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13 May 2015

German Regulator Allows Debt Funds to Originate Loans

http://docs.bepartners.pro/news/2015-05-12_BaFin-Verwaltungspraxis_Kreditfonds.pdf

The German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, or "BaFin") has announced a change in its administrative practice with regard to debt funds. Until now, German debt funds were only allowed to grant loans in very limited circumstances, such as shareholder loans to real estate companies, or were limited to the acquisition of bank-originated loans. With this change in administrative practice, German debt funds are no longer subject to these limitations and are now free to originate loans directly in Germany. This also means that foreign (non-German) debt funds are also allowed to issue loans in Germany.

In its publication dated 12 May 2015, the BaFin announced a change to its current administrative practice with regard to the origination (as well as extension and restructuring) of loans by German funds.

1. German Banking Act (Kreditwesengesetz, or "KWG") does not apply to credit transactions of alternative investment funds

Under the previous administrative practice, the German Banking Act prohibited German alternative investment funds (AIF) from granting loans as this was deemed to be "banking business" and thus required a banking license. Under the new administrative practice, the granting of loans is now deemed to be part of an AIF's "collective asset management" as defined under the German Investment Code (Kapitalanlagegesetzbuch, or "KAGB") and is therefore now specifically permitted under German investment law. To summarize in a nutshell: German investment law now trumps German banking law in this instance. If the German Investment Code allows a German AIF to grant loans, the German Banking Act cannot prohibit it.

2. AIF With License to Originate Loans

The German Investment Code regulates the so-called "eligible assets" that certain types of German funds, such as open-end or closed-ended institutional funds (Spezialfonds) and hedge funds, may acquire. A German AIF must therefore first determine if it is permitted to grant and hold loans under the German Investment Act. If that is the case, then the granting of loans is permitted collective investment management by the AIF under the German Investment Code and cannot be prohibited under the German Banking Act.

Please note that the new administrative practice does not affect UCITs as these vehicles are not allowed to grant loans pursuant to Art. 88(1) of the Directive 2009/65/EC in the first place.

3. Restructuring of Loans Permitted

German AIFs are not only allowed to directly originate loans in Germany under the new administrative practice, they are also permitted to extend and restructure loans that have been previously acquired from a bank. Prior to the new administrative practice, a German debt fund was only permitted to acquire loans from a bank and was never allowed to either extend or restructure these loans.

4. BaFin's Recommendations

In revising its administrative practice, the BaFin opened the floodgates for German debt funds by qualifying the granting of loans as collective investment management. However, in its May 12th publication, the BaFin also stated that it intends to amend the German Investment Code to reign in these same activities of German debt funds. The recommendations are meant to prepare the debt funds' business models for the upcoming amendment of the German Investment Code. In other words, while the BaFin has lifted the total prohibition against such activities for German debt funds, it will then seek to curtail it to a certain degree. The BaFin giveth, and the BaFin taketh away (at least in part).

The recommendations apply to a variety of issues, such as both to the origination of loans as well as for the acquisition of loans. The recommendations include, inter alia, the following:

- The BaFin will seek to limit the origination of loans only to German closed-end institutional AIFs (Spezial-AIFs) (other types of German funds will be allowed to acquire loans from banks but not originate them);

- open-end funds should not invest predominantly in acquired unsecuritized loans, i.e. a maximum of 50% of the value of open-end funds may be invested in unsecuritized loans;
- leverage may be used to a very limited extent;
- while the AIF may grant loans, it is still not allowed to undertake other banking business, such as accepting customer deposits;
- the AIF may not mismatch maturities, i.e. it cannot take out short-term loans to refinance long-term debt;
- the BaFin's Circular 10/2012 on the Minimum Requirements for Risk Management (MaRisk BA) will apply to the extent these requirements apply to the lending business and the AIF's loan origination.

5. Foreign Funds Should Benefit Too

The BaFin's latest publication addresses only German funds. However, in our opinion, the consequence of the new administrative practice should also be enjoyed by foreign funds. If a German AIF is permitted to grant, extend and restructure loans in Germany without a banking license pursuant to the German Banking Act, the foreign funds may not be prohibited from undertaking the same activities, provided such activities are permitted in their home jurisdiction. Once again, the German Investment Code trumps the German Banking Act. Hence, foreign funds such as Luxembourg SIFs or Irish LOIFs should be able to grant loans to German companies without triggering the German Banking Act.

6. Conclusion

It has been common knowledge that the German government and regulator have been discussing a modernization of the German investment laws and banking supervision. The result of these discussions is gratifying and the new administrative practice was published with unexpected speed. Funds have the opportunity to react prior to the upcoming amendment of the German Investment Code. In addition, the recent amendment to the German Investment Ordinance (Anlageverordnung) now allows institutional investors to invest in "real" debt funds. Finally, German borrowers now have access to a pool of new creditors, who are not subject to the regulation and capital adequacy requirements pursuant to Directive 2013/36/EU and the German Banking Act.

be in touch: If you have any questions, please do not hesitate to contact us!

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