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Credit Funds INSIGHT

Spotlight on Europe:

A NEW ERA IN DIRECT LENDING

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An overview of this issue

We are delighted to introduce issue 3 of Credit Funds *INSIGHT*, in which we cover a range of legal and transactional issues relevant to the Credit Funds sector from our offices across the globe. In this issue we will be looking at:

Spotlight on Europe: A new era in direct lending (p1)
With opportunities arising for asset managers to pursue direct lending in Europe, Diala Minott considers why this is the case and the new fund structures now available for direct lending funds.

Unitranche partnerships: A real alternative for borrowers (p3)
Tim Rennie discusses the recent trend for banks to partner up with credit funds to provide unitranche facilities and considers how such arrangements could be put in place, identifying the key advantages and disadvantages of such arrangements.

Ireland: Loan Originator QIAIFs and ICAVs – two new key players (p6)
Two new key players in Ireland's fund structures were introduced at the end of last year: the Loan Originator QIAIF and ICAV, which offer dedicated fund structures specifically for loan origination. Melissa Ashdown and Carrie Clay discuss their key features and requirements, which are seen as an important milestone in the loan origination space.

Luxembourg: The new special limited partnership regime (p8)
Luxembourg has taken the opportunity, with the transposition of the Alternative Investment Fund Directive into national law in July 2013, to build into the legislation favourable measures for the establishment of fund-raising vehicles, most notably the new special limited partnership. Nick Goddard and Isabelle Lentz discuss the key corporate and tax features of the new special limited partnership and the revamped limited partnership model.

Italy: A first Italian project bond – a new era for non-bank lending (p10)
In a landmark transaction in Italy, on 3 December 2014, Natixis closed a bank and bond refinancing of a portfolio of Italian solar plants made possible for the first time due to recent changes in Italy's debt capital markets framework. Carloandrea Meacci and Gianluca Fanti discuss the significance of the transaction which they acted on, along with the recent changes to the Italian securitisation law aimed at allowing Italian securitisation vehicles (SPVs) to carry out direct lending activity in Italy for the first time.

France: A new exemption for securitisation vehicles (p12)
There had been some concern that the marketing of securitisation vehicles to French investors within France could breach AIFMD's authorisation and conduct of business requirements. Hubert Blanc-Jouvan discusses the new decree supplementing the AIFMD law in France, published on 16 November 2014, which now clarifies the criteria under which securitisation vehicles will be subject to French AIFMD law.

Asset-backed securities: Final risk retention rules adopted by US regulators (p15)
In this article, Michael Miran provides an update on the final risk retention rules that have been adopted by the US regulators and summarises the consequences that the final rule will have on CLOs and the investment advisors who manage them. The final rule becomes effective for CLOs two years after the date of publication in the federal register and will apply to issuances of ABS made after the applicable effective date.

We hope that you find Credit Funds *INSIGHT* useful and enjoy reading this issue. Please let us know if you have any feedback or if there are any topics that you would like us to cover in future editions.

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SPOTLIGHT ON EUROPE:

A new era in direct lending

by Diala Minott

Opportunities for asset managers to pursue direct lending have arisen in Europe. This is due to the reduction in bank lending, caused by regulatory pressures including capital adequacy requirements and de-levering.

According to Moody's, as of May 2014, more than 60 new private debt funds were raising capital in Europe to the tune of over €33bn. Standard & Poor's estimate that European mid-size businesses will need to raise between €2.4trn and €2.8trn in debt funding over the next five years. In addition, a survey taken by the European Central Bank in March 2014 showed SMEs reporting lower availability of bank loans for the fifth year running. The European debt funds market, in particular the direct lending funds market, is still in its infancy but has the potential to become a permanent feature of European debt capital markets, especially since European corporates are now less heavily reliant on bank finance, marking a shift towards the US model.

National government support

2014 was a very active year, with European national governments providing support to direct lenders through programmes encouraging funding access for SMEs. The UK Government's Business Finance Partnership scheme not only lends to lenders providing finance to medium-sized businesses with a turnover of up to £500m, but also lends to lenders that provide alternative sources of finance to small businesses with a turnover of up to £15m, including the fast-growing "peer-to-peer" lender market which breached the £2bn lending threshold back in September 2014. The British Business Association, along with Britain's five largest retail banks, launched a year-long campaign in January 2014 to

build confidence and provide support to businesses seeking finance within the £25m bracket.

Unitranche

Meanwhile, banks have tried to counteract this threat by partnering with funds. In February 2014, Barclays announced its partnership with private debt lender BlueBay Asset Management to provide unitranche debt for mid-market private equity deals. This mirrored the earlier US partnership between alternative asset manager Ares Capital and GE Capital. Even insurers have begun to step in to bridge the funding gap left by the banks. In July 2014, Legal & General began to lend money directly to companies through its tie-up with the asset manager Pemberton Group.

