

BAI webinar „US Private Credit“ – regulatory update

Frank Dornseifer, Managing Director BAI e.V.

January 30, 2019

- Intro: www.bvai.de
- Overview: Investing into US Private Debt
- Fund Regulation (AIFMD)
- Investment Taxation (InvStG)
- Investor regulation (Solvency II and AnIV)
- Annex

Frank Dornseifer
Geschäftsführer /
Managing Director
Rechtsanwalt/attorney-at-law



Poppelsdorfer Allee 106
53115 Bonn
+49 (0) 228 96987-50
dornseifer@bvai.de

Advocacy
Association



Investment &
Regulation



Events



Science/ Public
Affairs



- **German AIFs (subject to KAGB/AIFMD)**
 - Closed-ended Spezial-AIF pursuant to § 285 KAGB
 - Open-ended Spezial-AIF pursuant to § 282 or § 284 KAGB (Fund of funds, Master fund)
- **EU-AIFs (e.g. Luxembourg AIFs marketed to German investors)**
 - Master fund
 - Fund of funds
- **US Private Debt (Funds)**
 - Funds subject to specific investor and tax requirements
- **Other means, e.g. ELTIFs (may be marketed even to retail investors), securitisations, notes, etc.**

Fund vehicles subject to the KAGB	Activity („what?“)	How?
<p>Closed-ended Special AIF (§ 285 sect. 2 KAGB) – LP model</p>	<ul style="list-style-type: none"> - Direct lending (loan origination) - Investing into debt funds - Purchase of loans including restructuring/prolongation 	<ul style="list-style-type: none"> - Direct exposure - Leverage < 30 % - 20% per borrower - Appropriate organizational structure and process organization (KAMaRisk)
<p><u>Opend-ended</u> Special AIFs (§ 282 sect. 2 sentence 3 KAGB) with fixed investment guidelines (284 sect. 5 KAGB) – mutual fund model</p>	<ul style="list-style-type: none"> - Purchase of loans (loan participation) - Shareholder loans - Investing into debt funds, but restrictions - Restructuring/ Prolongation 	<ul style="list-style-type: none"> - indirect exposure
<p>EU-AIFM, EU-AIF if marketing in Germany allowed (exemption: § 330 KAGB)</p>	<ul style="list-style-type: none"> - Direct lending - Restructuring/ Prolongation 	<p>No application of KAGB and KAMaRisk to EU-AIFMs; AIFMD Delegated Regulation for Risk and Liquidity Management</p>

Requirements for Direct Lending	Sensitive Aspects
<ul style="list-style-type: none"> • Particular requirements for direct lending <u>and</u> investments in unsecured loans as they exist in the MaRisk for credit institutions • No base in regulation (EU) 2015/35! • Organizational structure and process organization <ul style="list-style-type: none"> • Decision on lending/investment • Processing of loans • Control of the processing of loans • Processing of problematic loans • Valuation of securities • Early detection of risks • Proportionality 	<ul style="list-style-type: none"> • Linked with MaRisk for credit institutions (same business, same rules?) • Treatment of different business models and asset classes <ul style="list-style-type: none"> • Direct lending vs. purchase of loans • Bonded loans • Senior secured / unsecured loans • Syndicated loans • Infrastructure debt • Use of ratings, credit decisions or valuation of securities of credit institutions • Application also for EU-AIF(M)s



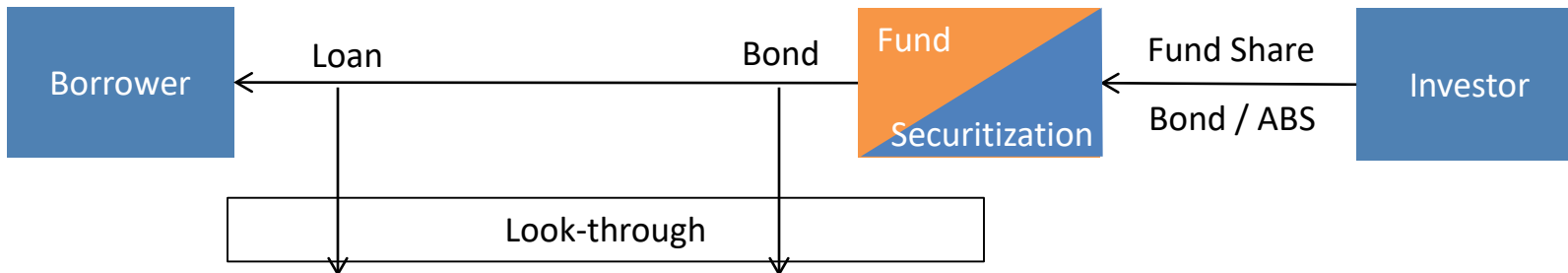
Circular 1/2017 (WA) from 10 January 2017 – KAMaRisk in force
 Section 5: Particular requirements for direct lending and investments in unsecured loans

