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Credit Funds INSIGHT

Spotlight on Insurance:

THE ARRIVAL OF THE NEW GERMAN INSURANCE ORDINANCE

ALSO IN THIS ISSUE:

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An overview of this issue

In our previous issue, we mentioned that the revised German Insurance Ordinance was expected to be launched this year. The highly anticipated revised German Insurance Ordinance was finally passed on 25 February 2015, prompting us to put the spotlight on insurance for this edition of Credit Funds *INSIGHT*. We take an in-depth look at the changes to the German Insurance Ordinance, the impact of BEPS and Solvency II on credit funds, as well as rounding up on other key areas that are developing in the credit fund space.

We hope that you find Credit Funds *INSIGHT* useful and enjoy reading this issue. Our magazine is evolving and we appreciate your invaluable comments. If you have any feedback or if there are any topics that you would like us to cover in future editions, please email **creditfunds@ashurst.com**.

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GERMANY: The arrival of the new Insurance Ordinance

by Tobias Krug and Alexandra Heitmann

The highly anticipated regulation to amend the German Insurance Ordinance expands investment opportunities for direct lending funds in Germany.

Following on from the implementation of AIFMD in Europe, in July 2013 Germany replaced its Investment Law (*Investmentgesetz*, InvG) and took the opportunity to create a uniform act, regulating all matters regarding collective assets, in the German Capital Investment Code (*Kapitalanlagegesetzbuch*, KAGB). Since then, the corresponding reform of the German ordinance regarding the investment of the restricted assets of insurance companies and pension schemes (*Anlageverordnung*, Insurance Ordinance) has been long overdue. After a long consultation period, the German Government finally passed the new Insurance Ordinance on 25 February 2015.

In this article, we focus on the opportunities for German insurance companies and pension schemes, as a result of the changes to the Insurance Ordinance, to invest in direct lending credit funds (i.e. funds directly investing in debt instruments such as loans and bonds).

Scope of application of the new Insurance Ordinance

The Insurance Ordinance currently applies to all insurance companies and pension schemes. However, its scope of application will be considerably narrowed following the implementation of the Solvency II regulation (2009/138/EU) (Solvency II) on 1 January 2016 into German law. After the implementation of Solvency II, only smaller insurance companies with a premium income of less than €5m and pension schemes and pension funds will be covered by the

Insurance Ordinance. This has sparked a debate as to how long the Insurance Ordinance will continue to exist.

Private equity funds and active debt funds

An important change was made to the old clause 13 which will help investments in closed-ended private equity funds and closed-ended active debt funds (Section 2 paragraph 1 clause 13 lit. b) Insurance Ordinance) ("**Clause 13°b**"). An investment in funds falling within the participation quota of Section 2 paragraph 1 clause 13 of the old Insurance Ordinance required the fund to have a "business model" (*Geschäftsmodell*) and to "bear entrepreneurial risks" (*unternehmerische Risiken*). In the past, these requirements have been difficult for debt funds to comply with, as even active debt funds found it hard to argue that they had a "business model".

According to Clause 13°b, companies may now additionally invest in closed-ended alternative investment funds (AIFs) which invest in not only equity but also equity-like instruments including debt investments, such as loans and bonds, without needing a "business model".

Even though the "business model" requirement does not apply to Clause 13°b, the mere passive holding of loans is still not permissible. Lending activity may not be limited to the administration of loans and credit management, so funds with a buy-and-hold strategy will not qualify. Only if the granting of loans is based on individual due diligence, and the investment is supervised on an ongoing basis, could a participation in such a fund be classified as an investment in accordance with Clause 13°b.

Under Clause 13°b, the fund must have its registered seat in any EEA or OECD full member state or be managed by a management company (*Kapitalverwaltungsgesellschaft*) having either obtained a licence from the German supervisory authority *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin) or an AIF management company being registered with BaFin and is subject to public supervision in order to protect the public.