Luxembourg

There was also significant activity in European legal reform aimed at encouraging direct lending. In 2013, Luxembourg decided to revamp its limited partnership regime at the same time as transposing the AIFM Directive into national law. As part of this revamping, they introduced a new limited partnership, which was inspired by the Anglo-Saxon limited partnership, with the hope that it would give a boost for the fund-raising activities of private equity managers. Asset managers can now either use the updated SCS regime or use the SCSp. Asset managers now have complete flexibility when choosing to establish either a regulated (under SIF and SICAR law) or unregulated (governed by the Company Act) investment vehicle. This followed the relative success of the SIF regime introduced in 2007. Market sources currently confirm that talks are in place to establish an unregulated SIF limited partnership thereby removing the CSSF approval element. Most SCSps so far have been in the real estate debt space and the market awaits the first regulated loan fund established in the form of an SCSp.

Ireland

Ireland has also made a significant legal reform with the introduction of its loan originator qualifying investor alternative investment fund (QIAIF) and Irish collective asset-management vehicle (ICAV). These funds will be regulated under AIFMD, meaning that they can be authorised for distribution across the EU. Funds in Ireland can already buy and sell private loans, and with these new funds they will be able to originate loans as well. There is particular interest in the ICAV and how that could work in tandem with the loan originator QIAIFs.

Not only have there been changes related to direct lending in Luxembourg and Ireland, Italy has recently reformed its securitisation law to allow primary lending according to certain criteria.

Trends

There has been a trend for asset managers to set up secondary loan funds with an eye to progressing to direct lending funds. The recent reforms in both Luxembourg and Ireland will provide some momentum by removing some of the uncertainty that was attached to direct lending funds in respect of shadow banking in those jurisdictions. A number of funds launched in 2014 included loans as an asset class or at least have loans as an investment component to them. We expect there will be keen interest in loan originating funds as we enter 2015. We also eagerly await the issuance of a new Article 17 of the German Insurance Ordinance, which will allow insurers to acquire interests in pure loan originating funds.

Summary

With the low interest rate environment, it is hard for investors in fixed income to meet yield requirements, so allowing funds to lend to companies directly goes a little way to solving the problem while mitigating the funding gap – which shows no signs of disappearing any time soon. While the direct lending fund market is still a nascent market in Europe, the combination of legal reforms addressing the uncertainty around shadow banking, SME initiatives and innovative solutions, such as bank/fund tie-ups, will provide the momentum it needs to grow and become a more permanent feature of the European debt capital markets.

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UNITRANCHE PARTNERSHIPS:

A real alternative for borrowers

by Tim Rennie

Unitranche deals have been a feature of the leveraged finance market for the past few years. Ashurst has been at the forefront of these new financing arrangements, acting for credit funds and banks on unitranche transactions.

In this article we look at the unitranche product and outline some of the structures available to credit funds and banks to lend together, providing a cheaper unitranche financing option for sponsors.

The key features of a unitranche financing are: (i) single term loan; (ii) typically used for an acquisition/refinancing; (iii) higher margin than a bank club deal; (iv) often a longer tenor than a bank club deal; (v) leverage multiple/headroom higher than a bank club might offer; and (vi) greater flexibility on the financial covenant package (e.g. only leverage and interest cover).

Unitranche facilities were originally structured as a product provided by credit funds, but banks are now regularly participating as well. The unitranche facility will typically be provided alongside a revolving credit facility which, in most cases, is provided by a retail bank which can – and will want to – provide any requisite ancillary facilities and hedging as part of the debt package. Credit funds generally are not set up to provide these banking products.

The revolving credit facility (along with all or part of the hedging) will rank super senior to the unitranche facility.

A bank providing the super senior revolving credit facility (the SSRCF) will need to go through its internal credit approval process for a small part of the financing structure and, as the facility is super senior, their fee and margin will be significantly tighter than the unitranche facility. Accordingly, while the facility is a low risk from the bank's

perspective (and the bank should pick up the ancillary business), the return for a bank providing just the SSRCF to a customer will not be as high as it would be if the bank also provided the term debt. However, due to the key features set out above, on most deals the banks are not prepared to provide this form of financing alone.

For this reason banks have been considering partnering up with credit funds to provide unitranche facilities, but in a way that achieves a lower credit risk exposure.

While the banks' appetite to lend has improved over the last couple of years, and pricing has become more competitive, the unitranche structure remains a competitive alternative if it can be priced at the right level. Put crudely, credit funds have not been able to compete on certain deals because the returns they need to generate for their investors is higher than the sponsor/borrower is prepared to pay. These circumstances have resulted in certain credit funds being attracted to work with banks to provide a unitranche on a "blended margin" basis, but where the credit fund takes the first loss if the facility is not repaid in full. Partnering with a bank can also result in the bank introducing opportunities to the credit fund of which they may not otherwise have been aware.

