

Modernization of French Alternative Investment Funds: The Stakes of Ordinance No. 2024-662 Dated July 3, 2024

JULY 18, 2024

Key Takeaways

The French Ordinance no. 2024-662 dated July 3, 2024, on the modernization of the regime governing alternative investment funds (the **Ordinance**) represents a major step forward. This has been long called in the Paris marketplace, in that it brings real innovations and much-needed clarifications for the competitiveness of French alternative investment funds.

Key points of the Ordinance:

1. **Legal context:** The Ordinance came into force on July 5, 2024. However, a ratification bill must be submitted to Parliament before October 4, 2024, to avoid the Ordinance becoming void.
2. **Consistency:** Introduction of targeted technical adjustments to facilitate the direct application of ELTIF II¹ under French law.
3. **New investment vehicle:** Creation of the *société de libre partenariat spéciale* (French special limited partnership) (**SLPS**) to compete with Luxembourg's special limited partnerships.
4. **Funds reserved for professional investors:**
 1. Introduction of the possibility for the *fonds professionnels spécialisés* (French specialized professional funds) (**FPSs**), including the *sociétés de libre partenariat* (French limited partnerships) (**SLPs**) to issue debt securities, making them more attractive to institutional investors subject to specific prudential constraints.
 2. Clarifications on the possibility for the FPSs, SLPs, and the *fonds professionnels de capital investissement* (French professional private equity funds) (**FPCIs**) to issue "tracking" units or shares or, for FPSs and SLPs only, "tracking" debt securities.
5. **Non-professional investors:** Partial alignment of the legal investment quota of the *fonds commun de placement à risques* (French venture capital funds) (**FCPRs**) with that of the FPCIs, to expand and make more attractive the "fund-of-funds" offering for non-professional investors.
6. **Eligible investments for SCPIs:** The Ordinance broadens the range of assets in which *sociétés civiles de placement immobilier* (French real estate investment trusts) (**SCPIs**) can invest and the possibilities for structuring investments.

An Ordinance subject to ratification by Parliament

The Ordinance, issued pursuant to Article 40 of the "Green Industry" Law², was published in the *Official Journal of the French Republic* on July 4, 2024, and came into force the day after its publication.

However, a ratification bill will have to be tabled by the Government in Parliament within three months of publication of the Ordinance (i.e., by October 4, 2024, at the latest), to avoid the Ordinance becoming void. The current political context and probable future political instability prevent us at present from gaining significant visibility on this timeline. We therefore remain cautious about the implementation of these measures and hope for a swift introduction of the ratification bill at the start of the next term of office and the rapid publication of the corresponding implementing measures.

Targeted and necessary adjustments in relation to the ELTIF II Regulation

The Ordinance provides several technical adjustments made necessary by the entry into force of the ELTIF II Regulation. As a reminder, the ELTIF II Regulation is directly applicable, meaning that it does not require implementation measures by EU Member States. However, as this is a "label" granted by competent local regulators which applies to a local legal form of alternative investment fund, the local legal rules of such relevant fund forms must make the operation of the ELTIF practicable.

These adjustments include, but are not limited to:

- For ELTIF-approved funds, the cap on redemptions of shares or units (gates) is no longer limited as a provisional measure if exceptional circumstances so require and if the interests of unitholders, shareholders, or the public so dictate. For these funds, the French Monetary and Financial Code also expressly refers to the application of the provisions of the ELTIF II Regulation in this area.
- The limit on receivables held by an FPCI (previously set at 10 percent of its assets) has been abolished.

Creation of the *Société de Libre Partenariat Spéciale* (French special limited partnership) (SLPS)

The SLP, introduced by Law No.2015-990 for growth, activity, and equal economic opportunities dated August 6, 2015, also known as the "Macron Law", aimed to make France more competitive on the international investment funds market by offering a flexible and attractive structure comparable to those available in other jurisdictions, such as U.S. or U.K limited partnerships or the Luxembourg limited or special partnership.

In the interest of adapting the offer of French funds to structures available in the main asset management jurisdictions, the SLPS – a new variant of the SLP albeit without a legal personality distinct from the one of its investors – is a direct response to the Luxembourg special limited partnership, insofar as it borrows its lack of legal personality.

While most of the legal framework for this new, innovative legal form is the same as that of the classic SLP (i.e., limited partnership, management bodies and structure, limited liability of limited partners), it features some interesting technical adjustments, such as, for instance, the creation of a *masse commune* (common pool), which the manager administers in the interest of the partners and is free to dispose of within the limits set out by the by-laws.

Logically, the SLPS should be subject to the same tax regime as the classic SLP (and therefore, by reference, to that of the FPCI). However, it will be up to the lawmakers to decide explicitly on this subject in the next finance bill. Additionally, the absence of legal personality for the SLPS should enable certain foreign investors to treat this vehicle as totally transparent under the rules applicable in their country of residence (e.g., Belgian investors), thus paving the way for new structuring possibilities.

Extending the possibility of issuing debt securities to FPSs and SLPs

FPSs and SLPs may now, under certain conditions that need to be specified by decree, issue debt securities in addition to units or shares. This has been expected for a number of years, with the objective of enabling FPSs and SLPs to represent credible alternatives to Luxembourg fund structures.