- **Isolated definition of and distinction between (only for taxation purposes)**
 - Mutual investment funds: subject to a “non-transparent” taxation system that provides for a separate taxation of funds and investors similar to taxation of corporations. With the exception of special investment funds, non-UCITS partnerships and funds subject to special legislation, this system initially applies to all investment vehicles irrespective of their legal structure or investor base.
 - Special investment funds: The semi-transparent taxation system that applies for all investment funds until 2017 will be retained for special investment funds under certain conditions.
 - (Non-UCITS-) Partnerships: subject to the general German provisions on taxation, which provide for transparent taxation at investor level.
 - Funds subject to specific legislation: Some funds such as equity investment companies, capital investment companies, REIT stock corporations and REIT corporations within the meaning of the German REIT Act, are subject to specific tax legislation that differs from the treatment applied to the above funds.

Mandatory Investment Guidelines („Anlagebestimmungen“) pursuant to § 26 nos. 1-10 InvStG, i.a.

- **Redemption right** (not exchange-traded) (no. 2) <= **Debt funds usually are closed-ended!**
- **Eligible assets (min. 90%) (no. 4)**
 - **Securities pursuant to § 193 KAGB and other investment instruments pursuant to § 198 KAGB** (no economic meaning of „securities“, no indirect purchase of securitization entities), closed-ended fund as security
 - Equities, money market instruments, derivatives, bank deposits; real estate (companies) pursuant to the KAGB, etc.
 - **German and foreign UCITS, German and foreign investment funds fulfilling the requirements of nos. 1-7**
 - **Special Investment Funds units**
 - PPP Companies
 - Precious Metals
 - **Unsecured loans**

cumulative, if not: (non-transparent) Investment Fund



Solvency II Stress Factors

Rating	Corporate Bonds/ Loans	Commercial Real Estate	Covered Bonds	Qualified Infrastructure	ABS Typ 1	ABS Typ 2	Equity Typ 1 ²	Equity Typ 2 ³
	1 yr	1yr	1yr	1yr	1yr	1yr		
AAA	0.9%	0.9%[2] ¹	0.7%	0.64%	2.1 %	12.5%		
AA	1.1%	1.1%[2] ¹	0.9%	0,78%	3.0%	13.4%		
A	1.4%	1.4%[2] ¹	1.4%	1.00%	3.0%	16.6%		
BBB	2.5%	2.5%[2] ¹	2.5%	1.67%	3.0%	19.7%	39%	49%
Unrated	3.0%	3.0%[2] ¹	Wie CRE	100.0% (?)	100.0%	100.0%		

1) Reduction of 50% if risk-adjusted value of the qualified security > value of the loan

2) Listed equity from EEA or OECD, AIFs without leverage

3) Listed equity from Non-EEA or Non-OECD-Countries, non-listed equity, other capital investments

- 26 April 2017: Consultation (*EIOPA-CP-17-003 Call for Evidence - Request by the European Commission to EIOPA for Technical Advice on the treatment of unlisted equity and debt without an ECAI rating in the standard formula*)
 - Recital 150 of the Solvency II Regulation: Review of the Solvency II standard formula until the end of 2018
- **Implementing Solvency regulation due mid of February**
 - According to the latest draft (Art. 176a et seq) it would be possible to assign a spread risk charge based on the CQS 2 or 3 to certain unrated loans without a recognized collateral. The qualification criteria are comprised of requirements for (i) the issuer, (ii) the instrument and (iii) the internal rating process of the investor. One of the key requirements is the maximum yield requirement where the yield of the target asset is not allowed to exceed certain thresholds derived from public bond indices.
 - The draft also provides for a model based on a third party approved internal model of a Basel or Solvency II regulated co-investor.

