March 2025

SPOTLIGHT

Private Debt Explosion
Breaking New Ground

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SPOTLIGHT

In this issue:

Introduction

We are delighted to bring you this edition of the *Spotlight Magazine*. With all the recent changes in the US, we are expecting an interesting year ahead of us!

In the last 12 months, we have seen private debt markets take off over other strategies. In particular, there are now more creative ways of bringing in new types of investors to this asset class, including insurers, pension plans and of course "retail", which has different meanings in different jurisdictions. We are also seeing creative solutions to raise capital for private debt with the launch of US-rated feeders, EU insurance wrapped feeders and private wealth platforms. This heady combination of legal innovation and a changing US regulatory landscape may make this year an even better fund-raising year for private debt.

Our first article takes us through what retail really means in private credit and the various bear traps to be aware of. From there we move on to a refreshed discussion on the ongoing debate of whether using an ELTIF or a regulated Luxembourg fund — called a Part II Fund — is optimal for a "retail" fund raise. We then discuss the recent changes in France allowing managers to be creative in how they raise funds in the country. The recent convergence of US and EU ESG changes, that we discussed in our last edition, is refreshed in an article that focuses on what managers need to be aware of, taking into account the rising anti-ESG sentiment from the US. This leads us neatly into an article that throws some light on the ever-evolving US regulatory landscape for private funds, with the likely changes at the SEC making waves in the global markets.

We round off with a useful tour of US direct lending solutions for non-US investors from a tax perspective and conclude this edition with an interesting opinion piece on the growing impact of artificial intelligence on the legal market.

We do hope you enjoy this edition and please feel free to reach out to any of our contributing authors on the topics covered.

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Retail vs Professional Investors

Who is the real target?

By Zachary Milloy

What you need to know

- In the EU, any investor which is not a per se professional investor under the Markets in Financial Instruments Directive 2014 (MiFID) or which requests to be treated as a professional investor and has completed the MiFID opt-up process will be considered a 'retail' investor.
- EU fund managers are restricted under Article 32 of the AIFMD and are only permitted to market an EU fund using the AIFMD marketing passport to EU professional investors.
- Not all EU jurisdictions have implemented a regime to market EU funds to 'semi-professional' investors.

Fund managers are increasingly looking to retail investors to diversify their portfolios. Whilst this can be a stable source of capital, there are legal and regulatory issues that must be considered in order to be able to access the retail investor base.

In recent years private fund managers have become hyper focused on expanding their existing investor base to include EU retail capital. One of the main reasons for pursuing retail capital is the opportunity to diversify a sponsor's capital pool and increase overall fund size by accessing capital that, until recent years, has been widely overlooked by private fund sponsors.

While retail investors can provide a stable source of capital, which is valuable for any alternative investment fund, the main hurdle fund managers have faced is the enhanced regulatory burden that usually applies to funds targeted at EU retail investors. Accessing retail capital for alternative investment funds in the EU can be a complex process, particularly when it comes to navigating the legal issues surrounding the distribution of these funds to retail investors. The regulatory framework in the EU is stringent and can present significant challenges for fund managers looking to tap into this market.

But what is really meant by 'retail' in the context of distribution of alternative investment funds in the EU, and what profile of investors are sponsors really trying to target when launching a fund available to 'retail' investors?

In the EU, any investor which is not a per se professional investor under the Markets in Financial Instruments Directive 2014 (MiFID) or which requests to be treated as a professional investor and has completed the MiFID opt-up process will be considered a 'retail' investor. This is particularly relevant for EU high-net-worth investors who, despite their wealth and sizeable investment portfolio, may be unable to meet the MiFID criteria to opt-up to professional investor status.

One of the key legal issues that fund managers must consider when distributing alternative investment funds to retail investors in the EU is compliance with the Alternative Investment Fund Managers Directive (AIFMD). The AIFMD sets out rules and requirements for the marketing and distribution of alternative investment funds to professional investors in the EU, with the aim of protecting investors and ensuring transparency in the market.

From a marketing and distribution perspective, EU fund managers are restricted under Article 32 of the AIFMD and are only permitted to market an EU fund using the AIFMD marketing passport to EU professional investors. However, Article 43 of the AIFMD allows EU members to set domestic rules permitting fund managers to market funds under the AIFMD to retail investors. This is the first hurdle, and often the most important, for fund managers to overcome when accessing retail capital.

While it seems to be a binary distinction between EU retail and professional investors, and the AIFMD marketing passport is restricted to only professional investors, the reality is that in most EU jurisdictions there exists a third category of EU investor as a construct under domestic EU member states laws. This third category of investor is the 'semi-professional' investor to whom certain EU funds can be marketed under the AIFMD (owing to Article 43).

By way of example of local investor qualifications allowing access to a broader investor base, a Luxembourg RAIF can be marketed to 'well-informed' investors, which includes MiFID professional investors or investors which invest a minimum of €100,000 and confirm in writing that the investor is aware of the risks related to the investment.

Equally, Germany recognises 'semi-professional' investors, which are a subset of German investors, that EU AIFMs are permitted to market an EU fund to using the AIFMD marketing passport regime. A German semi-professional investor is an investor that invests at least €200,000 and is assessed by the AIFM as having sufficient expertise, experience and knowledge to make an investment in the relevant fund. Importantly, however, German semi professional investors are not required to meet two of the three MiFID quantitative requirements, which are often the most difficult requirements for EU high-net-worth investors to meet.

Other examples of semi-professional investor qualifications are evident in Finland, Cyprus, Belgium and Sweden, among others.

It should be highlighted, however, that given the local requirements of each EU member state, not all EU jurisdictions have implemented a regime to market EU funds to 'semi-professional' investors and therefore a careful analysis of domestic regimes will be required before launching a fund seeking to raise capital from both professional and semi-professional investors. In certain jurisdictions fund managers must obtain authorisation from relevant EU member state regulators before marketing their funds to retail investors. This authorisation process can be time consuming and costly, requiring detailed documentation and compliance with a range of regulatory requirements.