This latter requirement is taken to mean that having a fully regulated investment manager in the form of an AIFM will suffice for Clause 13°b purposes, rather than needing the fund itself to be regulated. Taking into account that direct lending credit funds can now be put in the private equity category, this is a welcome change to the previous interpretation, which was usually read to mean that the fund itself had to go through the time and cost of becoming regulated by a supervisory body (such as the CSSF, for example, in Luxembourg).

Umbrella funds

Interestingly, in respect of an investment in a private equity fund via umbrella funds (*Dachfonds*), under the new Insurance Ordinance, only the umbrella fund needs to fulfil the requirements set out in the Insurance Ordinance, not the target funds.

BaFin has already announced that it will address this point and any consequential risk of possible circumvention in a new circular (*Rundschreiben*). Even though such circular will not be legally binding, it will be considered mandatory interpretation for all affected market participants.

What you need to know

- **According to Clause 13°b, companies may now additionally invest in closed-ended alternative investment funds which invest in not only equity but also equity-like instruments including debt investments without needing a "business model".**
- **According to Clause 17, alternative special investment funds which do not follow a private equity, active debt, real estate or UCITS strategy (i.e. securities funds), may now be acquired within the new quota for alternative strategies.**
- **Only the umbrella fund needs to fulfil the requirements set out in the Insurance Ordinance, not the target funds.**

Special investment funds

Additionally, a new clause, clause 17 (Section 2 paragraph 1 clause 17 Insurance Ordinance) ("**Clause 17**"), was introduced which allows alternative special investment funds which do not follow a private equity, active debt, real estate or UCITS strategy (i.e. securities funds), to be acquired within the new quota for alternative strategies. Under Clause 17, there is no requirement that a debt fund has to follow an active strategy. German insurance companies and pension funds can thus invest in direct lending credit funds which do not fulfil the criteria of an "active" fund which would be a requirement for Clause 13°b, as mentioned above.

The key requirement is that such fund is a German or EU AIF, its manager having its registered seat in the EEA and has an AIF licence either in Germany or in its home state and is subject to public supervision in order to protect investors.

