

March 2026

# SPOTLIGHT

## Gold Rush: The Quest for New Private Capital

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The Rise of Evergreen Credit Funds

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Rated Note Feeders:  
What You Need to Know

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Growth and Innovation  
in Fund Finance

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Recent Trends:  
European Credit Fund Terms

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Unlocking New Investors Through  
Shari'ah-Compliant Funds

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AIFMD and Leverage —  
Beware of the SPVs

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ESG: SFDR 2.0 and What Credit  
Managers Should Do Now

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Digging Deeper: Tax Structuring  
of Private Credit Platforms

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## In this issue:

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<b>The Rise of Evergreen Credit Funds</b>	<b>2</b>
<hr/>	
<b>Rated Note Feeders: What You Need to Know</b>	<b>4</b>
<hr/>	
<b>Growth and Innovation in Fund Finance</b>	<b>6</b>
<hr/>	
<b>Recent Trends: European Credit Fund Terms</b>	<b>8</b>
<hr/>	
<b>Unlocking New Investors Through Shari’ah-Compliant Funds</b>	<b>10</b>
<hr/>	
<b>AIFMD and Leverage – Beware of the SPVs</b>	<b>13</b>
<hr/>	
<b>ESG: SFDR 2.0 and What Credit Managers Should Do Now</b>	<b>16</b>
<hr/>	
<b>Digging Deeper: Tax Structuring of Private Credit Platforms</b>	<b>18</b>
<hr/>	
<b>Upcoming Industry Events</b>	<b>20</b>
<hr/>	
<b>PHundMFN</b>	<b>21</b>

## Introduction

We are delighted to bring you this edition of *Spotlight Magazine*. With “Gold Rush: The Quest for Private Capital” as our theme, we focus on how private credit managers are adapting products, terms and structures to compete for new pools of capital in a market that remains active but increasingly more disciplined.

We begin with “The Rise of Evergreen Credit Funds”, which considers the rise in popularity of evergreen products designed to build long-term investor relationships, with important design choices being made around liquidity, subscriptions and performance fees. We then move to another product that is rising in popularity — the rated note feeder. In “Rated Note Feeders: What You Need to Know”, we examine the key structuring techniques involved, especially with respect to cash-flow mechanics, distribution controls and default remedies.

Next, we follow our fund finance team on innovations in the fund finance market. “Growth and Innovation in Fund Finance” tracks how new types of lenders are reshaping the market as borrowers seek broader flexibility. As facilities evolve through changes to tranching, financial covenants and hybrid structures, sponsors are benefiting from easier access to a wider pool of capital and financing that works across more fund types and asset classes. In “Recent Trends: European Credit Fund Terms”, we capture the market shift toward tighter investment and borrowing parameters, tougher events and new side letter battlegrounds. Next, we step into another increasingly popular product — Shari’ah funds. In our article “Unlocking New Investors Through Shari’ah-Compliant Funds”, we explore the scale and growth of Shari’ah-compliant capital, the widening demand base (including in Europe), and the structuring and governance considerations for sponsors.

To round off this edition, we have a few regulatory and tax updates. “AIFMD and Leverage — Beware of the SPVs” highlights how leverage calculations can unwittingly pull in an SPV-level borrowing for private credit funds and the contrast with the private equity market. In “ESG: SFDR 2.0 and What Credit Managers Should Do Now”, the likely regulatory reset under SFDR 2.0 is discussed, including the dominance of Article 8 and 9 funds in the EU market, the proposed label thresholds, the Taxonomy alignment and the closed-end fund exemption, amongst other topics. Finally, in “Digging Deeper: Tax Structuring of Private Credit Platforms”, it’s time to reflect on how tax outcomes and tax certainty are increasingly part of the “gold rush” as insurers, Shari’ah-compliant investors and private wealth capital deploy through evolving platform structures.

We hope you enjoy this edition and welcome any follow-up with the contributing authors.

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# The Rise of Evergreen Credit Funds

A compelling addition to a fund manager's product line

By Diala Minott and Alexander Scordino

The last year saw an explosion of new evergreen fund strategies as managers looked to diversify their offering and tap into new investor capital.

## Introduction

According to *Bloomberg*, evergreen fund assets (all private fund strategies) topped \$233 billion by the end of 2025, an increase of \$61 billion over the year. This growth reflects a broader “quest for new capital”, as managers expand beyond traditional closed-end vintages to access longer-term, repeatable investor demand. Evergreen funds are used as tool to invest alongside flagship funds, but also as a standalone strategy to access investors looking to deploy with the manager for the long term.

2025 also saw a significant increase in the number of evergreen SMA products. Evergreen SMAs encourage investors to be invested for the long term, rather than focusing on any specific fund vintage. They often invest alongside the manager's flagship debt products, allowing investors to have rolling exposure to different fund vintages. These SMA strategies offer reduced, or zero carry arrangements as an incentive to keep strategic investors committed to a relationship with the manager, providing an additional buffer of capital that can help smooth the fund raising gap between vintages.

The key design choices for evergreen funds are (i) how open-ended or liquid the product is, (ii) how investors subscribe, (iii) how performance is measured, and (iv) how liquidity is managed under AIFMD II.

## Building an Evergreen Product

Given the nature of evergreen products and their long or indefinite terms, managers must decide what exit terms are available to investors. Evergreen funds can take a

## What you need to know

- More managers are introducing evergreen products to build long term client relationships and tap new investor capital.
- Evergreens can take a variety of forms from fully open-ended to semi-closed ended.
- Regulatory and upcoming changes under AIFMD II have a bearing on the investor liquidity options offered to investors.
- Firms need to decide on whether direct subscriptions or the commitment model will be implemented.
- Evergreen funds can be split into different rolling vintages to allow performance fees or carry to be calculated for a specific pool of assets.

variety of forms depending on strategy and investors targeted ranging from fully open-ended funds which allow investor redemptions (subject to liquidity management requirements), to semi-closed ended structures which do not allow redemptions but allow investors to elect to terminate the investment period and have their investments “run-off” after a minimum period. Investors may additionally have the option of having income distributed or all proceeds retained within the fund until they elect to be “run-off” or redeem out of the fund.

How open-ended or liquid an evergreen strategy is will depend on a number of factors including regulatory requirements, strategy, and investor interest. Given the additional liquidity management requirements that apply for open-ended funds under AIFMD II (as further discussed below) we have seen managers prefer closed-

ended evergreen structures for direct lending funds. These structures typically offer the ability for investors to elect to switch their interests into a run-off class. The “run-off” class will restrict further investments (similar to ending the investment period) and allow investments to mature without forced liquidation. Typically, an investor may only elect to be “run-off” after three to five years. This approach can appeal to investors seeking long-term exposure while still preserving a defined pathway to exit.