	Direct investments	Indirect Investments via investment funds and other structures				
	From the balance sheet	Open-ended Special AIF with fixed investment guidelines pursuant to § 284 KAGB	Closed-ended EU Special Funds / closed-ended Special AIFs	Closed-ended EU Special Funds / Closed-ended Special AIFs	Structured Bonds	Participation Certificates
Numbers of § 2 sect. 1 of the Investment Ordinance	<p>No. 4c Corporate loans (including infrastructure debt):</p> <ul style="list-style-type: none"> Loans to new corporates with no investment grade Loans to infrastructure portfolio companies <p>Loans from companies domiciled in the EEA/OECD No credit institution/no bank</p> <p>„Speculativ grade“</p> <p>lex specialis</p>	<p>No. 16 Opend-ended loan funds</p> <p>Special AIFs pursuant to § 284 KAGB and not subject to no. 14c</p> <p>Redemption right once a year for fungibility reasons</p> <p>Eligible Assets pursuant to § 284 KAGB Only up to 30% loans/unsecured loans</p> <p>Only shareholder loans, no direct lending to other borrowers</p> <p>Restructuring and prolongation of unsecured loans is possible</p>	<p>No. 13b „Private Equity Funds“, („active“) PE-like investment strategy</p> <p>If not PE-like, no. 17 is applicable</p> <p>Closed-ended loan funds</p> <p>“other instruments to finance companies“</p> <p>Direct lending and restructuring</p> <p>Secondary purchase of loans</p> <p>EuVECAs, EuSEFs, ELTIFs EU-AIFs</p>	<p>No. 17 “Other AIFs“</p> <p>Applicable, if not nos. 13b, 14c, 15 and 16 apply</p> <p>If not PE-like strategy (i.e. „passive“), no. 17 is applicable and not no. 13b</p> <p>Closed-ended loan funds</p> <p>EuVECAs, EuSEFs, ELTIFs, EU-AIFs</p>	<p>No. 10a ABS and ABS-like Structures (if „asset linked“)</p> <p>§ 284 KAGB: Eligible in form of securities?</p>	<p>No. 9</p>

§ 285 KAGB – closed-ended Special AIF	Investment Fund pursuant to the InvStG	§ 2 sect. 1 No. 13b Investment Ordinance/ Circular	§ 2 sect. 1 no. 17 Investment Ordinance / Circular
Definition of § 1 sect. 5 KAGB (no „redemption right“)	§ 1 sect. 2 InvStG and § 1 sect. 1 KAGB (open-ended and closed-ended funds, if not subject to § 26)	Closed-ended AIFs	Investmente funds pursuant to § 1 sect. 1 KAGB (open-ended or closed-ended)
<ul style="list-style-type: none"> Investment in instruments with valuable current market price Limitation for leverage of 30% of the capital Limit of 50% for partner’s loans 	<ul style="list-style-type: none"> InvStG does not apply if fund is limited partnership (LP is tax transparent) No prescriptions with regard to eligible assets 	<ul style="list-style-type: none"> Eligible Assets pursuant to § 261 sect. 1 no. 4 KAGB, equity or equity-like capital and other instruments to finance companies Licence under KAGB/AIFM „light“ and AIFM with domicile in the EEA or OECD Short-term leverage up to 10% (Nr. 13b, cf. Circular) 	<ul style="list-style-type: none"> No prescriptions with regard to eligible assets <p><u>but</u></p> <ul style="list-style-type: none"> No open-ended real estate funds for retail investors Not subject to § 2 sect. 1 nos. 13b, 14c, 15 and 16 KAGB licence and AIFM with domicile in the EEA
Maximal exposure to single borrower up to 20%		Issuer limit of 1% of the restricted assets	Issuer limit of 1% of the restricted assets if closed-ended AIF
	Local business tax for direct lending activities?		

§ 284 KAGB – Special AIFs with fixed investment guidelines	§ 26 InvStG: <u>minimum of 90% of the NAV invested in following assets:</u>	§ 2 sect. 1 no. 16 Investment Ordinance (with reference to § 284 KAGB)
Redemption right before liquidation (open-ended)	Redemption right once a year	Redemption right once a year pursuant to the draft of the Circular to the Investment Ordinance
Securities	Securities pursuant to § 193 KAGB and other instruments pursuant to § 198 KAGB	
Money Market Instruments, Derivates, Bank Deposits, Real Estate, Real Estate Companies	Money Market Instruments, Derivates, Bank Deposits, Real Estate, Real Estate Companies, instruments pursuant to § 231 <u>KAGB</u>	
Target AIFs: <ul style="list-style-type: none"> • Opend-ended German, • EU and • Third country investment funds 	Target-AIF: <ul style="list-style-type: none"> • German and foreign UCITS, • German and foreign funds fulfilling the requirements of § 26 no. 1-7 • Special Investment Funds 	<ul style="list-style-type: none"> • Special AIFs fulfilling the requirements of § 284 KAGB and not being subject to no. 14c • Similar EU investment funds • <u>AIFM from the EEA</u> • Licence pursuant to § 20 KAGB or similar supervision
PPP Companies, Precious Metals, <u>unsecured loans</u>	PPP Companies, Precious Metals, <u>unsecured loans</u>	Limit of 30% for unsecured loans? (cf. Draft of the Circular to the Investment Ordinance)
	Issuer limit of 10%	