There have been a couple of high-profile partnerships (for example, the GE-Ares fund and the Barclays-BlueBay arrangement) but these are by no means the only arrangements in place. The rest of this article considers how such arrangements could be put in place and seeks to identify certain key advantages and disadvantages of these arrangements. We look at the following:

- establishing a new fund which provides the unitranche directly;
- entering into an agreement among lenders to regulate certain matters between the bank and the credit fund; and
- lending directly with no separate arrangement.

Establishing a fund

The bank and the credit fund establish a fund (for example, a Luxembourg specialised investment fund or a securitisation vehicle). There are advantages and disadvantages from, among others, a regulatory, management and investor base perspective, for the various fund structures. The fund documentation may provide for the credit fund to take the first loss either across the portfolio of investments or on a deal-by-deal basis.

ADVANTAGES

- Separate corporate governance
- Funds available for deployment
- Only one unitranche lender – fewer intercreditor issues

DISADVANTAGES

- Time and cost of establishing and maintaining the fund (including compliance with any local regulatory requirements)
- Costs of employing fund-specific personnel
- Capital committed to be invested in the fund can incur capital allocation costs and cannot be used for other investments
- The borrower/sponsor may not have visibility as to whether decisions will be determined jointly or by one of the investors
- Accessing additional funds in a distressed scenario could be difficult if the lender is a closed-ended fund
- The arrangement is exclusive – any new bank or credit fund pairing would require another fund to be established

Agreement among lenders

A framework agreement is entered into between the bank and the credit fund which regulates how the unitranche facility will operate. This can be put in place either for all investments or entered into on a deal-by-deal basis. As a minimum, the agreement will provide for the credit fund taking first loss on enforcement, and in return for this will receive better economics from the deal, prior to any default with the bank paying over to the credit fund a portion of the margin received under the facility agreement. This could be structured either as a contractual entitlement or a transfer by way of assignment, each of which gives rise to significant jurisdictional, tax and insolvency issues that will need to be carefully considered by the bank and the credit fund and allocated or mitigated to the extent possible and, depending on the structure and the tax analysis, require limited disclosure to the borrower.

ADVANTAGES

- Pre-agreed documentation can provide a competitive advantage in a time-constrained bid timetable
- No capital commitment, funds are only deployed at the time a transaction is closed
- No maintenance costs, as the bank and credit fund are both lenders of record
- While a documented arrangement reflects the commercial agreement and addresses the legal issues of the original bank and credit fund, it could easily be rolled out for another bank or credit fund if they substantially accepted the same commercial terms and the key underlying analysis did not change

DISADVANTAGES

- Time and costs incurred in agreeing the contractual framework prior to the first transaction
- Any increase in the unitranche commitments will require a pro rata contribution by the bank and credit fund in proportion to their original commitments to avoid varying the margin
- Any disagreement between the bank and credit fund could result in stalemate
- Any pre-enforcement prepayment must be shared pro rata between the unitranche lenders to preserve the blended margin
- Any transfer or debt purchase transaction by a sponsor is unlikely to be acceptable, as this would necessitate that party acceding to the private agreement among lenders
- Sponsors have limited visibility of the terms of the agreement among lenders and may therefore be concerned that they do not know who would be calling the shots

No separate arrangement

Banks and credit funds may decide that they do not feel they need to set up a separate legal entity or enter into an agreement between themselves, rather they are comfortable setting out their respective rights in the facilities agreement and intercreditor agreement to which the borrower is party.

This type of arrangement requires there to be one term loan facility or tranche provided by the lender and a separate term loan facility or tranche provided by the credit fund. While this arrangement moves away from there being "one tranche", the other features of a unitranche financing (summarised above) would be maintained.

ADVANTAGES

- Greater flexibility to the sponsor to get the most advantageous deal vis-à-vis the bank's facility and the credit fund's facility
- Neither the bank nor the credit fund needs the other's consent to sell down their respective facility
- Each creditor's voting entitlement is clear as the borrower is party to all documents

DISADVANTAGES

- If there are no pre-agreed terms between the bank and credit fund, this could adversely affect the deal timetable, particularly agreeing the voting arrangements and enforcement protocol

Conclusion

The unitranche debt product is an exciting and evolving feature of the market, giving borrowers a real alternative to the traditional bank-led debt product. The structures highlighted above take advantage of the banks' and credit funds' risk appetite, they enable the banks to participate in a product for which they were initially only invited to provide the SSRCF, and they permit the credit funds to lend on transactions which are priced more competitively than those on which they could lend alone.

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IRELAND:

Loan Originator QIAIFs and ICAVs – two new key players

by Melissa Ashdown and Carrie Clay

Loan Originator QIAIFs and ICAVs are set to overhaul the way loan origination operates in Ireland.