Additionally, sponsors will need to be mindful of wider EU regulation that will apply directly when marketing funds to investors that are considered retail investors under MiFID, most notably the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. The PRIIPs Regulation covers a range of investment products marketed to retail investors, including alternative investment funds. Investors which are considered 'retail' investors under MiFID will be within scope of the PRIIPs Regulation requirements. Sponsors raising capital from retail investors will need to prepare a Key Information Document in accordance with the PRIIPs Regulation, in addition to complying with domestic investor qualification requirements in relevant EU jurisdictions.

Overall, the legal issues surrounding the distribution of alternative investment funds to EU 'retail' investors in the EU require careful consideration. Fund managers must navigate a range of domestic regulatory frameworks, obtain the necessary authorisations and ensure compliance with disclosure and investor protection requirements. Notwithstanding these challenges, sponsors should carefully consider their target market as there may well be a step in between raising capital from traditional institutional investors and a full-scale retail offering.

While the legal hurdles can be daunting, with the right expertise and resources, fund managers can successfully access a broader pool of capital and unlock new opportunities for growth and success in the EU market.

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The ELTIF, the Part II and the EU Private Wealth Market

Will ELTIF 2.0 displace the revised part II UCI?

By Joachim Cour and Yves Elvinger

With the ELTIF 2.0 RTS taking effect in October 2024, we consider whether ELTIF 2.0 is now a viable alternative to Luxembourg Part II UCIS for marketing private credit strategies to retail investors.

The EU is home to €33 trillion in private savings. A goal of the Capital Market Union (CMU) is to unlock the potential of these savings for the real economy. ELTIF 2.0 is meant to be instrumental for this objective, but other vehicles (such as the Luxembourg Part II fund) offer solutions.

European Context

In recent years, we have witnessed efforts at the EU level to further develop the CMU with the aim of facilitating cross-border investments and unlocking access to capital. In a specialist report to the EU Council, Enrico Letta noted that in the EU there are €33 trillion in private savings, mainly held in currency and deposit accounts.

The European long-term investment fund (ELTIF) is expected to play a large part in the CMU objective, enabling AIFMs to market ELTIF/AIFs in the EEA with passports to both retail and professional investors.

The publication of the final regulatory technical standards (RTS) under the revised ELTIF Regulation have put an end to confusion that existed around liquidity rules for ELTIFs and have confirmed the latter as a suitable vehicle to structure evergreen funds.

While the ELTIF 2.0 rules were being finalised, managers have launched several vehicles targeting the EU private wealth market, using the Luxembourg 'Part II' funds.

Evergreen Standard

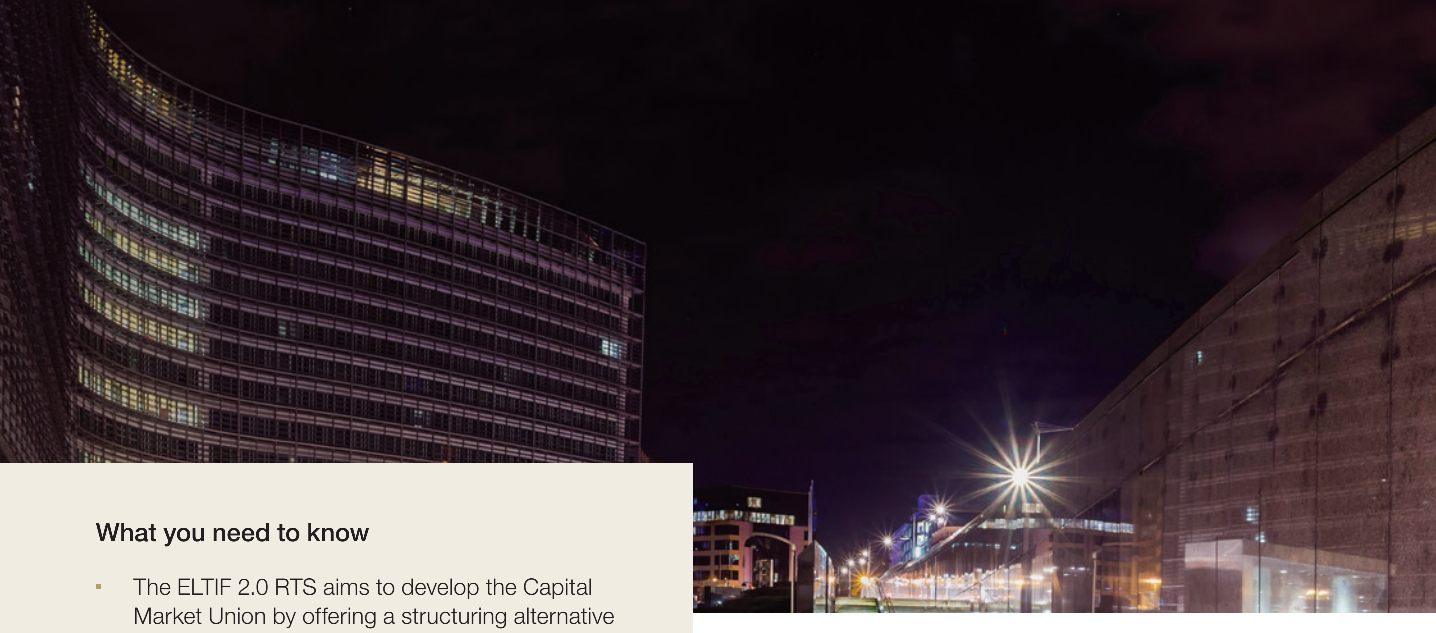
As the professional investor market has matured over the last decade, alternative managers have been targeting private wealth investors by setting up Luxembourg evergreen vehicles, replicating a model that was successful in the US where similar funds are structured as REITs or BDCs.

These vehicles share common features that have set a standard in the market. They (i) accept fully funded subscriptions (generally on a monthly basis and at NAV), (ii) offer some liquidity to investors by allowing redemptions (generally on a monthly or quarterly basis at NAV subject to a limit of 3% to 5%) and (iii) target all types of assets including real estate, private debt, private equity and funds. Sizeable players (such as Apollo, ARES, Blackstone, EQT, KKR, etc.) have already launched their evergreen vehicle (often in the Part II format).