In particular, this new feature will make it easier for FPSs and SLPs to accommodate certain institutional investors with specific prudential constraints. Indeed, investment in debt securities, for some of them, has a more favorable impact on their capital adequacy ratio under Solvency II (Directive 2009/138/EC and its implementing texts).

Aligning part of FCPRs' legal quota with that of FPCIs, facilitating fund-of-funds strategies for non-professional investors

The Ordinance also follows a logic of strengthening offerings, particularly those of funds open to non-professional investors. Given the constraints imposed by the FCPR legal quota, French fund-of-funds managers were unable to offer French non-professional investors (particularly in the context of the democratization of private equity) the same range of fund-of-funds products as those reserved for professional clients.

Indeed, FCPRs could only invest in rights held in entities incorporated in a member state of the Organisation for Economic Co-operation and Development, and for the purposes of calculating the 50 percent legal investment quota, these rights were only taken into account up to the percentage of direct investment by the entity in question in eligible companies.

From now on, the definition of investment entities eligible for the FCPR legal quota is aligned with that of the FPCIs, allowing FCPRs to invest in "rights representing a financial investment issued under French or foreign law in an entity whose main purpose is to invest directly or indirectly" in companies eligible for the 50 percent investment quota.

When calculating the legal quota for FCPRs, rights held in another investment fund are now included in the 50 percent investment quota of the FCPRs "up to the percentage of direct or indirect investment of the assets of the entity concerned in companies eligible for this same quota".

This dichotomy between FPCIs and FCPRs used to exclude a number of potential investments from FCPRs' investment strategies. This measure will therefore enable fund-of-funds products in the form of FCPRs to offer greater diversification, which is particularly welcomed by non-professional investors.

On the other hand, this regulatory change should not affect the calculation of the tax quota provided for by Article 163 *quinquies* B of the French Tax Code, which provides that investments made indirectly through an investment entity are only taken into account within the limit of a single level of interposition.

The possibility of creating "tracking" units, shares, or debt securities

The Ordinance finally clarifies the possibility for professional funds (FPSs/SLPs and FPCIs) to create units or shares "giving rise to different rights on all or part of the fund's assets or income". This possibility is also extended, for FPSs and SLPs only, to the issue of debt securities with these same characteristics.

However, it is specified that these arrangements must not qualify as a securitization transaction within the meaning of Regulation (EU) 2017/2402 of December 12, 2017, laying down a general framework for securitization and creating a specific framework for simple, transparent, and standardized securitization (the **Securitization Regulation**). This restriction, already provided for in relation to the *organismes de*

financement spécialisés (French specialized financing vehicles), is intended to prohibit the tranching of credit risk, subject to the Securitization Regulation and considered from a prudential point of view for the investor, as an investment in a securitization transaction.

This clarification is to be welcomed insofar as, on the basis of existing texts, the very principle of creating "tracking" securities, and the contours of this possibility when used, were relatively vague (with varying practices depending on fund managers and depositaries). More complex structures, in line with current practices in certain European jurisdictions, will now be possible.

In practice :

- The interaction of these different classes of shares, units, or debt securities with the carried interest rights of the management teams should be expressly provided for in the constituting documentation of the relevant investment structures.
- The issuance of debt securities by FPSs and SLPs could open up new opportunities for structuring NAV financing operations. The decrees required to implement this measure are therefore eagerly awaited by the relevant stakeholders.

New possibilities for legal structuring of real estate asset acquisitions by SCPIs

The draft of the PACTE Law (Law No.2019-486 dated May 22, 2019, on the growth and transformation of businesses) adopted by the French National Assembly provided, under certain conditions, for the possibility for SCPIs to invest in furnishings (enabling, for example, the installation of photovoltaic panels on the roofs of buildings acquired with a view to rental) or to invest in real estate assets through companies other than partnerships. Unfortunately, much to the dismay of industry professionals, the French Constitutional Council censured these measures, considering them not to be relevant with the purpose of the PACTE Law (i.e., treated as a 'legislative rider').

The list of eligible assets for SCPIs has therefore been updated, and the new Article L. 214-115 of the French Monetary and Financial Code explicitly allows these entities to invest in "furnishings, equipment goods or movable properties allocated to these buildings and necessary for their operation, use or exploitation, as well as any renewable energy production process with a view to rental or exploitation or both, and real rights relating to such assets".

The same article now also allows SCPIs to invest in real estate assets through companies (other than partnerships) that are unlisted, which assets are mainly comprised of real estate, and whose partners' liability is limited to the amount of their contributions. These criteria are cumulative. This is a welcome innovation, as it brings SCPIs closer to OPCIs in terms of structuring underlying investments. It will also broaden the scope of assets in which funds raised by SCPIs may be invested, enabling them to invest in jurisdictions where the restriction to structuring through partnerships could have been a hindrance to deployment.

From a tax point of view, the possibility for SCPIs to directly operate furnished or equipped properties should be considered with caution, since this type of rental constitutes a commercial activity which, if not carried out on an ancillary basis, may result in the SCPI being subject to corporate income tax.

Footnotes

¹Regulation (EU) 2023/606 amending Regulation (EU) 2015/760.

²Law no. 2023-973 of October 23, 2023, on green industry.

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