Depending on the type of investors, managers will need to consider whether to use a direct subscription model (where interests are purchased on day one and investors are fully drawn) or the commitment model where investors are subject to regular drawdown notices. A direct subscription model is typically more popular for funds targeting retail or high-net-worth investors while the commitment model is more familiar to institutional investors. In a “quest for new capital” context, getting this subscription mechanic right is often critical to widening the investor base without changing the core strategy.

## Measuring Performance

Managers looking to earn carried interest or performance fees from their evergreen funds, will need to decide whether to use vintage periods or NAV to measure performance, each of which has benefits depending on the strategy.

Vintage period models are often helpful for evergreen funds that invest alongside flagship funds as the vintage periods can be tied to the term of the relevant flagship vintage. Each vintage will have its own investment period, and a harvest or realisation period based on a defined pool of assets (usually the assets acquired in the investment period). Investments that do not mature before the end of a vintage are typically rolled to the next vintage. Carried interest or performance fees would then be paid based on the performance of the assets assigned to the vintage period (as if it was a mini-closed-ended fund). This structure can preserve the “closed-end” economics that institutional investors are familiar with, while still offering an evergreen wrapper.

NAV models are often seen in funds with a standalone multi-strategy and more open-ended products that allow redemptions. NAV-based funds have a continuous investment period with no vintaging. The fund invests in perpetuity and all income and principal proceeds received from investments are reinvested unless needed to meet redemption requests. Performance fees are typically calculated with reference to a high-water mark to prevent overpayment in times of volatility. This approach can align with investors seeking steady,

ongoing exposure, but requires closer attention to liquidity management where redemptions are permitted.

## AIFMD II Liquidity Management Requirements for Open-ended Funds

If a manager intends to allow investor redemptions, regulatory liquidity requirements will apply.

AIFMD II, which will come into force in April 2026, will require AIFMs to ensure that the open-ended AIFs they manage select at least two liquidity management tools (LMTs) from the harmonised list set out in Annex V, points 2 to 8, of the amended AIFMD.

These LMTs include (1) quantitative-based LMTs, namely redemption gates, extension of notice periods and redemptions in kind, and (2) anti-dilution tools (ADTs) including redemption fees, swing pricing, dual pricing and anti-dilution levies. To facilitate such selection, in its Guidelines, ESMA highlighted the Financial Stability Board’s recommendation of having a balance between quantitative based LMTs and ADTs. According to ESMA, it could also be considered to have one LMT to be used under normal market conditions (ADT) and another (quantitative-based LMT) in case of stressed conditions.

Additional rules, including (i) more restrictive leverage limits; (ii) a requirement to retain at least 5% of originated loans; and (iii) lending more than 20% of capital to a single borrower apply for loan-originating AIFs.

To select the most appropriate tools for an open-ended AIF, AIFMs will need to consider the investment strategy, the liquidity profile and the redemption policy of the AIF.

## Conclusion

Evergreen products present new opportunities for credit fund managers, but careful structuring is required to keep products relevant for the long term while complying with regulatory requirements.



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# Rated Note Feeders: What You Need to Know

Preserving operational flexibility whilst meeting the requirements of rated debt.

By David Richardson

Rated note feeders allow sponsors to potentially access a broader and deeper pool of capital from certain institutional investors, although this may come at the cost of requiring some tighter operational restrictions on the fund. In order to make their funds compatible with rated note feeders, sponsors must adapt cash-flow waterfalls, default mechanics and post-investment period distribution controls to preserve seniority of repayment and provide genuine credit enhancement for the rated noteholders.

## What you need to know

- Rated note feeders introduce debt-like constraints to fund structures that need to be understood and managed by sponsors.
- Fundamental cash-flow mechanics likely to shift post-investment period towards sequential paydown and tighter distribution controls.
- Sponsor default remedies and enforcement rights to be tailored to avoid disrupting rated debt cash flows.
- Established, homogenous investment strategies with existing manager track records are preferable from a ratings perspective.

Rated note feeders are increasingly being used by private credit sponsors to broaden their investor base, particularly among institutions that require fixed income and/or rated debt exposure to underlying private credit assets. For sponsors accustomed to traditional closed-ended fund structures, however, introducing a rated note that is issued by a feeder fund is not simply a cosmetic change. It requires a meaningful shift in how certain structural, legal

and operational features of the fund are designed and operated. This article sets out some of the key differences sponsors should expect and the areas in which existing fund practices and provisions may need to adapt when introducing a rated note feeder for the first time.

## What Is a Rated Note Feeder in Practical Terms?

In simple terms, a rate note feeder is a feeder fund that issues a combination of rated notes and LP equity to investors, and in turn invests into an underlying master fund as a limited partner. The feeder therefore raises both equity and rated debt from its investors and uses those commitments to meet capital calls from the master fund.

From a sponsor's perspective, this capital often looks and feels like traditional LP capital: It is committed upfront, drawn over time and invested alongside other fund capital. However, economically and legally it is quite different. Unlike LP capital, the rated notes carry fixed repayment expectations, defined cash-flow priorities and external constraints driven by rating requirements. The core challenge for sponsors is therefore not access to capital but alignment — how to preserve the core economics and operational flexibility of a private credit fund whilst also meeting the predictability and credit enhancement required by both rated debt investors and rating agencies.

## Structural Differences From Traditional Closed-Ended Funds

The most important structural difference relates to how cash flows are expected to behave over the life of the fund. In traditional closed-ended funds, capital might typically be drawn pro rata (either to net invested capital or to capital commitments) during the investment period and have flexible recycling and distribution rights. In contrast, a rated note feeder introduces a clearer distinction between an investment phase and a repayment phase with regards to the operation of these mechanisms.

During the investment period, drawing debt and equity pro rata is generally acceptable. Once that period ends, however, rating agencies will usually expect a shift towards sequential paydown, where cash flows are prioritised to service interest and repay principal on the rated notes before any distributions are made to LP equity. As a general rule, sponsors should expect tighter rules around capital calls, recycling and distributions as the fund matures, with an increasing emphasis on leverage reduction rather than reinvestment flexibility. Post-investment period, such tighter rules around distributions may include the use of guardrails that prevent equity distributions from being made unless certain leverage and coverage metrics are satisfied.