Loan originating funds

Loan originating funds are fund structures which source loan assets by directly originating loans for their underlying portfolios. Due to an increase in demand for non-bank lending, loan origination is an area that has significant growth opportunities.

The establishment of loan originator qualifying investor alternative investment funds (Loan Originator QIAIFs) and Irish collective asset-management vehicles (ICAVs) will, for the first time in the European Union, offer dedicated fund structures specifically for loan origination.

The Central Bank of Ireland (CBI) is now accepting applications for Loan Originator QIAIFs, and it is expected that ICAVs will be offered from early 2015.

Loan Originator QIAIFs

The CBI has proposed regulation which will allow Irish alternative investment funds to be loan originating entities. This regime will operate under and be compliant with the Alternative Investment Fund Managers Directive (AIFMD).

The CBI has recently published a revised version of its AIF Rulebook (the Rulebook) which contains the framework for Loan Originator QIAIFs. Authorised alternative investment fund managers (AIFMs) will be able to manage Loan Originator QIAIFs and market them in the European Union via the AIFMD passport, provided they meet the additional requirements set out in the Rulebook.

Key features and requirements

Loan Originator QIAIFs will be available to qualifying investors (which includes banks, pension funds and individuals) who subscribe for an initial investment of not less than €100,000. Although prior authorisation from the CBI is required for the establishment of Loan Originator QIAIFs, this can be obtained within a 24-hour period, assuming prior approval of the AIFM by the CBI has been obtained, offering investors a fast and streamlined process compared to approval regimes in other jurisdictions.

The CBI has imposed several risk management and investor safeguards on Loan Originator QIAIFs which covers

aspects such as leverage, disclosure, diversification, liquidity, and the granting of credit, for example:

- Loan Originator QIAIFs' activities must be limited to "*the business of issuing loans, participating in loans, participations in lending and to operations directly arising therefrom, including handling assets which are realised security, to the exclusion of all other commercial business*".
- Loan Originator QIAIFs are required to establish and implement procedures, policies and processes in a range of areas including risk management, diversification and the granting of credit.
- Loan Originator QIAIFs must limit their exposure to any one issuer or group to 25 per cent of its assets within a specified time-frame.
- Broadly speaking, Loan Originator QIAIFs must be closed-ended and have a fixed term.
- Loan Originator QIAIFs are not permitted to have gross assets in excess of 200 per cent of their net asset value.
- Loan Originator QIAIFs are prohibited from lending to certain categories of borrowers such as natural persons, the AIFM or other investment funds.

ICAVs

The enactment of the ICAV legislation further broadens Ireland's portfolio of investment fund structures. The ICAV will co-exist alongside existing structures, such as private limited companies and limited partnerships. The ICAV Bill was published on 29 July 2014 and the structure is expected to be finalised by early 2015. Once the framework is established, it will be possible to structure a Loan Originator QIAIF as an ICAV, providing a loan origination corporate vehicle.

Key features and requirements

The creation of the ICAV has been driven by investor and industry demands, and will provide an administrative-light vehicle offering potential tax benefits to US investors. The ICAV structure has a number of advantages compared to other structures on offer, including:

- there are no diversification requirements;
- compliance with many of the Irish company law general requirements will not be necessary so the structure will have a relatively low administrative burden; and
- the vehicle can be open- or closed-ended.

The ICAV structure arguably provides the greatest benefits to US investors by allowing them to make an election under the US "check the box" rules. This election will permit such investors to avoid certain tax consequences which would otherwise apply. ICAVs also profit from a favourable Irish tax regime.

Conclusion

The introduction of these two new structures is an important development in the loan origination space and it is expected that there will be significant interest in these two new products.

The CBI has been accepting applications for Loan Originator QIAIFs since 1 October 2014 and it is expected that the framework for ICAVs will be finalised in early 2015.

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LUXEMBOURG:

The new special limited partnership regime

by Nick Goddard and Isabelle Lentz

Inspired by the flexibility and tax transparency of the Anglo-Saxon form of limited partnership, Luxembourg now has two limited partnership models: the modernised *Société en commandite simple* (SCS) and the new *Société en commandite special* (SCSp).

The introduction of the new SCSp was brought about, in 2013, by changes in the Luxembourg limited partnership regime, prompted by the implementation in Luxembourg of the Alternative Investment Fund Managers Directive. The main feature of the new SCSp is that, unlike the SCS, it is not vested with legal personality.

Uptake for these vehicles was initially slow with sponsors not wishing to use untested vehicles. However, since the AIFMD has come into full force, we have seen increased sponsor interest, particularly driven by those cases where sponsors are attracted to the EU "marketing passport" available to EU-managed EU AIFs. Where that is a key driver of structure, there are a number of options. But if a tax transparent, flexible partnership-style vehicle is required, the two most obvious options are now these Luxembourg partnerships or the traditional English limited partnership.