Part II funds are not a new product — they may be traced back to the law of 25 August 1983 on undertakings for collective investments. Through the past decades, multiple Part IIs were launched, and the vehicle has since gained the trust of many regulators around the world. In July 2023, more corporate structuring options were released (including as a special limited partnership or as a partnership limited by shares). Besides, an ELTIF can be set-up as a Part II Fund and the combination of the ELTIF passport and the Part II structure offers an efficient and attractive vehicle to approach the private wealth market.

Marketing

Part IIs benefit from the AIFMD marketing passport in the EEA for professional investors as well as some semi-professional investors. Unlike the ELTIF product,



What you need to know

- The ELTIF 2.0 RTS aims to develop the Capital Market Union by offering a structuring alternative capable of reaching a wider investor base than the current Luxembourg Part II Fund.
- An ELTIF enables AIFMs to market ELTIF/AIFs in the EEA with passports to both retail and professional investors.
- An ELTIF can be set-up as a Part II fund and the combination of the ELTIF passport and the Part II structure offers an efficient and attractive vehicle to approach the private wealth market.
- Although Part II funds benefit from the AIFMD marketing passport in the EEA, unlike the ELTIF products, Part IIs cannot be marketed to retail investors with this passport.
- An ELTIF's biggest advantage over a Part II fund is that it provides the benefit of an EU wide marketing passport for all investors.

Part IIs cannot be marketed to retail investors with this passport, but the fact that they are regulated by a trusted regulator (CSSF) and have had a longstanding existence eases registration with certain regulators in the EEA (*e.g.*, Germany) and beyond (Asia, Middle East). For certain countries, the setting up of a parallel fund (*e.g.*, France) is necessary, whilst other countries may be penetrated via local feeders.

Compromises and Opportunities

ELTIF's biggest advantage over the Part II is that it provides the benefit of an EU-wide marketing passport for all investors. However, managers need to be mindful of the investment limitations and asset eligibility requirements, which require an in-depth assessment of the contemplated strategy and portfolio of assets. Moreover, the prescriptive rules governing the liquidity terms need to be assessed with caution.

Sponsors that already manage retail vehicles (often UCITS) are accustomed to the product-type restrictions contained in the ELTIF and will generally struggle less to adapt to those limitations than sponsors who are used to managing closed-ended, alternative funds for institutional investors.

Often, the ELTIF restrictions will prevent such a sponsor from packaging their flagship strategy into an ELTIF format.

However, the size of the private wealth market worldwide and the investor appetite for alternative strategies drive innovation, and alternative managers are now considering the ELTIF positively by using, for example, the ELTIF as a co-investment vehicle, proposing a subset of their strategies and portfolios that can meet the ELTIF requirements.

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New Opportunities in the French Private Funds Landscape

The Loi Industrie Verte seeks to modernize and innovate for the competitiveness of the French private funds landscape.

By Andras Csonka

The French law n°2023-973 of October 23, 2023, on Green Industry (the "**Green Industry Law**"), alongside Ordinance n°2024-662 of July 3, 2024, brings significant reforms to the French private funds landscape. These legislative measures are designed to enhance the competitiveness of French private funds, making them more appealing to both domestic and international investors.

New Eligible Funds for Life Insurance Products, PEA, and PER

At the end of 2023, the total savings available in French life insurance products amounted to nearly €1.923 billion, while the French stock savings plans (*Plan d'Épargne en Actions* – **PEA**) represented approximately €113 billion. Meanwhile, the French retirement savings plans (*Plan d'Épargne Retraite* – **PER**) represented around €109 billion as of the first quarter of 2024. These figures illustrate the immense potential for private funds to tap into significant pools of capital within the French financial ecosystem.

One of the purposes of the Green Industry Law is to channel these vast savings into financing the real economy and encourage greater democratization of private equity.

To achieve this, the law extends the list of instruments eligible for the PER (pursuant to certain criteria) such as professional private equity funds *(fonds professionnels de capital investissement* – FPCI), specialised professional funds (*fonds professionnels spécialisés* – FPS), limited partnerships (*société de libre partenariat* – SLP), specialized financing vehicles (*organisme de finance ment spécialisé* – OFS), and the newly introduced special limited partnership (*société de libre partenariat spéciale* – SLPS).

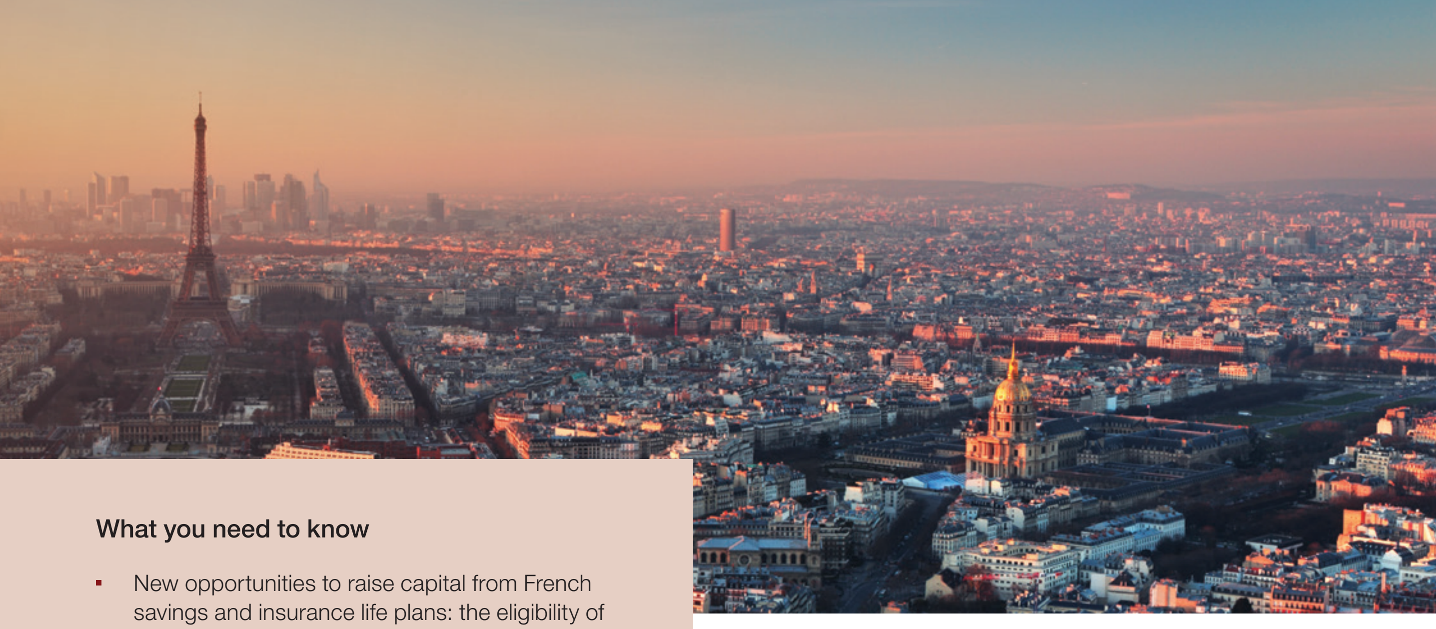
For insurance life products, certain of the above-mentioned French vehicles were already eligible, however, the Green Industry Law has now specifically made the OFS, commonly used in private debt strategies, eligible for inclusion in life insurance products.