## Defaults Must Behave Like Debt

An important feature of using rated note feeders relates to default remedies. In a traditional closed-ended fund's constitutional documents, defaulting investors can face a myriad of severe consequences: forfeiture of distributions, forced transfers, set-off rights or even partial or complete write-down of their interest. These remedies are effective deterrents in an LP equity context but they are not all compatible with rated debt.

If a feeder fund issues rated notes, the cash flows supporting those notes cannot be exposed to remedies that could arbitrarily interrupt or eliminate them. As a result, default provisions applicable to the feeder fund as a limited partner of the master fund must be tailored such that remedies that impair or extinguish feeder fund cash flows from the master fund must be disappplied. This tailoring of default provisions is typically achieved through side letters, although it can also be achieved through wholesale amendments to the master fund documents.

For sponsors, this means accepting that any rated note investor cannot always be treated identically to other investors in respect of their rated notes, even if it participates economically on otherwise similar terms.

## Other Considerations for Rating Agencies

Rated note feeders are often issuing rated notes before the portfolio is fully constructed (possibly before any investments have been made). Rating analysis is thus heavily influenced by the following factors:

- The sponsor's track record and consistency of strategy across prior vintages.
- Portfolio construction discipline and enforceable limits.
- The predictability of cash flows from the underlying portfolio investments.

These considerations have practical consequences: Rating agencies may find it harder to accommodate first-time funds or highly bespoke strategies due to a lack of track record, consistency and/or predictability. By contrast, established, homogeneous strategies such as middle-market direct lending are well suited as they allow credible modelling of portfolio behaviour and cash flows.

## Final Thought for Sponsors

A feeder fund rated note is not simply another class of interests; it is a hybrid of fund LP capital and structured debt, and it introduces the aforementioned complexity that private credit managers may not be accustomed to. For sponsors willing to accept tighter rules around cash flows and defaults, the trade-off is access to a broader and deeper institutional investor base. Success depends on recognising early where existing fund practices must adapt in order to accommodate the requirements of issuing rated debt, and the smooth implementation of any such changes.



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# Growth and Innovation in Fund Finance

An overview of recent market changes in subscription line lending.

By Jennifer Passagne and Katherine Tandler

In response to funds considering new ways to add leverage to fund structures, both bank and nonbank lenders have modified the traditional subscription-backed credit facility to offer more bespoke solutions. We explore some of these recent structural developments.

Historically, subscription-backed credit facilities (sublines) have been attractive to fund managers for providing quick access to liquidity at traditionally low rates. The standard subline is a secured loan made by a bank to a fund, where the collateral for the loan is the fund's right to call capital from its investors (and certain associated rights and remedies), together with the accounts into which capital contributions are funded. The subscriptions of the portion of investors that the lenders have deemed creditworthy will determine the maximum loan amount — typically a 90% advance rate if the investors in question are rated, and a 65% advance rate if the investors have been approved by the lenders for another reason. While the commercial terms have adjusted over time with the market, the facility documents themselves have been known to be standardised in terms of lender protections and typical borrower representations, warranties and undertakings.

However, as the world of fund finance continues to develop, we have seen more significant changes to the structuring of these facilities, with new lenders entering the market and borrowers looking for more creative

## What you need to know

- As new types of lenders enter the fund finance market, borrowers are increasingly requesting broader flexibility in their financings.
- Lenders have accommodated these requests by implementing certain structural changes in their facilities with respect to tranching, financial covenants and hybrid structures.
- These developments have benefitted sponsors by providing them with easier access to a wider pool of capital, as well as financing for a wider range of fund types and asset classes.

financing solutions. Below is an examination of some of the more meaningful trends that we have witnessed: the addition of tranche elements to these facilities, as well as a focus by lenders on the assets of the fund rather than just capital commitments.

The typical subline is a revolving loan, often with a one- or two-year initial term (plus certain committed or noncommitted extension options). However, as more nonbank lenders accumulate excess cash and look to access the fund finance market (sublines are relationship loans, and typically low-risk for lenders), we have seen some novel structures emerge so that borrowers can take better advantage of working with these new financiers.

One such example is the introduction of tranching concepts into subline facilities, including term loan tranches and A/B note structures. These tranches typically exist alongside the revolving portion of the facility but likely have different financial terms and maturities than the revolving piece. This structuring is attractive to borrowers and lenders as it assists with securitising the loans, in turn helping borrowers access nonbank capital such as debt funds, which might be interested in making a single investment rather than a revolving set of loans. Tranching can also be attractive if the borrowers intend to have the facility, or certain portions thereof, rated in order to draw in capital that would otherwise be inaccessible for regulatory reasons (for example, by insurance companies).

Separately, we have also begun to see some deviations in the security package and underwriting for sublines. Typically, a subline is focused “upwards” in the fund structure, i.e., towards the subscriptions of the investors that would be accessed upon a lender’s exercise of remedies. However, increasingly we are now seeing lenders direct focus “downwards” toward a fund’s investments. This is the case even if the facility is not a true “NAV” facility or “hybrid” (NAV/subline), and not secured by the fund’s assets. On sublines, this will take the form of financial covenants that the fund is required to maintain; for example, by keeping the NAV ratio or value-to-cost ratio above a certain specified level.

While these covenants pose additional requirements for funds, they can also be useful to borrowers as they may permit a lender to extend or maintain a loan they traditionally would not be able to make. For example, financial covenants make it more attractive for lenders to keep or introduce facilities later in the life of the fund, when the borrowing base is smaller. Not all lenders have embraced the NAV facility concept for all fund types, given the extensive underwriting involved, so these covenants provide a way for such a lender to maintain a subline but receive extra comfort about the value of the fund’s assets and investors’ desire to fund future capital calls. Maintaining the subline structure with these

additional covenants could also be helpful for funds that have restrictions on collateralising their investments or are seeking borrowing base credit for investors that the lender would not typically have underwritten.

In situations where a lender is willing to contemplate underwriting a fund’s assets, we have been seeing some hybrid structures that are secured by both investor capital commitments and equity pledges from the borrowers, together with control over the accounts into which borrowers receive distributions. Often, these loans are made in the context of a particular transaction that the fund is looking to leverage, limiting the scope of a lender’s credit analysis to only one deal. While these types of financings will also contain additional negative covenants in order to preserve the value of the pledges, they are helpful to borrowers who may not otherwise be able to finance a specific transaction.