Since they are so heavily based on the Anglo-Saxon form of limited partnership, they offer a great deal of flexibility around key issues such as economics and control. Moreover, much of the know-how and technology used in English or Jersey limited partnership agreements can be adopted as a starting point for drafting.

Key corporate features

SCS	SCSp
Intuitu personae companies which have no concept of capital, contributions of the partners consist of partnership interests. As a result, there is no minimum capital requirement. There are no legal restrictions on distributions	
Established by a private partnership agreement (notarial deed required when regulated). Must be registered with the Luxembourg Register of Commerce and Companies	
Has separate legal personality	Does not have separate legal personality, however, three exceptions mitigate the downside: (i) has a domicile at the place of its central administration; (ii) registrations and other formalities regarding assets pooled within the SCSp or on which the SCSp has any right shall be made in the name of the SCSp; and (iii) assets pooled within the SCSps shall exclusively satisfy the rights of creditors whose rights have arisen in connection with the SCSp lifespan
Must prepare annual accounts. No legal accounting reserve required	No obligation to prepare annual accounts

Key tax features

SCS	SCSp
Tax transparent. They will generally not be subject to Luxembourg corporate income tax, municipal business tax or net wealth tax as long as, as would usually be the case: (i) the GP holds less than five per cent of the partnership; and (ii) the partnership constitutes an AIF	
Distributions will be free of Luxembourg withholding tax, whether the partners are located in Luxembourg or elsewhere	
UK resident carry-holders can benefit from the beneficial taxation regime under the BVCA 1987 memorandum	
No VAT on most management fees. However, there is likely to be an irrecoverable VAT cost on certain fees, such as legal fees	

Finally, it is worth remembering that Luxembourg also continues to allow the establishment of a *Société en Commandité par Actions* (SCA) as a fund vehicle. This is a tax opaque vehicle, sometimes called a "partnership limited by shares" in English. It is a very different beast from the SCS and SCSp but is still very commonly seen depending on investor requirements.

Conclusion

The new SCSp provides the contractual flexibility needed in order to meet the needs of sponsors and investors in much the same way as English and Jersey limited partnerships do. Given the AIFMD position, some sponsors that would historically have almost chosen Jersey by default as the jurisdiction of their fund vehicle will be looking very hard at Luxembourg and/or the UK now.

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ITALY: A first Italian project bond – a new era for non-bank lending

by Carloandrea Meacci and Gianluca Fanti

In a landmark transaction, on 3 December 2014, lead arranger Natixis closed a €165m bank and bond refinancing of the portfolio of solar plants in Italy of Antin Solar Investments.

The project bond

The project bond is senior secured unwrapped and unrated, has a maturity of 14 years (amortising), and is listed on the Extra-MOT PRO of the Italian Stock Exchange, according to which it includes a fixed rate tranche of 3.5 per cent and a floating rate tranche at Euribor + 3.35 per cent.

As a result of its closing, it's widely thought that a significant number of similar projects in Italy will now be financed through capital markets, in lieu of or in conjunction with bank debt.

This deal benefitted from recent changes to the Italian legal and tax framework relevant to the debt capital markets, which made a deal like this possible for the first time in Italy.

Alternative debt capital market providers are also expected to benefit from recent changes to the Italian Securitisation Law.

Changes to Italy's legal and tax frameworks

Historically, Italian companies which were not listed were prevented from issuing bonds for a number of legal and tax constraints. However, in 2012,[1] unlisted Italian companies incorporated as joint stock companies (S.p.A.) were granted the possibility to issue bonds without the limits set out under Article 2412 of the Italian Civil Code, whereby the maximum amount of bonds cannot exceed twice the aggregate of the issuer's share capital and reserves, subject to the listing of the bonds on a regulated market or a multilateral trading facility (MTF) or the issuance of "convertible bonds", granting to the bondholders the right to subscribe for shares of the issuer.

To further enhance the issuance of bonds, in 2014, a number of additional legal and tax benefits were introduced,[2] such as:

(i) investment funds may subscribe for such bonds;

(ii) insurance companies may apply their technical reserves to subscribe for such bonds;

(iii) interest on such bonds is fully deductible (subject to, *inter alia*, the usual limit based on 30 per cent EBITDA) and exempt from the 26 per cent withholding tax,[3]

1 See the "First Development Decree" (Law 134/2012) and "Second Development Decree" (Law 221/2012).

2 See the "Destination Italia Decree" (Law 9/2014), "Sblocca Italia Decree" (Law 164/2014) and "Competitiveness Decree" (Law 116/2014).