For life insurance plans, PER, and PEA, if the above-mentioned French vehicles are approved as European Long-Term Investment Funds (ELTIFs), then some criteria normally required to be eligible for such plans will not be applicable.

Introduction of the Special Limited Partnership

One of the key innovations introduced by the Green Industry Law is the creation of the special limited partnership (SLPS), which is designed to address the limited attractiveness of the classic SLP in certain foreign jurisdictions.

This issue arose due to the fact that some non-French investors would treat the SLP as being non-tax transparent in certain jurisdictions due to its legal personality. To remedy this, the Green Industry Law introduced a new form of alternative investment fund (AIF) into French law: the special limited partnership (SLPS) which is has no legal personality unlike the classic SLP. This is a crucial distinction as it affects the entity's legal status and tax treatment in certain non-French jurisdictions.



What you need to know

- New opportunities to raise capital from French savings and insurance life plans: the eligibility of certain French private funds for French savings and life insurance plans has been expanded to include ELTIFs and private debt vehicles.
- Introduction of the Special Limited Partnership (Société de Libre Partenariat Spéciale): a new vehicle tailored for international investors.
- Development of the existing French private funds landscape: major innovations such as the possibility to issue debt securities for certain French private funds.

In France, the SLPS should be subject to the same tax regime as the classic SLP (and therefore, by reference, that of the FPCI). However, for certain foreign jurisdictions, the absence of legal personality of the SLPS should allow the SLPS to be treated as fully transparent under the tax rules applicable in the jurisdictions of certain non-French investors.

In addition, the SLPS structure retains the classic characteristics of a limited partnership (SLP), such as the general structure with management bodies (a general partner, a manager and an alternative investment fund manager (AIFM)) and the limited liability of the limited partners.

This enhanced regime makes the SLPS more attractive in various jurisdictions, helping fundraising efforts and reconciling the divergent tax approaches of various foreign investors.

Other Major Innovations

The Green Industry Law also introduces several other key innovations designed to increase the competitiveness of French private funds:

- The law confirms the ability of professional funds, such as FPCI, FPS and SLP, to create tracking shares. This feature offers the flexibility to have different rights on all or part of the assets or their products, thereby allowing for greater customization of fund structures and making these funds more appealing to a wider range of institutional and retail investors.
- Expected for a few years, and with the same objective of providing a competitive landscape for various sponsors to present credible alternatives to Luxembourg fund structures, the FPS and the SLP (including the SLPS) may now, under certain conditions, issue debt securities in addition to shares. This new feature will make it easier for FPS and SLP (including the SLPS) to accommodate certain institutional investors with specific prudential constraints. The ability to issue debt securities will also enable funds to structure more complex offerings that align with current investment practices in other European jurisdictions, particularly Luxembourg, which has long been a hub for alternative investment funds.

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EU and UK Approaches Addressing Greenwashing in the Financial Market

Demand for sustainable investments has prompted regulators like the FCA and the ESAs to address greenwashing in the financial market.

By Ruth Knox and Jessica Howe

Greenwashing risk has increasingly become a focus in private markets due to growing scrutiny from regulators like the FCA in the UK and the ESAs in the EU. Private markets play a crucial role in the transition to a sustainable economy, but greenwashing can undermine investors' trust in the sector.

Introduction

Greenwashing (the misrepresentation of sustainability credentials of financial products or services) poses significant risks for private market operators. As global pressure mounts to address (in particular) environmental risks and impacts, regulators in the EU and UK have sought to further clarify their approaches to tackle greenwashing. This article explores the regulatory frameworks, enforcement mechanisms and practical implications for private market participants.

Policy Background

In June 2023, the European Supervisory Authorities (ESAs) — comprising the European Insurance and Occupational Pensions Authority, the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) — published progress reports on greenwashing and their final individual reports in June 2024, focusing on identifying and mitigating greenwashing risks within the EU financial system.

Similarly, the UK Financial Conduct Authority (FCA) launched consultations on its anti-greenwashing rule in November 2023, and published the final form anti-greenwashing rule and accompanying guidance in April 2024. Whilst the ESAs and the FCA have taken different regulatory approaches to addressing greenwashing as outlined herein, there are also material similarities that can be drawn out.

Application of Anti-greenwashing Guidance at Entity or Product Level

UK

The FCA's anti-greenwashing rule applies to all FCA-authorised firms (including credit institutions, asset managers and payments institutions) and requires that communications about financial products or services are "clear, fair and not misleading".

In the finalised guidance, the FCA reminds firms that guidance from the Competition and Markets Authority and the Advertising Standards Authority (ASA) (as well as FCA Principles 6 and 7 or, as relevant, the Consumer Duty (Principle 12 and PRIN 2A)) apply to sustainability-related claims made at the entity level. This guidance is broadly an extension of the FCA's clear, fair and not misleading rule, with the addition, under the ASA's guidance, of a "social responsibility" principle. This principle provides that marketing materials must be prepared with a sense of responsibility to consumers and society. Marketing communications must not condone behaviour prejudicial to the protection of the environment.