We believe that innovative solutions like the ones described above will continue to evolve in order to meet the changing needs of borrowers. In turn, we may see more borrowers entering the market, seeking capital from the broadening pool of lenders. In sum, as the fund finance world continues to develop, we expect that sublines in their traditional and increasingly sophisticated multifaceted forms will remain a core liquidity and leverage tool for GPs throughout the life of a fund.



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# Recent Trends: European Credit Fund Terms

By Diala Minott and Mark Fung

Amidst a more volatile fundraising environment, 2025 saw a push for stronger fund governance and side letter comfort addressing both the new investment regulations introduced during the current tense geopolitical climate and the ongoing innovation in fund structuring.

## What you need to know

- Investors are pushing for stricter investment and borrowing parameters as a result of deteriorating borrower performance.
- Managers are being asked to sign up to harsher cause events and key person events.
- New areas for side letter negotiations stemming from recent regulatory developments and innovative fund structures.

**Operational Restrictions** — Industry reports generally point to a decline in the average interest coverage ratio on private credit loans combined with an increase in the use of payment-in-kind facilities in the past year, indicating that borrowers continue to experience liquidity stress. This has translated to investors advocating for stricter operational parameters for funds they are investing in, such as borrowing limits and investment restrictions. Whilst a cap of 30% of total commitments remains the market norm, we have seen many investors push for lower limits, such as 20% or even 10%. Most managers have generally been successful in resisting such changes, especially where they have an established track record in the strategy and the position is consistent with a prior

vintage. That said, on the rare occasion or two, managers have agreed to gradually reduce the level of borrowing by reducing the cap on borrowing as of the end of the fundraising period or investment period, but only where a fund is nearing the end of its fundraising and therefore its capital requirements have become clearer and the client is able to determine that the fund does not need to borrow as much as envisaged.

In a similar vein, larger investors are beginning to push against the standard 10% single obligor concentration limit, with varying degrees of success. Where they have conceded, managers have been able to temper the bite by building in a grace period to syndicate down the portion of any investment in excess of the concentration limit.

**Manager Conduct** — Additionally, investors have sought more onerous provisions around managers' conduct in managing their funds. In particular, there has been an increase in requests from LPs around the key person provisions, whether it be higher time devotion requirements or lower departure triggers for key person events, although in many cases investors are able to get comfortable based on the manager's AIFMD duties and the naming of additional key persons to demonstrate a deep bench. Stronger investors have also been able to negotiate access to the manager to discuss strategy and obtain information and/or soft commitments around hiring and strategy plans.

Time devotion requirements should also be carefully considered to ensure that agreeing to a higher threshold does not lead to inadvertent breaches across multiple funds where key persons work across a number of strategies. Managers have also generally been able to resist requests to include a key person event as a cause event, thus giving rise to a removal event. In our view, it is still the norm for a key person event to result in the suspension of the investment period and, if unresolved, an investor vote to either reinstate the investment period or liquidate the fund.

Compared to funds launched in recent years, the investor approval threshold for without cause removals gradually lowered from 75-80% down to 66%, in most cases, or even 50% in the most investor-friendly formulations, reflecting a downturn in fundraising sentiment following the boom in 2021-22.

**Regulatory Developments** — There are ever increasing requests from U.S. investors and multinational institutional investors seeking undertakings by managers to comply with the U.S. Outbound Investment Regulations (OIRs). Stemming from escalating geopolitical tensions between the U.S. and China (and the rest of the world generally), the OIRs (broadly speaking) establish reporting requirements for, or prohibitions on, U.S. persons' investments in or with a Chinese-owned or controlled entity engaged in the following sectors: (i) semiconductor and microelectronics, (ii) quantum information technologies and (iii) artificial intelligence (Covered Transactions).

Managers should be aware of the OIRs, even if neither they nor the funds they manage have any U.S. nexus, as U.S. investors have an obligation under the OIRs to perform due diligence on prospective investments to ensure they do not fall within the categories outlined above by way of side letter comfort. Aside from agreeing to operate in a manner consistent with the OIRs, managers should be prepared to provide (i) additional information rights to enable investors to comply with their own OIR obligations and (ii) excuse and/or transfer rights in the event the fund participates in a Covered Transaction.

Under the Trump administration, we have seen a rise in U.S. anti-ESG legislation restricting states from investing in strategies that consider ESG factors or that

exclude investments in sectors such as fossil fuels or firearms, and we are expecting further regulation of the consideration of ESG factors by managers in making investment decisions. This divergence in sentiment from European regulators and investors is expected to continue in 2026, and it remains to be seen if and how this needs to be reconciled under fund documents and side letters.

**New Fund Structures** — 2025 saw the proliferation of rated note feeders in Europe, which has expanded participation in credit funds to investors who wish to hold debt rather than equity, largely insurance companies looking to benefit from the preferential regulatory capital treatment of rated debt as compared to fund equity.

Consequentially, a side letter is typically entered into between the master fund, the rated feeder and noteholders to primarily ensure compliance by the rated feeder with the raft of ratios, covenants and limits with respect to the underlying master fund portfolio required to maintain the rating of the notes issued. Provisions commonly include: (i) information rights for the rated feeder service providers to perform calculations of the aforementioned ratios and limits; (ii) borrowing restrictions and negative pledge covenants; (iii) disapplying and/or modifying the defaulting investor provisions under the master fund documents as they apply to the rated note feeder; and (iv) audit rights. It is therefore important for managers to ensure that the master fund documents are sufficiently permissive to allow for these rights at the outset of the fund launch.



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# Unlocking New Investors Through Shari'ah-Compliant Funds

Shari'ah-compliant structures broaden the investor universe as demand accelerates globally.

By Conor Funston and Adam Saarany

Islamic funds entered 2025 with strong momentum, reaching an estimated \$308 billion assets under management (AUM) in 2024, and forecasts point to a 12.4% compound annual growth rate through 2033, driven by rising demand for Shari'ah-compliant options, regulatory enhancements and growing appetite for ethical and ESG-aligned investments.

## What you need to know

- Rapid growth in Shari'ah-compliant AUM creates a scalable route to new investors, alongside strong forecasts for continued expansion.
- Demand is broadening beyond the GCC and MENA, with Europe growing and non-Islamic investors seeking ethical, ESG-aligned investment options.
- Managers can access wider liquidity by offering stand-alone, feeder or parallel Shari'ah structures alongside conventional platforms and documentation.
- Shari'ah compliance introduces governance and operational requirements, including screening restrictions, Shari'ah guidelines, a board and ongoing monitoring.