3 This has been recently extended to: (i) schemes established in Italy or other EU member states if more than 50 per cent of their assets are invested in such instruments and their shares are held exclusively by Qualified Investors; and (ii) securitisation vehicles issuing securities to be held by Qualified Investors if more than 50 per cent of their assets are invested in such bonds, similar instruments or notes.

subject to the fulfilment of certain requirements, being mainly the listing of the bonds on a regulated market or a MTF in the EU, Norway or Iceland, or that the bonds are held by one or more "Qualified Investors";[4]

(iv) the Italian substitute tax regime equal to 0.25 per cent of the nominal amount of the principal (previously applicable only to certain bank loans) has been extended to bonds. This represents a material tax saving when complex security packages are involved which, in the aggregate, may otherwise be subject to an approx. 3-4 per cent registration tax;

(v) the special privilege over moveable assets (previously applicable only to certain bank loans) has been extended to bonds to the extent that they are placed and traded exclusively among Qualified Investors; and

(vi) a concept partially analogous to a UK security trustee has been introduced, thus superseding the cost and time of further registration formalities otherwise applicable any time that the bonds are transferred.

Direct lending by securitisation vehicles

As part of the efforts to enhance the role of alternative debt capital providers in the Italian market, the Italian Government has recently introduced certain amendments to Law No. 130 of 30 April 1999 (the Italian Securitisation Law), aimed at allowing Italian securitisation vehicles (SPVs) to carry out direct lending activity in Italy.

Italian SPVs are now allowed to directly lend to entities, excluding individuals and micro-enterprises, on condition that: (i) the borrowers are selected by a bank or a financial intermediary registered under Article 106 of the Italian Banking Act; (ii) the notes issued by the Italian SPVs are held by "Qualified Investors" as defined under Article 100 of the Italian Financial Consolidated Act; and (iii) the relevant bank or financial intermediary responsible for the selection of the borrowers retains a significant economic interest in the transaction in accordance with the criteria set forth in the implementing regulation by the Bank of Italy.

All the provisions of the Securitisation Law (save for Article 4, which expressly governs the assignment of receivables in the context of a securitisation) apply to securitisations of loans originated by the same issuer. Among others, from the date of advance (either in full or in part) of the loans by the SPV, the receivables, arising out of such loans and the collections (repayment of principal and interest) thereof, are segregated from the SPV's own assets and the assets pertaining to any other securitisation transactions carried out by the SPV for the benefit of the noteholders.

Impact

While there is a common strategy behind all the various recent reforms implemented in Italy, aimed at developing alternative sources of funding for Italian enterprises, the actual impact on the market of each of them varies and will vary in the future.

Indeed, the likelihood of this new structure developing in the market, which is based on SPVs engaging in direct lending, will largely depend on the Bank of Italy's implementing regulation, which is still awaited.

4 In particular, in order to be eligible for the withholding tax exemption, the investor (in the case of listed bonds) shall be: (i) the effective beneficiary of the relevant interest; (ii) an institutional investor with specific experience in financial investments; and (iii) incorporated in a so-called "white-list country" for tax purposes (excluding, for example, the Cayman Islands). If the bonds are not listed, in addition to the conditions mentioned above, the bonds shall be held by and circulated exclusively between Qualified Investors.

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FRANCE: A new exemption for securitisation vehicles

by Hubert Blanc-Jouvan

A new Decree, supplementing French AIFMD provisions, provides important exemptions, easing concerns facing French securitisation vehicles.

French credit funds

In France, credit funds can be structured as an Alternative Investment Fund (AIF), such as a *fonds professionel spécialisé*, subject to French AIFMD Law[1], or as a securitisation vehicle, in which case its treatment under French AIFMD Law has raised concerns.

Marketing concerns

There has been concern that the marketing of securitisation vehicles to French investors, in France, may breach the authorisation and conduct of business requirements provided by AIFMD. If so, managers and arrangers would need to strictly rely on reverse solicitation when selling notes issued by securitisation vehicles in France.

These concerns stem from French AIFMD Law, which provides that French securitisation vehicles are AIFs and are governed by certain provisions set out in the French Monetary and Financial Code, and which dictates that such securitisation vehicles are subject to French AIFMD Law if they appear to have been structured in such a way so as to circumvent the application of AIFMD. This approach is consistent with the position taken by the European Commission in its Q&A on AIFMD: "*it should be emphasized that the reference to a securitization special purpose entity [in Article 4(1)(an) of AIFMD] should be interpreted narrowly and should not be used in order to circumvent the application of the AIFMD. Given the potentially high risk of misuse of this exemption for circumventing the AIFMD, the Commission supports the idea of the development of guidelines by ESMA against circumvention of the AIFMD*".

1 "French AIFMD Law" refers to the law implementing the Alternative Investment Fund Managers Directive in France, published in 2013.