EU

Unlike the FCA, the ESAs have not introduced a standalone anti-greenwashing rule. Instead, they confirmed that existing EU regulations, such as the Sustainable Finance Disclosure Regulation and the Corporate Sustainability Reporting Directive, sufficiently address greenwashing. Accordingly, EU enforcement focuses on ensuring compliance with disclosure requirements. The ESAs' concept of greenwashing considers the subjective perceptions of consumers, investors, and market participants, broadening the interpretive scope, and is applied by the ESAs at both the entity and product levels. The ESAs have developed eight common characteristics of greenwashing, highlighting misleading claims, incomplete information and inconsistent metrics as key risks.

What you need to know

- Regulators are intensifying their oversight of firms' sustainability claims, seeking to ensure adherence to new rules and maintain market integrity.
- Firms are required to ensure that any sustainability-related claims are fair, clear and not misleading, with the FCA and ESAs providing guidance to support compliance.
- Adhering to these standards can support a firm's reputation as a trusted market leader, attracting investors that seek to gain a competitive edge through targeting investments which pursue substantial and measurable sustainability-related returns.
- Noncompliance with these regulations exposes firms to legal risks, including regulatory scrutiny and engagement, enforcement action, and litigation, which can have significant and long-lasting reputational impacts.

Comparing Regulatory Themes and Practices

Despite procedural differences, the FCA and ESAs converge on core regulatory themes. Both emphasise:

- **Accuracy and Transparency**: Claims must be fair, clear and not misleading.
- **Mitigation of Risks**: Firms should adopt robust processes to substantiate sustainability claims and avoid vague or unverifiable language.
- **Focus on Accountability**: Both regulators stress the importance of ensuring that sustainability disclosures align with broader legal and ethical standards.

So although financial firms will need to align their practices with the nuanced guidance from both authorities, it is useful to know that there is significant overlap.

The FCA emphasises a principles-based approach, focusing on firms' communication about sustainability. In contrast, ESMA's approach, for example, includes detailed recommendations at both the entity and product levels, such as strengthening governance processes, ESG data management and external validation processes, alongside the integration of ESG risk management systems. While UK firms may need similar enhancements to meet the FCA's anti-greenwashing rule, ESMA explicitly outlines these measures.

Firms conducting their own mapping exercises across UK and EU requirements could take the view that closing any gaps with the ESAs' proposals and applying this to their UK business could also improve FCA compliance (and ensure uniform approaches). Additionally, the FCA provides more detailed insights on certain aspects of greenwashing, such as the importance of mitigating risks throughout the product lifecycle, whereas the ESAs only briefly acknowledge risks across the finance value chain.

Conclusion

The EU and UK financial regulators share a common understanding of greenwashing in financial markets but adopt distinct approaches to addressing it. The FCA has introduced a specific rule to mitigate against instances of greenwashing in communications, whereas the ESAs have taken the approach of explaining how existing sustainable finance regulations work to prevent greenwashing.

The introduction of the FCA's new rule and the ESAs' publication of numerous guidance materials on the matter indicate that both regulators are likely to become more proactive in terms of enforcement against greenwashing. That is expected to result in enhanced engagement, formal enforcement action and potentially litigation.

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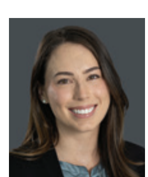

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The New SEC Leadership

What can industry participants expect?

By Ryan Swan

As private fund sponsors bid farewell to Chair Gensler and welcome Paul Atkins as the next SEC chair, this article examines the potential areas that will be the subject of SEC focus under Atkins' tenure.

What you need to know

- In Q1 2024, private fund sponsors were focused on assessing potential impacts, costs and business disruptions resulting from the pending implementation of the SEC's Private Fund Adviser Rules. This was subsequently met by the US Fifth Circuit Court chastening the SEC by vacating the Private Fund Adviser Rules in their entirety.
- In Q1 2025, private fund sponsors bid farewell to Chair Gensler and welcome Paul Atkins, who will serve as the next SEC chair.
- Early speculation is that the SEC under Atkins will prioritise fostering capital formation, supporting reforms SEC enforcement and promoting sensible industry regulation.

A lot can happen in a year. In Q1 2024, private fund sponsors (and our 2024 US Regulatory Update Spotlight Article) were focused on assessing potential impacts, costs and business disruptions resulting from the pending implementation of the US Securities and Exchange Commission's Private Fund Adviser Rules — one of the most significant US private fund rulemakings in recent memory. Enter the US Fifth Circuit Court, which chastened the SEC by vacating the Private Fund Adviser Rules in their entirety, thus alleviating private fund sponsors from the looming compliance burden and undoing one of the signature rulemakings under SEC Chair Gary Gensler's tenure. Now, in Q1 2025, private fund sponsors are saying goodbye to all that as they bid farewell to Chair Gensler (who stepped down as of 20 January 2025) and welcome Paul Atkins, who has been nominated by President Donald Trump to serve as the next SEC chair.

Atkins previously served as an SEC commissioner for six years under the George W. Bush administration. Since then, he has worked in the private sector, including most recently at Patomak Partners, a risk management and consulting firm for fintech, banking and asset management businesses. In addition to Atkins, four other commissioners head the SEC. Under a Republican administration, Republican-appointed commissioners will represent a 3-2 majority on matters submitted to commissioner votes, such as new rulemaking and enforcement activity. Current Republican-appointed commissioners, Hester Peirce and Mark Uyeda, previously served as counsel to Atkins during his time as a commissioner. Based on public commentary, their pronouncements as commissioners and their time spent working together, observers expect alignment on policy priorities among Atkins, Peirce and Uyeda. So, what can financial industry participants expect under the new SEC leadership?

Chair Atkins

The US asset management industry has largely cheered the selection of Atkins to head the SEC. Atkins is said to support practical regulation and reforms to the SEC enforcement focus and process. Atkins is expected to usher in a regulatory environment focused on the SEC's core mission of facilitating capital formation and protecting investors — particularly retail investors. Atkins is also viewed as a proponent of the crypto industry, and crypto participants are hopeful that he will play a role in helping address regulatory uncertainty. In contrast to Chair Gensler, then, the SEC under Atkins' leadership is expected to pursue a less sweeping regulatory agenda and to promote transparency with regard to the enforcement process.