Islamic funds entered 2025 with powerful momentum, as assets under management reached an estimated \$308 billion in 2024, underscoring the segment's growing scale and sophistication. Building on this base, current forecasts indicate the market is poised for robust expansion, with estimates pointing to a compound annual growth rate of 12.4% from 2025 to 2033. This trajectory reflects deepening investor demand for Shari'ah-compliant investment fund options driven by a range of factors including rapid economic expansion in core markets such as the GCC and Southeast Asia, which are increasing demand for Shari'ah-compliant financial products; ongoing enhancements to national regulatory frameworks; and rising appetite for ethical and ESG-aligned investments that naturally align with Islamic principles.

While a large part of the market remains concentrated in the GCC and wider MENA region, Europe has also seen growth within the segment. The Shari'ah-compliant funds market provides opportunities not only for Islamic investors but also investors seeking more ethically aligned investments, and provides funds with an opportunity to tap new pools of liquidity.

## Shari'ah-Compliant Funds

Shari'ah-compliant funds are investment funds structured in compliance and which operate in accordance with the principles of Islamic Shari'ah — the Islamic legal system derived from the Qur'an and the rulings of Islamic scholars. While in many respects, an Islamic fund will not differ substantially from a conventional fund, Islamic Shari'ah includes principles to be followed when structuring and operating a Shari'ah-compliant fund.

Key principles include:

- **Prohibition on *riba*:** Most commonly known by its prohibition of the payment or receipt of interest, the prohibition on *riba* more broadly prohibits unjust enrichment, including the creation of financial gain through wealth or money alone without risk sharing linked to a real underlying asset. This prohibition has implications when structuring Shari'ah-compliant funds, including the types of assets that may be invested in (e.g., restricting investments in companies engaged in conventional banking); the use of conventional leverage within the fund structure; and the structure used for manager compensation.
- **Prohibited sectors:** Shari'ah prohibits activities deemed incompatible with Islamic principles — activities that are harmful or offensive. Areas covered by this prohibition include activities relating to tobacco, alcohol, pork and pork-related products, pornography, conventional financial services, arms and gambling. This principle impacts the asset classes eligible for investment by such funds. The underlying investments must be Shari'ah-compliant.
- **Prohibition of *gharar*:** *Gharar* refers to the uncertainty, speculation or hazard created by lack of clarity. Shari'ah prohibits transactions involving excessive uncertainty or speculation. This principle affects Shari'ah fund structures in a number of ways, including through its impact on eligible asset classes in addition to the fund's use of arrangements such as conventional hedging or insurance policies.

## Structuring Options

While applying Islamic principles to fund structures necessarily involves tailoring certain features of conventional models, a wide array of flexible Shari'ah-compliant structuring options is available to achieve the

same target economic outcomes. In practice, Shari'ah-compliant and conventional funds share substantial commonality in their architecture and documentation, and conventional concepts can be adapted to operate in a Shari'ah-compliant manner. Equally, Shari'ah-compliant structures can be deployed alongside, or embedded within, broader conventional fund platforms maximising the potential investor universe for such funds.

Additionally, we have seen Shari'ah investors close into conventional funds without any amendments to the constitutional documents, typically instead through side letter arrangements that provide enhanced disclosure and reporting rights for the investor to monitor exposure limits whilst also offering tailored transfer or exit provisions which can be triggered if any such exposure limits are breached. However, the ability to attract Shari'ah investors in this way can depend on each investor's Shari'ah requirements as well as the fund's structure and the underlying asset class.

## Stand-Alone or Combined Structures

Shari'ah-compliant funds may be organised to invest across a broad spectrum of asset classes, including corporate equity, infrastructure, real estate and mezzanine finance. The optimal structure for a particular fund will turn on various considerations, most notably the underlying asset strategy and the target investor base.

If the investor base consists exclusively of Islamic investors, a fund can be established as a fully Shari'ah-compliant, stand-alone vehicle. Alternatively, sponsors can employ hybrid arrangements that combine Shari'ah-compliant and conventional structures to expand the pool of prospective investors, allowing a single platform to access both Islamic and conventional markets. Common models include Shari'ah-compliant feeder funds and parallel co-investment vehicles operating alongside a conventional fund.

Under a parallel co-investment structure, the Shari'ah-compliant vehicle operates alongside a master fund. The master fund may pursue both conventional and Shari'ah-compliant investments and the Shari'ah-compliant vehicle may elect to participate in those investments of the master fund that are Shari'ah-compliant. Under a feeder fund structure, the Shari'ah-compliant vehicle is segregated and provides Shari'ah-compliant capital to the fund for deployment into investments.



### Segregated Structures

Because real economy assets are hard to screen perfectly, Shari’ah compliant funds often use structural segregation to insulate Islamic investors from any exposure to haram activities. In a stand-alone fund, this typically means separating the asset holding structure from the Shari’ah funding vehicle. Asset holding vehicles may sit under an orphan SPV on charitable trust. The funding vehicle then finances the asset holders, with profits and capital returned via Shari’ah compliant arrangements.

### Practical Considerations

In order to ensure Shari’ah compliance, the underlying documentation for an Islamic fund will typically include Shari’ah guidelines and investment restrictions to which the fund must adhere in its operations and investments, together with screening criteria to assess the Shari’ah compliance of potential investments.

A Shari’ah board will be established for the fund consisting of one or more Shari’ah scholars who will issue a fatwa, or Islamic juristic opinion, stating their view that the fund structure is in accordance with the principles of Shari’ah. The Shari’ah board will also be responsible for the ongoing monitoring of the fund and its operations to ensure it remains in compliance with Shari’ah.

### Other Considerations

The core considerations that govern the formation of a conventional fund likewise apply to a Shari’ah compliant fund, including selecting suitable jurisdictions and designing the structure to minimise tax leakage. While Shari’ah compliant structures introduce additional factors — such as the treatment of particular Shari’ah contracts under the tax rules of certain jurisdictions and the purification of haram tainted returns — flexible, practical structuring solutions are available to address these issues and facilitate access to available investment capital.



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# AIFMD and Leverage — Beware of the SPVs

AIFMD II shines a spotlight on SPV level debt.