Strictly speaking, this qualification of securitisation vehicles as AIFs under French law only applies to French securitisation vehicles. However, non-French securitisation vehicles can also be treated as AIFs and be subject to French AIFMD Law.

What is it?

A new Decree clarifying the scope of exclusions from French AIFMD-implementing rules.

What is the effect for me?

The rule provides guidance on whether a credit fund should be subject to French AIFMD-implementing rules or benefit from an exclusion which could facilitate its marketing in France otherwise than through reverse solicitation.

The Decree

On 16 November 2014, a decree was published, clarifying the cases and criteria which securitisation vehicles are subject to under French AIFMD Law (the Decree).

According to the Decree, securitisation vehicles should be subject to French AIFMD Law if their purpose is to be exposed, for more than 50 per cent of their assets, to risks resulting from securities or any other assets which do not constitute an exposure to a credit or insurance risk, when such securities and assets are managed on a discretionary basis by the manager of the securitisation vehicle or take the form of derivative transactions which are entered into, managed, or terminated by the manager of the securitisation vehicle on a discretionary basis.

For the purpose of calculating whether the threshold of 50 per cent is exceeded, exposures held by the securitisation vehicle, directly or indirectly through a third party, must be taken into account, excluding however:

- the purchase and temporary and ancillary holding of deposits made with credit institutions established in any EEA or OECD member state that can be reimbursed or withdrawn at any time on the request of the securitisation vehicle and government bonds;
- the temporary holding of debt securities, notably as a result of repurchase transactions, securities lending transactions, or any other equivalent transactions; and
- derivative transactions entered into for the purposes of: (i) hedging the risks to which the securitisation vehicle is exposed; or (ii) being exposed to an insurance or a credit risk.

The Decree further provides that decisions taken by the manager of the securitisation vehicle to acquire and sell securities or to enter into, manage or terminate derivative transactions, or to amend all or part of the risks to which the securitisation vehicle is exposed by entering into such derivative transactions, will not constitute a discretionary management for the purposes of the Decree when the decisions are taken:

- within the framework of conditions which are

exhaustively set out in the constitutional documents/by-laws of the securitisation vehicle, and in order to comply with the criteria for the selection of the underlying assets as defined in such documents; or
- following a "change of circumstances", when the decision taken by the manager of the securitisation vehicle has not for the sole purpose to generate an income or the payment of a single balance in favour of the securitisation vehicle.

Finally, the Decree provides that the following securitisation vehicles are excluded from the scope of the structures which could be subject to the French AIFMD Law:
- *fonds de prêts à l'économie* (a newly established French structure designed to invest in loans and in which French insurance companies can invest their regulated assets) structured as securitisation vehicles;
- structures which represent one or more securitisation transactions as defined in the Capital Requirements Regulation; or
- structures issuing debt securities in accordance with an asset-backed commercial paper programme, i.e. a programme of securitisation, the securities issued by which predominantly take the form of a commercial paper with an original maturity of one year or less.

What does this mean?

It now appears that if a structure falls within the scope of the exclusions set out above, it will not be necessary to limit the value of the portfolio which constitutes securities or to limit the discretionary management power of the manager.

The Decree applies to all securitisation vehicles which are constituted after 17 November 2014, and to existing securitisation vehicles as from the date when their constitutional documents are amended to implement a significant change in their investment strategy.

However, it should be noted that French rules relating to the marketing of securities in France (such as the rules relating to the Prospectus Directive in France and the rules governing marketing activities themselves) will continue to apply. Accordingly, legal advice should be obtained on a case-by-case basis to determine the conditions under which securitisation vehicles can be marketed in France.

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ASSET-BACKED SECURITIES:

Final risk retention rules adopted by US regulators

by Michael Miran

Final risk retention rules provide significant implications for CLOs and their investment advisors.

On 21–22 October 2014, six US regulatory agencies (the Agencies) jointly adopted a final rule (the Final Rule) relating to the credit risk retention requirements in respect of asset-backed securities (ABS), including collateralised loan obligation (CLO) transactions, imposed by Section 941 of the Dodd–Frank Act (the D–F Act). The Final Rule generally adopts the provisions of the rule proposed by the Agencies in September 2013 (the Proposed Rule), with certain modifications.

This article provides a brief summary of the consequences that the Final Rule will have on CLOs and the investment advisors who manage them (each, a CLO Manager). The Final Rule will become effective for CLOs two years after the date of publication in the Federal Register, and will apply to issuances of ABS made after the applicable effective date (which could include additional issuances and refinancings made in connection with CLOs). References in this article to an "ABS interest" include an issuance of CLO securities.