Rulemaking

During his tenure, Chair Gensler set a blistering pace for new regulation by issuing numerous proposed rules affecting a broad swath of the US capital markets and financial services industries. After multiple adverse rulings in the US courts — including the aforementioned ruling in the Fifth Circuit Court that vacated the Private Fund Adviser Rules in their entirety — the SEC's rulemaking agenda was significantly curtailed under mounting political pressure and legal setbacks.

As a result, Chair Gensler leaves behind a number of proposed rules that are unlikely to be revived in their current forms under an Atkins-led SEC. This includes a number of regulations affecting private fund sponsors that never made it beyond the proposal stage. Many of these proposals were met with vociferous opposition from the private fund industry, including rules relating to (i) investment advisers' cybersecurity programs, (ii) oversight of outsourced service providers, (iii) a major overhaul of the existing client custody rule, (iv) the use of artificial intelligence and potential conflicts of interest and (v) mandatory ESG disclosure requirements.

A return to a comparatively modest rulemaking agenda and pace should be welcome news to private fund sponsors, many of which allocated significant resources to evaluating and preparing for the torrent of proposed reforms. None of this is to suggest that the SEC's new leadership is planning to rip up the rulebook, but Atkins is expected to focus more on bread-and-butter regulation aimed at broadly protecting the capital markets and retail investors in particular, as well as rules that thoughtfully foster valuable new markets and asset classes (such as cryptocurrencies), in each case without stifling innovation. Atkins also has been outspoken in his support for a more rigorous cost-benefit analysis applied to the SEC rulemaking process and for strict adherence to the SEC's delegated statutory authority. These sentiments, which Atkins has expressed publicly, dovetail with the criticisms by private fund sponsors (and other observers) of the Gensler-era rulemakings and may suggest a leadership that is willing to listen to feedback regarding the practical challenges of regulatory compliance.

Private Funds

Private fund sponsors have been an express area of focus for SEC rulemaking and the SEC's Division of Examinations for several years running. Atkins, together with his former clerks Peirce and Uyeda, has expressed that private funds and their institutional and sophisticated investors are appropriately regulated under the existing framework, which may mean an overall lighter touch than in recent years — *i.e.*, fewer rulemakings and precedent-setting enforcement actions aimed at the industry.

Enforcement

Atkins also has expressed support for key changes in the enforcement process, including returning to an emphasis on the protection of retail investors, policing comparatively major misconduct and declining to pursue controversial cases or cases of overreach where the commission relies on its own interpretations of legal, accounting and business thresholds or judgements regardless of industry practice. Atkins is a proponent for reforms to SEC enforcement, including by promoting transparency and clarity for regulated entities. A shift *away* from an atmosphere of regulation by enforcement is expected to be well received by private fund sponsors and other industry participants.

Past performance is not a guarantee or forecast, etc., but the early speculation is that the SEC under Atkins will prioritise fostering capital formation and sensible regulation — a welcome change.

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US Direct Lending: Structuring Solutions for Non-US Investors: What You Need to Know

Non-US investors continue to analyse optimal structures to access US direct lending market.

By Rob Wilson

As direct lending in the United States continues to develop significantly, prospective non-US investors in direct lending funds focused on United States investment seek optimal, tax-efficient structuring solutions to enable access to the United States market while minimising US tax leakage and reporting requirements.

As the market for direct lending in the United States continues to develop significantly, prospective non-US investors in direct lending funds focused on US investment seek optimal, tax-efficient structuring solutions to enable access to the US market while minimising US tax leakage and reporting requirements. Non-US investors engaged in a trade or business in the United States (or that invest in a partnership that is engaged in a trade or business within the United States) are generally subject to US taxation on income that is "effectively connected income" with such US trade or business and are required to file a US federal income tax return. Furthermore, the US Internal Revenue Service takes the position that regularly making, negotiating and structuring loans in the United States constitutes a US trade or business.

Outlined below are several structuring solutions that fund managers use to minimise the risk that a non-US investor will be deemed to be engaged in a US trade or business and incur "effectively connected income".