By Zach Milloy

For alternative investment funds (AIFs) regulated under the European Union's Alternative Investment Fund Managers Directive (AIFMD), leverage remains a double-edged sword. It can amplify returns but also heighten systemic risks, which in turn has promoted stringent regulatory oversight. Special purpose vehicles (SPVs) — entities often established below the fund level to hold assets, facilitate transactions or manage debt — add another layer of intricacy. While SPVs offer structural flexibility, their use in leveraging investments requires careful navigation to avoid a fund incurring leverage for AIFMD purposes.

## What you need to know

- Under the AIFMD, leverage must be calculated using two methods outlined in the Level 2 Regulations — the gross method and the commitment method.
- Alternative investment fund managers (AIFMs) must include borrowings by financial or legal structures (like SPVs) controlled directly or indirectly by the AIF if those structures were set up to increase exposure.
- Private credit funds must include SPV level debt in an AIF's overall leverage ratio for regulatory purposes.
- Private equity funds benefit from a specific exemption, allowing the AIF to disregard SPV level debt when calculating the AIF's leverage ratio.
- The disparity highlights AIFMD's nuanced approach: Credit funds' leverage is seen as more systemic due to interconnected debt markets while private equity's is more isolated.

This article explores leverage at the SPV level under the AIFMD, highlighting differences in calculation for credit and private equity funds, the exemption for private equity funds under Article 6(4) of the AIFMD Level 2 Regulations (Commission Delegated Regulation (EU) No 231/2013) and insights from the European Securities and Markets Authority's (ESMA) Q&A.

## Understanding Leverage Under AIFMD

The AIFMD defines leverage broadly as any method by which an AIFM increases the exposure of an AIF beyond the capital committed by investors. Such methods include borrowing cash, using derivatives or embedding leverage in securities. The AIFMD aims to mitigate risks from excessive leverage, which could contribute to market instability or amplify losses during downturns.

Under the AIFMD leverage must be calculated using two methods outlined in the Level 2 Regulations — the gross method and the commitment method. The gross method sums the absolute values of all positions, excluding cash in the base currency, to provide a snapshot of total exposure without netting or hedging offsets. The commitment method on the other hand allows netting and hedging, converting derivatives into equivalent underlying positions and incorporating committed but undrawn capital.



AIFMs must set leverage limits for each AIF, disclose those limits to investors and report to regulators if leverage is employed “substantially” — typically when exposure under the commitment method exceeds three times the net asset value (NAV).

SPVs enter the equation as subsidiaries or controlled entities below the fund. SPVs are commonly used to isolate assets, ring-fence liabilities or optimise tax and legal structures. In leveraged strategies, SPVs might borrow to finance acquisitions, effectively amplifying the fund’s exposure without direct borrowing at the fund level. However, AIFMD requires AIFMs to look through these structures in certain cases, consolidating leverage to prevent circumvention of the relevant AIFMD rules.

### **Leverage at SPV Level: The General Rule**

Under Article 6(3) of the Level 2 Regulations, when calculating exposure via the gross method, AIFMs must include borrowings by financial or legal structures (like SPVs) controlled directly or indirectly by the AIF, if those structures were set up to increase exposure. This “look-through” approach ensures transparency and prevents hidden leverage. For the commitment method, similar principles apply under Articles 7-10, where exposures from controlled entities are aggregated if they contribute to the AIF’s overall risk profile.

This consolidation is crucial for compliance. If an SPV borrows to acquire assets on behalf of the AIF, that debt counts toward the AIF’s leverage ratio. Failure to include it could lead to underreporting, triggering regulatory scrutiny or sanctions. ESMA emphasises that AIFMs

must assess control and purpose: If the SPV is AIF-controlled and debt-financed to boost returns, inclusion is generally mandatory.

Notably, temporary borrowings fully covered by investor capital commitments (i.e., a subscription line) can be excluded from an AIF’s leverage calculation.

### **Differences in Calculation for Credit and Private Equity Funds**

The treatment of SPV leverage diverges significantly between credit funds (often loan-originating) and private equity funds, reflecting their distinct strategies and risk profiles.

Credit funds, which primarily originate or invest in loans, frequently use SPVs to structure debt issuances or hold loan portfolios. Under AIFMD II (due to be implemented by EU Member States by April 2026), loan-originating AIFs face explicit leverage caps: 175% of NAV for open-ended funds and 300% for closed-ended ones, calculated via the commitment method. SPV-level borrowings are typically included in a loan-originating AIF’s leverage calculation, as the debt directly enhances the AIF’s credit exposure. The changes under AIFMD II are causing more sponsors to closely consider their leverage calculations.

The inclusion of SPV level debt stems from the absence of exemptions for credit strategies. ESMA’s guidance underscores that debt at SPV level must be aggregated with the AIF if it indirectly increases the AIF’s exposure. Credit funds often employ leverage through direct

borrowing, repurchase agreements, securities lending or derivatives within SPVs, all of which factor into leverage calculations.

In contrast, private equity funds benefit from a tailored exemption. Article 6(3) of the Level 2 Regulations provides that, for AIFs whose core policy is acquiring control of non-listed companies or issuers, borrowings at the level of those entities need not be included in the AIF's exposure calculation, provided the AIF bears no potential losses beyond its investment in the company or issuer.

This "no pass-through" approach recognises that private equity leverage is typically ring-fenced at the portfolio company level, not amplifying fund-level risks in the same way. ESMA clarifies that subsequent borrowings (e.g., for dividends) are also excluded if no additional losses accrue to the AIF. As a result, private equity funds report lower leverage ratios, facilitating higher leverage at the SPV level without requiring the same level of reporting or investor disclosures under the AIFMD.

The disparity highlights AIFMD's nuanced approach: credit funds' leverage is seen as more systemic due to interconnected debt markets while private equity's is more isolated. Yet, although SPV level debt could be structured as non-recourse to the AIF and its investors in both scenarios, an AIF pursuing a credit strategy will be considered "leveraged" for regulatory purposes and an AIF pursuing a private equity strategy will not.

For a time, there seemed to be a market view that the "no pass-through" approach available for private equity AIFs applied to any AIF which held unlisted shares in an SPV, irrespective of the overall investment strategy of the AIF. However, in June 2023, ESMA updated its Q&A document to provide critical clarification. Section VII. Q&A 1073 addresses real estate AIFs but has broader implications. It states that the Article 6(3) exemption does not extend to AIFs using SPVs for real estate acquisitions as the policy isn't "acquiring control of non-listed companies". Instead, leverage at SPV level must be included in the AIF's leverage calculation as it indirectly increases the AIF's exposure.

