("**EU**") member states by 16 April 2026. It will introduce for the first time a harmonised pan-European regime for loan-origination funds, with managers of such funds being able to avail of an EU-wide management and marketing passport.

Some of the new rules in AIFMD 2.0 will apply to all AIFs engaged in loan origination activity, while other requirements will only apply to AIFs that come within the definition of a "loan-originating AIF" ("**LOFs**").

An LOF is defined as an AIF:

- having an investment strategy that is mainly to originate loans; or
- having originated loans with a notional value representing at least 50% of its net asset value.

"Loan origination" or "originating a loan" means the granting of a loan directly by an AIF as the original lender. Where the loan is granted through a third party or special purpose vehicle which originates a loan for or on behalf of the AIF or its AIFM, the AIF will still be considered as originating the loan where the AIFM or AIF is involved in structuring the loan, or defining or pre-agreeing its characteristics, prior to gaining exposure to the loan.

LOFs are closed-ended by default but the directive permits open-ended LOFs if it can be demonstrated that the AIF has liquidity management tools available that are consistent with its investment strategy and broader liquidity risk management system and redemption policy. The AIFM must select at least two appropriate liquidity management tools from a list provided in the annex to the directive (unless the AIF is a money market fund, in which case, the AIFM may select one liquidity management tool). ESMA will develop further requirements for an LOF to remain open-ended.

The key requirements applicable to AIFs that originate loans are set out in the table below.

Risk Retention	An AIF that originates loans is required to retain 5% of the notional value of each loan it originates and subsequently transfers to a third party: (a) until maturity for loans with a maturity of up to eight years, or for loans granted to consumers regardless of their maturity; and (b) for a period of at least eight years for other loans. Derogations from the risk retention rules are permitted where: ▪ the AIFM starts to sell assets of the AIF in order to redeem units or shares as part of the liquidation of the AIF; ▪ where the sale of the loan is necessary to enable the AIFM to implement its investment strategy, to comply with EU sanctions or with "product requirements", or is due to a deterioration in the risk associated with the loan.
Leverage Limits	The leverage of an LOF must not exceed the following limits: ▪ Open-ended funds: 175% ▪ Closed-ended funds: 300% Leverage will be calculated according to the commitment method and expressed as the difference between the fund's exposure relative to the fund's NAV. AIFMs will be permitted to rectify their positions should the fund unintentionally breach the cap for reasons beyond the AIFM's control. Borrowing arrangements fully covered by capital commitments from investors in the AIF will not be taken into consideration. The thresholds will not apply to an AIF whose lending activities consist solely of originating shareholder loans, provided that the notional value of those loans does not exceed in aggregate 150% of the AIF's capital. This derogation will not apply to real estate shareholder loans.
Loan Concentration Limits	The notional value of loans originated to any single borrower must not exceed in aggregate 20% of the AIF's capital if the borrower is a financial undertaking, an AIF or a UCITS. This limit applies as of the date specified in the fund documentation of the AIF, which must be no later than 24 months from the date of the first subscription of units or shares in the AIF. This limit will cease to apply once the AIFM starts to sell assets of the AIF in order to redeem units or shares as part of the liquidation of the AIF and will be temporarily suspended where the capital of the AIF is increased or decreased (such temporary suspension to last no longer than 12 months).

Prohibitions	An AIF may not grant loans to certain linked entities: the AIFM or its staff, to the depositary or sub-depositary, or to an entity being part of the same group as the AIFM. AIFMs may not manage AIFs that engage in loan origination where the whole or part of the investment strategy is to originate loans with the sole purpose of transferring those loans or exposures to third parties (originate to distribute).
Risk Management Policies	AIFMs of AIFs originating loans will have to implement and maintain effective policies, procedures and processes for granting. This requirement will not apply to shareholder loans, where their notional value does not exceed in aggregate 150% of the capital of the AIF.
Costs and Expenses Disclosure	All costs and expenses linked to the administration of the loans must be disclosed in offering documents and annual reports.

Transitional Provisions

AIFMD 2.0 contains transitional provisions to address AIFMs already engaged in loan origination strategies as at the effective date of the directive, that is 15 April 2024. These transitional provisions mean that pre-existing AIFs originating loans will be deemed to comply with certain requirements of the AIFMD until 16 April 2029. Those AIFs will be deemed to comply with the leverage and concentration limits and the rules relating to liquidity risk management for open-ended AIFs originating loans. However, the transitional provisions have implications for pre-existing fund portfolios and future fundraising plans as from 15 April 2024.

<table>
<tr><th colspan="3">AIFMS managing AIFs that originate loans established before 15 April 2024:</th></tr>
<tr><td>that raise additional capital after 15 April 2024</td><td colspan="2">will be deemed to comply with the leverage and concentration limits and the requirements relating to liquidity management for open-ended AIFs until 16 April 2029.</td></tr>
<tr><td></td><td>where the notional value of the loans originated by the AIF to any single borrower is greater than 20%, or the leverage of an AIF is greater than 175% (for open-ended AIFS) or 300% (for closed-ended AIFs) as at 15 April 2024</td><td>The AIFM may not increase the notional value of loans or, for LOFs, increase leverage until 16 April 2029. After that date, the concentration and leverage limits in AIFMD 2.0 will apply.</td></tr>
<tr><td></td><td>where the notional value of the loans originated by the AIF to any single borrower is below 20%, or the leverage of an AIF is below 175% (for open-ended AIFs) or 300% (for closed-ended AIFs) as at 15 April 2024</td><td>The AIFM may not increase the notional value of loans or, for LOFs, increase leverage above the limits set out in AIFMD 2.0.</td></tr>
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that do not raise additional capital after 15 April 2024	will be deemed to comply with the leverage and concentration limits and the requirements relating to liquidity management for open-ended AIFs in respect of those AIFs.
in respect of loans originated prior to 15 April 2024	may continue to manage such AIFs without complying with the rules relating to: prohibitions on loans to linked entities; cost attribution and disclosures; the originate-to-distribute prohibition and the 5% retention on resale requirement.
in respect of loans originated after 15 April 2024	must comply with the rules relating to: prohibitions on loans to linked entities; cost attribution and disclosures; the originate-to-distribute prohibition; and the 5% retention on resale requirement, after 16 April 2026.

Pre-existing AIFs originating loans may opt in to the requirements set out in AIFMD 2.0. If the AIFM decides to opt in to the requirements, it must notify its home national competent authority.

Implementation in Ireland

Ireland was the first EU member state to introduce a specific regulatory framework for loan originating investment funds. Industry is currently engaging with the Central Bank of Ireland in relation to the implementation of AIFMD 2.0 in Ireland to ascertain how the current Irish regime can be harmonised with the EU framework and when this can be done.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at **www.matheson.com**.

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