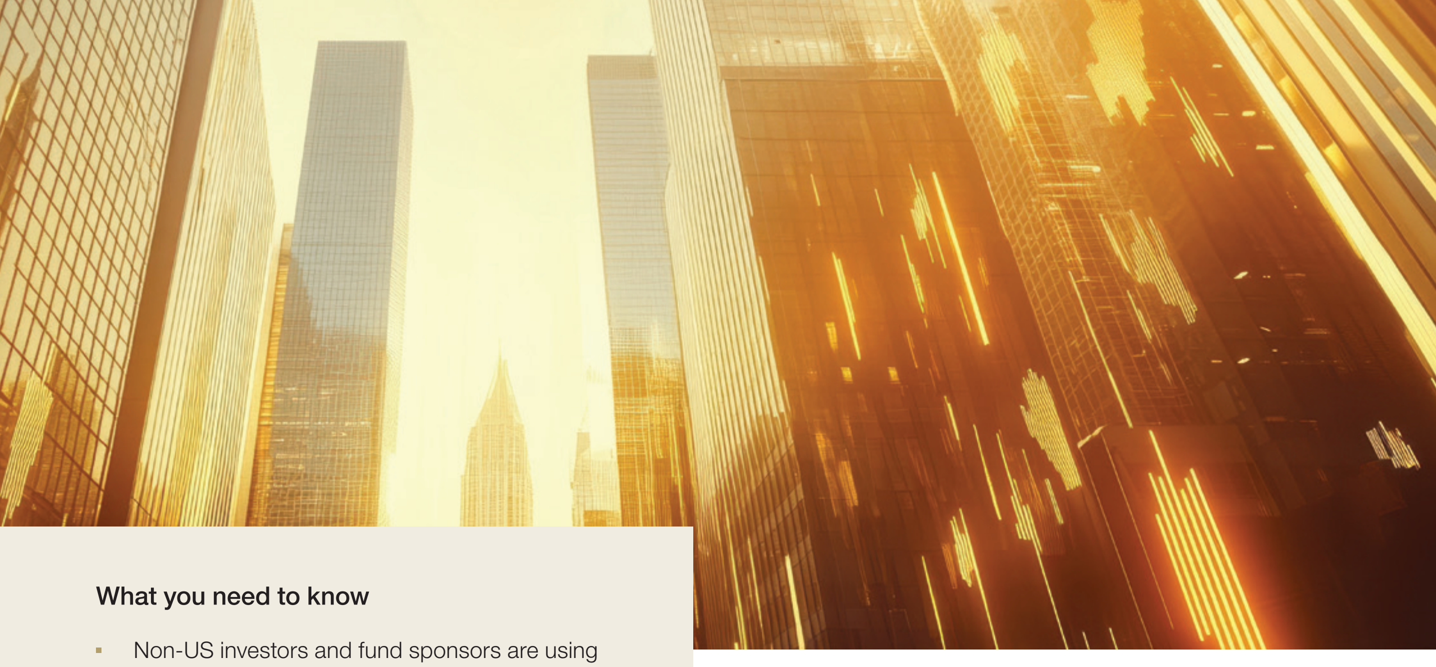
Leveraged US Blocker

In a leveraged US blocker structure, a non-US investor will generally invest through a US partnership (feeder partnership) into a US corporation (blocker corporation) that will invest directly in a US fund (taxed as a partnership), which makes the direct lending investments. The feeder partnership capitalises the blocker corporation with a combination of equity and debt. The terms of such debt are often determined by a transfer pricing study.

Use of this structure "blocks" non-US investors from incurring effectively connected income but comes at a cost. The blocker corporation itself is subject to US federal income tax on its net income (although interest paid by the blocker corporation on its debt may generate deductions, reducing the net effective tax rate of the blocker corporation). Furthermore, interest payments made from the blocker corporation (which would generally be subject to a 30% US federal withholding tax when made to non-US persons) may qualify for the "portfolio interest exemption" or otherwise qualify for exemption or reduction pursuant to a non-US investor's tax treaty claim.

Season and Sell

The season and sell structure generally requires two fund entities: (1) an onshore fund that engages in US direct lending (and will be treated as engaged in a US trade or business) and (2) an offshore fund that acquires certain loans from the onshore fund after a requisite "seasoning period". Unlike the leveraged US blocker structure, this structure allows non-US investors to access the US direct lending market while minimising US tax leakage. Typically, the offshore fund will be required to wait 60 to 90 days after the full funding of a loan by the onshore fund before acquiring a portion of directly originated loans. Furthermore, some fund managers require that the offshore fund hire an "independent



What you need to know

- Non-US investors and fund sponsors are using creative structures to avoid US tax leakage when accessing the US direct lending market.
- Taxable blocker structures remain popular but there has been an increase in the use of season and sell and treaty structures.
- Nonblocker structures generally impose certain restraints on investor composition, which make such structures more difficult to properly implement.

investment professional" that has final sign-off on the acquisition of seasoned loans from the onshore fund. While this structure avoids the US tax leakage present in the leveraged US blocker structure, it requires significant funding through both the onshore and offshore funds.

Treaty Structures

Treaty structures can present themselves in many forms. In some instances, a fund or investment vehicle may itself be eligible to claim tax treaty benefits. For example, Irish ICAVs and S.110 companies generally satisfy the definition of "resident" in the US-Ireland tax treaty to be eligible to claim tax treaty benefits. However, the ability of such entities to claim tax treaty benefits on income from US direct lending usually depends on the makeup of its investor base (*e.g.*, greater than 50% US/Irish investor base). Another variation of a tax treaty structure allows non-US investors to "bring their own treaty". In such structures, any intermediary fund vehicles are required to be fiscally transparent in the jurisdiction of the non-US investor tax treaty claimant. For each variation of a tax treaty structure, it is vital that the fund/non-US investor avoid being attributed a US "permanent establishment". Where a fund has a US manager, the US manager may cause the fund/non-US investor to have a US permanent establishment unless the US manager is deemed to be acting as an independent agent in the ordinary course of its business.

Use of a BDC/RIC Blocker

The business development company (BDC) structure requires a US fund vehicle that complies with various US SEC requirements, while also meeting certain operational requirements, to qualify a regulated investment company (RIC) for US federal income tax purposes. A RIC will not pay US corporate income tax on income and gains it distributes to its shareholders. Additionally, a RIC serves to block ECI. Furthermore, dividends paid by a RIC to non-US persons may qualify for an exemption from US withholding taxes to the extent such dividends are paid from certain interest income of the RIC which would be exempt from US withholding tax if paid directly to a non-US investor (instead of to the RIC). (Such dividends are referred to as "interest-related dividends".)

As we move into 2025, we expect many managers to deploy the above strategies as they seek to increase their direct lending capabilities.