For credit funds, this guidance implies similar treatment: SPV debt for loan origination or asset holding purposes must be included in the AIF's leverage calculation. This Q&A heightens the risk around overuse of the "no pass-through" approach for non-PE funds, as miscalculation could lead to AIFs incurring more leverage than is permitted under the AIF's documents, AIFMD leverage limits and as disclosed to investors.

### **Practical Implications and Warnings**

AIFMs must beware of SPVs as leverage amplifiers. For credit funds, full inclusion demands robust monitoring systems to track SPV exposures in real time, especially given AIFMD II's leverage limits. For real estate debt funds, the use of back-leverage can result in an AIF exceeding leverage limits. While private equity AIFs enjoy some leeway, the exemption can be undermined if SPVs guarantee debts or expose the AIF to losses beyond its investment in the portfolio company (a key consideration when structuring leverage in private equity deals).

In summary, while SPVs enable sophisticated strategies, AIFMD's leverage rules require sponsors to remain conscious of regulatory leverage limits and limits included in fund documents and disclosed to investors. Best practices include stress testing SPV exposures and regular calculation of an AIF's leverage ratios. Navigating this terrain requires expert advice to ensure the appropriate use of SPV leverage without facing regulatory or investor backlash.



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# ESG: SFDR 2.0 and What Credit Managers Should Do Now

Redefining the framework through labels, a transition category and tailored investment criteria.

By Ruth Knox and Joanna Broadwith

SFDR 2.0 marks a major reset, shifting from disclosure-focused rules to a label-driven framework. The draft introduces a transition category and rebrands Article 8 as “ESG Basics” and Article 9 as “Sustainable”. Credit managers should monitor developments and begin assessing the potential impact on portfolios.

## What you need to know

- **EU Dominance:** Article 8 and 9 funds represent nearly 50% of EU AUM and over 60% of EU funds.
- **Regulatory Reset:** SFDR 2.0 introduces simpler rules, lower administrative burden and stronger enforcement.
- **Label Thresholds:** All three categories require 70% sustainable investments, defined differently for each label.
- **Taxonomy Alignment:** Half of current Article 9 funds should achieve 15% Taxonomy alignment, an alternative to the 70% threshold.
- **Exemption:** Closed-end funds that were created and distributed before the date of application of SFDR 2.0 are exempt.

The European Commission’s proposed Sustainable Finance Disclosure Regulation (SFDR) 2.0 marks a major evolution of the EU sustainable finance framework. While the original SFDR focused largely on disclosures, SFDR 2.0 introduces a label-driven classification system, new product categories, mandatory sustainable investment thresholds and prescriptive exclusions. Although still in draft form, credit managers should begin monitoring developments and assessing potential portfolio impacts.

The proposal notes that nearly 50% of EU AUM is designated as Article 8 or Article 9, representing over 60% of EU funds. Europe remains the dominant market globally, accounting for up to 84% of global sustainable fund assets, meaning SFDR 2.0 will have material implications for credit managers operating in Europe or with EU fund exposure. The European Commission’s stated objectives are simpler rules, lower administrative burden and stronger enforcement, with the framework designed to clarify obligations, harmonise disclosures, and introduce meaningful and comparable sustainable finance labels.

## Product Categories

SFDR 2.0 replaces the current Article 8 and 9 designations with three new product categories: Transition Products (Article 7), ESG Basics (Article 8) and Sustainable Features (Article 9). Each category carries a mandatory minimum sustainable investment threshold of 70%, though “sustainable investments” are defined differently for each label. Transition Products require investments to meet clear and measurable transition objectives, such as credible transition plans, science-based targets or engagement strategies with defined milestones. ESG Basics funds must invest in assets that meet the label’s sustainability criteria, which could include ESG ratings or sustainability indicators outperforming the investment universe or reference benchmark, or a demonstrable positive sustainability track record. Sustainable Features funds must meet specific environmental or social sustainability targets, measured using relevant indicators.

Each product category also has mandatory exclusions, with stringency increasing from Article 8 to Article 9. ESG Basics funds must comply with Climate Transition Benchmark exclusions and avoid companies deriving 1% or more of revenues from the exploration, mining, extraction, distribution or refining of hard coal and lignite. Transition Products carry the same exclusions, with additional restrictions on fossil fuel-related activities. Sustainable Features funds face the most extensive exclusions, following Paris-Aligned Benchmark rules and covering fossil fuels and high-carbon energy generation. Approximately 50% of Article 9 funds are expected to meet a 15% Taxonomy alignment threshold, which may serve as an alternative to the 70% sustainable investment requirement for Transition and Sustainable Features funds, ensuring measurable climate alignment and incentivizing investment in Taxonomy-eligible activities.

The draft also recognizes a fourth category of mixed funds, in which the 70% sustainable investment threshold can be met using a combination of Article 7, 8 and 9 assets. Within Article 7 and 9, a subset of funds may be categorised as impact products, focused on achieving measurable social or environmental outcomes. Closed-end funds that are closed to new investment before the SFDR 2.0 revisions come into force are carved out of these requirements.

### Other Points to Consider

SFDR 2.0 also introduces additional structural changes. Article 6 products, which are not sustainability-related, may include ESG information, but it cannot be a central element of precontractual disclosures and cannot form the basis of claims under Article 7, 8 or 9. Combined products under Article 9a may include multiple categories, but all ESG claims must remain clear, fair and non-misleading. Phase-in periods allow full implementation of ESG strategies, particularly for alternative or private assets. Detailed templates for disclosures will be published through delegated legislation. Article 3 website disclosures remain, while Articles 4 (entity-level PAI) and 5 (remuneration) disclosures are deleted. SFDR 2.0 also explicitly references the Unfair Commercial Practices Directive (2005/29 EC) and Directive 2024/825, highlighting that ESG claims must be accurate, fair and non-misleading. Fund names, marketing and precontractual disclosures must align with the new labels; products cannot claim “sustainable,” “green,” “ESG” or “impact” unless they meet the relevant category criteria. Sponsors will need to document their use of external and in-house data sources, including methodology, assumptions and the management of missing data.

The commission published the SFDR 2.0 Proposal on 20 November 2025. Trilogues with the EU Council and Parliament are pending, and the legislative process may extend to late 2026 or early 2027. The revised proposal is expected to apply 18 months after it enters into force, with no grandfathering for existing products, even if they remain open to investment.