General risk retention requirement

The Final Rule imposes a minimum five per cent base risk retention requirement to essentially all CLO transactions, whether SEC-registered or otherwise (with certain exemptions not likely to be applicable to CLOs), and prohibits the "sponsor" of the CLO from hedging or otherwise transferring[1] its retained interest prior to the applicable sunset date. The Final Rule allows a sponsor to satisfy its risk retention obligation by retaining an eligible vertical interest, an eligible horizontal residual interest, or any combination thereof as long as the amount of the eligible vertical interest and the eligible horizontal residual interest combined is no less than five per cent. The amount of eligible vertical interest is equal to the percentage (not fair value, as provided by the Proposed Rule) of each class of ABS interests issued in the securitisation transaction held by the sponsor as eligible vertical risk

1 Subject to the right of a sponsor to transfer retention to a "majority-owned affiliate" as described under "Other provisions".

retention, and the amount of eligible horizontal residual interest is equal to the fair value of the eligible horizontal residual interest divided by the fair value of all ABS interests issued in the securitisation transaction. Specified disclosure must be made in respect of how such fair value calculation is determined, including with respect to the assumptions utilised.

Retention period

For all ABS interests other than RMBS (which have their own sunset provision), the transfer and hedging restrictions in the Final Rule will expire on or after the latest of: (i) the date on which the total unpaid principal balance of the securitised assets that collateralise the securitisation is reduced to 33 per cent of their original unpaid principal balance; (ii) the date on which the total unpaid principal obligations of the ABS interests issued in the securitisation is reduced to 33 per cent of their original unpaid principal obligations; or (iii) two years after the date of the closing of the securitisation.

CLO Manager – the securitiser

In the Final Rule, the Agencies reiterated their position that the text of the D–F Act should be interpreted that a CLO Manager is the "securitiser" of a CLO because the CLO Manager "organises and initiates a securitisation transaction by indirectly transferring assets to the issuing entity". In the context of CLOs, the Agencies stated that a CLO Manager is the "securitiser" because the CLO Manager has sole authority to select the commercial loans to be purchased by the CLO issuing entity for inclusion in the CLO collateral pool, directs the issuing entity to purchase such assets in accordance with investment guidelines, and manages the securitised assets once deposited in the CLO structure.

Safe harbour for certain non-US transactions

The Final Rule contains a limited safe harbour for certain non-US securitisations provided that:

- the securitisation is not required to be registered under the Securities Act of 1933;
- no more than ten per cent of the dollar value of all classes of ABS interests in the securitisation are sold or transferred to US persons (as defined in the Final Rule) or for the account or benefit of US persons;
- neither the sponsor of the securitisation nor the issuing entity is:
  (i) organised under the laws of the US or any state or territory thereof (a US jurisdiction);
  (ii) a branch or office (wherever located) of an entity organised under the laws of any US jurisdiction; or
  (iii) a branch or office located in the US of an entity that is organised under the laws of a non-US jurisdiction, and
- if the sponsor or issuing entity is organised under the laws of a non-US jurisdiction, no more than 25 per cent (as determined by unpaid principal balance) of the assets that collateralise the ABS interests were acquired, directly or indirectly from a US entity.

Lead arranger option

Under the Final Rule, the lead arranger retention option outlined in the Proposed Rule survives (referred to as an "open market CLO" in the Final Rule) as the only CLO specific exemption to risk retention by a CLO Manager. Consistent with market reaction to this option in the Proposed Rule, it is expected that this option will be of limited utility at best.

Other provisions

The Final Rule adopts the approach taken in the Proposed Rule whereby a sponsor may have all or a portion of the required retention held by one or more majority-owned affiliates.[2] The Agencies have included this approach in the Final Rule because it ensures that any loss suffered by the holder of the risk retention will either be the sponsor or an entity in which the sponsor has a substantial economic interest. However, it may provide certain CLO Managers with some flexibility in the manner in which they hold and finance risk retention.

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2 "Majority-owned affiliate" is defined in the Final Rule as an entity (other than the issuing entity) that, directly or indirectly, majority controls, is majority controlled by or is under common majority control with, such person. For purposes of this definition, majority control means ownership of more than 50 per cent of the equity of an entity, or ownership of any other controlling financial interest in the entity, as determined under GAAP.

WATCH THIS SPACE:

German Insurance Ordinance: a new loan originator Article 17

We eagerly await the issuance of the newly created alternative asset class article for dedicated loan originator funds. It is expected to be launched this year and will allow originator funds to be acquired by German insurers.

Forthcoming events

Credit*flux* Direct Lending Workshop
5 February 2015, Ashurst's offices, Broadwalk House, 5 Appold Street, London EC2A 2HA

Ashurst's Annual CLO and Credit Fund Managers' 'Casino Royale' Evening at Claridge's
18 March 2015, Claridge's, 49 Brook Street, Mayfair, London W1K 4HR

Credit*flux* Credit Symposium and Manager Awards
6 May 2015, The Landmark Hotel, 222 Marylebone Road, London NW1 6JQ