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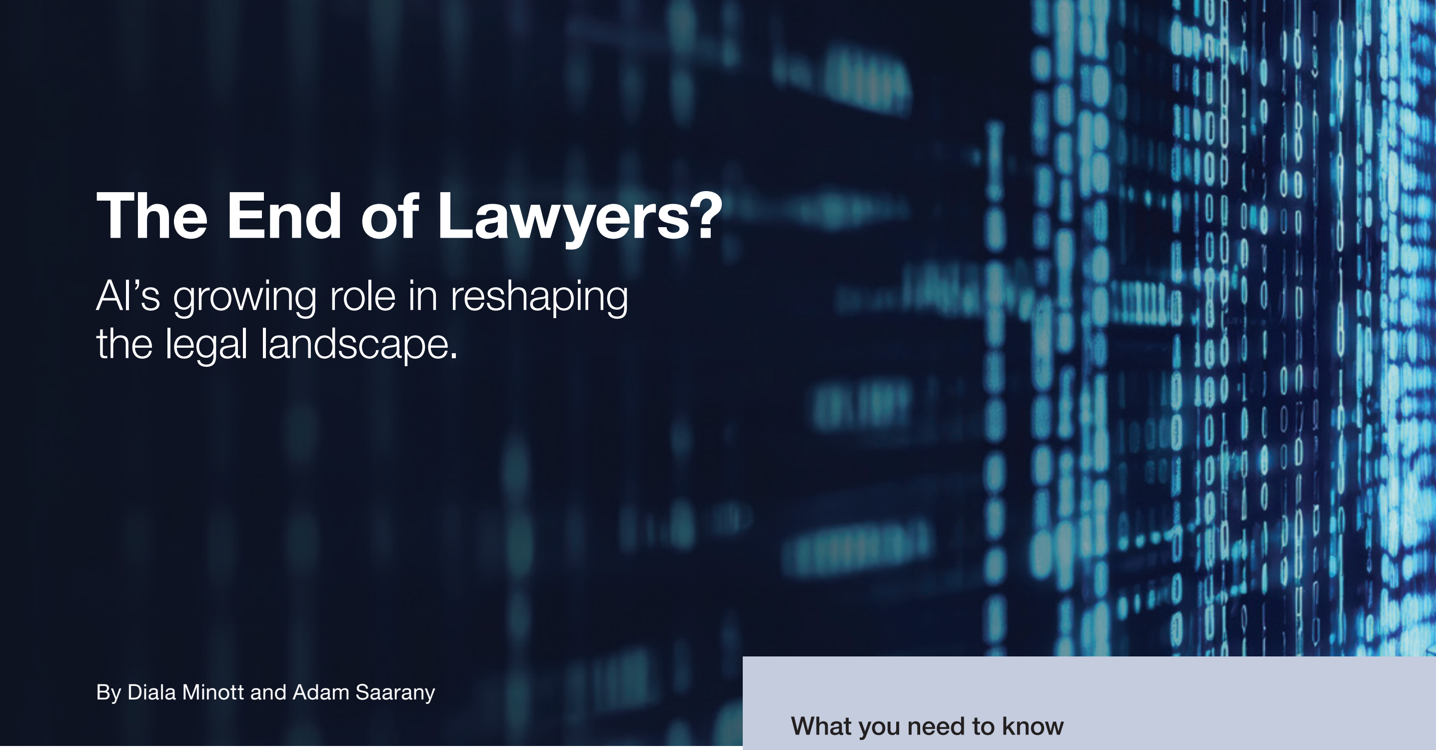

The End of Lawyers?

AI's growing role in reshaping the legal landscape.

By Diala Minott and Adam Saarany

What you need to know

- A recent report by Goldman Sachs estimates that almost half of all legal tasks are ripe for automation by generative AI.
- 43% of the 200 largest US law firms have now committed a dedicated budget for investing in AI.
- Although the future of AI is potentially all-encompassing, the current use cases are not without limitations.

Artificial intelligence (AI) is profoundly impacting — and, in some cases, fundamentally disrupting — the majority of our key industries. The legal profession is no exception. From processing large volumes of legal documents in minutes to automating established routine legal processes that have historically required hours (if not days) of a human lawyer's time, AI has undeniably already altered the legal landscape.

This has been surprising given that, historically, the implementation of innovative technology has been a hard sell to law firms. As an industry, the legal field prioritises caution; anything that could jeopardise a firm's reputation for accurate, detailed and reliable work is immediately questioned. However, this caution can only go so far. Continued technological advancements in other sectors have heightened pressure on lawyers to keep up and, by doing so, future-proof their industry. As with all service professions, client expectations reign supreme and innovations are coming for the legal field, whether it wants it or not.

In fact, a recent report by Goldman Sachs estimates that almost half of all legal tasks are ripe for automation by generative AI, a sentiment that has been increasingly echoed by legal commentators and clients alike.
As a result, law firms have responded. According to LexisNexis, 43% of the 200 largest US law firms have now committed a dedicated budget for investing in AI. While investments, surveys and the general buzz around AI does paint the picture that the existing role of the lawyer may soon be on its way out, it does not tell the full story — or at least the story as we know it now.

Although the future of AI is potentially all-encompassing, the current use cases are not yet without limitations. Most of the existing and trusted AI solutions within the legal market are principally constrained to large language models and machine learning algorithms which are trained only on vetted amounts of information with predefined parameters. Admittedly, this current manifestation of AI does excel in creating significant efficiencies with respect to legal tasks that are by their nature repetitive, mundane and time consuming. For example, it is easy to picture how AI can sift through vast amounts of documents to organise and analyse patterns and automate routine and basic processes at a speed that far outstrips that of human capability.

The technology does, however, have a ceiling. It is still prone to flawed reasoning and sometimes surprisingly basic errors. In addition, many AI solutions are susceptible to "hallucinations" — a situation where the AI model effectively makes something up or produces inaccurate, misleading or nonexistent information. Tests confirm this. For example, Thomson Reuters have demonstrated that AI is currently incapable of being accurately and reliably used to interpret the complexities of case law. The AI solution in this instance was unable to account for the nuances in the law's application within different jurisdictions. While the AI solution correctly identified and provided information about a specific law in one jurisdiction, it gave the exact same answer again when asked about the same law in another jurisdiction despite there being no such law in existence. If such advice by the AI solution were to be relied upon in a real-world setting, it could have ultimately presented serious consequences. The risk of inaccurate legal advice cannot be understated.

Therefore, despite recent advances, it is clear that human oversight is still required for effective and reliable use. AI's inability to exhibit critical thinking, to weigh variables, to quantify risk and/or to apply commercial considerations (including bargaining power or empathy) all make it an incomplete replacement for a human lawyer. These are all traits and attributes that are fundamental to the existing role of *human* lawyers that fellow *human* clients have come to expect. AI experts are also unsure whether AI will ever be able to close these gaps. At the very least, it is clear that the technology is still some distance away.

Taking all this into account, it looks like it might not yet be Armageddon for us human lawyers after all. We should therefore not be as fearful of AI as we may have initially anticipated. Instead of a competitor, AI should be looked at as a novel tool or even a colleague that we must invest in developing and forgive its initial shortcomings as it rises through the ranks of the corporate ladder. If we approach it this way, AI can only add value by creating significant efficiencies and thereby allowing human lawyers to focus on the important aspects that are truly helpful to our clients: deepening our knowledge, formulating effective strategies and providing quality advice. But all with a "human" touch.

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Upcoming Industry Events

PDI Europe Summit
13-14 May 2025
London

SuperReturn International
2-6 June 2025
Berlin

Global ABS
10-12 June 2025
Barcelona

Debtwire Private Credit Forum and European Direct Lending Awards
17 June 2025
London

AIMA Alternative Credit Council Global Summit
8 October 2025
London