### Actions for Credit Managers

Credit managers should closely monitor developments on SFDR 2.0, particularly the final definitions of “sustainable investment” and the detailed exclusions for each product category. Preliminary assessments will depend on the nature of the portfolio. It is advisable to determine whether current funds will remain open for new investment in 2028–29, as closed funds will fall outside the scope of SFDR 2.0 if they were created and distributed before the date of application of this regulation. For open funds, credit managers should review current SFDR product categorisation and consider the likely impact of the new requirements. For Article 8 and 9 funds, this includes assessing whether investments can meet the draft sustainable investment thresholds and comply with compulsory exclusions. For Article 6 funds, managers should consider the new restrictions on sustainability-related disclosures, ensuring that ESG information is limited, accurate and does not form the basis of claims in marketing or fund names.

By taking these preliminary steps, credit managers can begin to understand potential implications for their portfolios, anticipate areas where strategy or reporting may need adjustment and stay informed as the SFDR 2.0 framework progresses through the EU legislative process. Early monitoring and assessment will help managers respond efficiently once the final regulation is published and enters into force.



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A photograph of the Tower Bridge in London at dusk, with the sky transitioning from blue to orange and yellow. The bridge's towers and suspension cables are illuminated, and the city lights are visible in the background.

# Digging Deeper: Tax Structuring of Private Credit Platforms

Platform structuring to accommodate new categories of investors.

By Catherine Richardson, Jenny Doak and Alicia Osei

As credit fund platforms seek to attract a more diverse range of investors, managers are seeking to accommodate the differing tax profile of such investors in structuring their platforms.

The private credit gold rush is no longer confined to a familiar band of institutional investors. As insurers, Shari'ah-compliant investors, and retail and private wealth platforms step into the market as long-term capital providers, private credit managers are being required to re-examine the foundations of their platforms. This shift in the investor base requires consideration of the current tax landscape, including taxation of the underlying investments, entity level taxation and taxation of the investors' returns.

From a platform design perspective, managers continue to consider the most appropriate jurisdiction in which to establish debt platforms. Ireland, Luxembourg and the UK have been popular jurisdictions within Europe, having introduced an increasing choice of entity type to attract investors that offer various commercial advantages and drawbacks, including most recently adding the UK's Qualifying Asset Holding Company (QAHC) to the list of choices. For this new wave of investors, managers are also considering the establishment of parallel structures to provide investors with alternative points of entry. For example, insurers are often investing through rated note feeder funds whereas private wealth platforms may be subject to fewer regulatory constraints but may introduce a wider range of investor jurisdictions.

The taxation profile of the fund structure, including whether such vehicle is regarded as transparent or opaque for tax purposes, tax treatment of investments,

## What you need to know

- New classes of investors, including insurers, Shari'ah-compliant investors, and retail and private wealth funds are increasingly looking at deploying capital into private capital platforms.
- For these new investors, it will be equally relevant that the platform design ensures they are taxed as if investing directly in the underlying assets and that investment management activities do not create a taxable presence in the manager's jurisdiction.
- However, as these investors have different tax profiles to more traditional institutional investors, platform structures are evolving to meet these additional requirements.

and European interest limitation rules and anti-hybrid rules all continue to require consideration in the design of the debt platform.

Another key consideration in platform design is ensuring that investment management activities do not give rise to an inadvertent permanent establishment in the investment manager jurisdiction. In the UK, the rules relating to transfer pricing, permanent establishment and diverted profits tax (DPT) are subject to reform (as at the time of writing, the Finance Bill is progressing through the House of Commons). The changes to the definition of "permanent establishment" are intended to align the UK provisions with the 2017 OECD Model Convention. The key changes are that habitually playing the principal role leading to the conclusion of contracts is sufficient to cause a permanent establishment, and exclusive



agents that are closely related to the principal cannot be independent. Managers should review whether any UK-based agents could create a taxable presence under the revised provisions. The amendments to the Investment Manager Exemption are however welcome, including those to clarify the application of the rules to “investment funds”. The replacement of the UK’s DPT with the unassessed transfer pricing profits (UTPP), which will be taxed under the corporation tax regime, can bring this tax within the scope of the UK’s treaty network and is another welcome development.

In designing the platform, the goal will generally be to put investors in the same tax position they would be had they invested in the relevant assets directly. It will also be important to investors that they have no tax filings outside their home jurisdiction and, ideally, any exemptions are claimed at the fund level.

Investors will usually be required to provide tax status confirmations. Besides enabling the fund to meet tax reporting requirements, investors’ tax status can be relevant both in relation to withholding tax at the investee level and tax at the fund vehicle level itself. For example, to qualify as a UK QAHC, at least 70% of the investor base must fall within a prescribed statutory category. Whereas this is a well-trodden path for investors such as sovereign wealth funds and pension funds (which will usually have tax exempt status), it can be a more involved process for newer investor categories. For example, an insurance company’s classification may depend on the nature of its insurance business, private wealth platforms often involve a diverse range of jurisdictions that require tracing up multiple layers of funds, and retail investors often invest through widely held open-ended funds. The form of investment and economic arrangements will be important to Shari’ah-compliant investors, including whether such arrangements are within the scope of

any Islamic finance regime, such as the one in the UK. Managers need to ensure that their diligence questions are appropriately targeted and build in sufficient time to evaluate responses. Similarly, new categories of investors may have additional questions about the tax profile of the fund and the underlying investments for their own tax planning and reporting purposes.

Finally, investors are increasingly seeking to understand the fee and carried interest arrangements and, in some strategies, looking for a more tailored approach. Notably, the UK carried interest tax regime is being overhauled with effect from 6 April 2026, after which carried interest will be taxed as trading income rather than capital gains at a top rate of 47%, but a bespoke effective rate of around 34.1% will be available for “qualifying carried interest”.



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## Upcoming Industry Events



### CapLink European Private Capital Summit

25 February 2026  
London



### AFME & FT Live Global ABS

9 June – 11 June 2026  
Barcelona



### 24th Annual International Conference on Private Investment Funds (IBA)

8 March – 10 March 2026  
London



### Debtwire Private Credit Forum and Awards Europe 2026

17 June 2026  
London



### SuperReturn Private Credit Europe

9 March – 11 March 2026  
London



### PDI Europe Summit

5 May – 6 May 2026  
London

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A person in a dark suit and white shirt is shown from the chest up, holding a glowing, golden orb in their right hand. The orb is surrounded by a bright, warm light and several small, sparkling particles. Overlaid on the scene is a white line graph with an upward-pointing arrow at its end, set against a dark blue background with faint, semi-transparent grid lines.

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