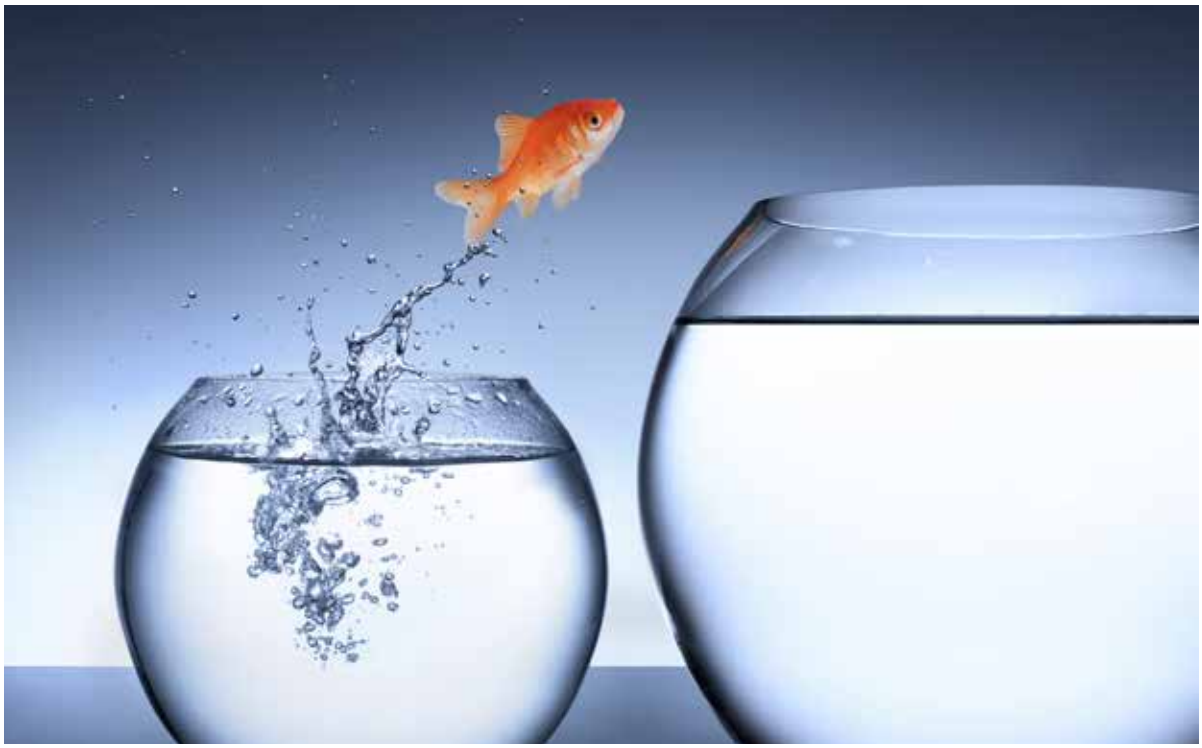
Quantitative restrictions

Investments under Clause 17 may not exceed 7.5 per cent of the insurance company's restricted assets.

Investments under Clause 13°b may not exceed 15 per cent and, together with other investments allowed under the Insurance Ordinance, such as investments pursuant to Clause 17, may not exceed 35 per cent of the insurance company's restricted assets.

Foreign domiciled funds

Foreign domiciled private equity funds or active debt funds may also be investment targets under the new Insurance Ordinance.



If the management company of the relevant fund has its seat of registration in a member state of the EEA or in a full member state of the OECD that does not belong to the EEA, it may qualify as an investment target under the following conditions:

(i) it is subject to public oversight for the purpose of investor protection; and

(ii) it has a licence or registration of the respective state whose requirements are comparable to the requirements under the German Capital Investment Code for licensing and registration.

Due to the consistent application of the AIFM regulation, management companies from the EEA are generally considered to fulfil comparable requirements. The situation is different with management companies from full member states of the OECD that do not belong to the EEA. In the latter case, the relevant insurance company or pension scheme will have the responsibility to investigate whether there is a proper status of comparability. As a consequence, the comparability as the decisive core criteria will need further interpretation and clarification by BaFin (as supervisory authority) to provide legal certainty.

Transferability

The existing requirement for shares in investment funds to be freely transferable will continue to apply for all fund categories credit funds may be put into, i.e. loan/credit and equity funds set out in Clause 13°a and b as well as special investment funds regulated by Clause 17.

Banking licence

Although the new Insurance Ordinance makes it easier for German insurance companies and pension schemes to invest into debt funds, the granting of loans (lending business) generally still requires a banking licence under German law (with a few exceptions, such as lending via a fronting bank or lending in bond format).

Conclusion

The recent changes to the Insurance Ordinance are a welcome change, with potential to encourage further investment in direct lending funds by German insurance companies and pension schemes (in both active and passive debt funds). We expect that the regulatory requirements for non-EEA funds and the question of whether, in relation to equity funds having a fully regulated investment manager in the form of an AIFM, additional obligations are required for the target funds of umbrella funds and will be clarified by BaFin in a circular.

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SOLVENCY II AND CREDIT FUNDS:

What you need to know

by Anne Tanney

In the run-up to implementation of Solvency II, fund managers are seeking guidance on how the new rules will apply to insurance investors, including the treatment of fund assets in the insurer's capital calculation and how managers should cater for the capital impact when structuring credit funds.

While the actual capital calculation depends on an insurer's entire investment portfolio, in this article we aim to give an overview of the framework to assist with understanding the capital drivers which impact investment decisions.

Solvency II

The new capital regime is found in EU Directive 2009/138/EC on the taking up of insurance business ("**Solvency II**"), which will start to apply to insurance and reinsurance companies from the beginning of 2016. Delegated acts setting out the detailed capital treatment of financial assets held by insurers (the "**Delegated Acts**") came into force on 18 January 2015.

Under Solvency II, insurance companies must hold eligible "own funds" equal to the Solvency Capital Requirement ("**SCR**") to cover the amount of unexpected losses arising both from their underwriting business and the assets in which they invest. Essentially, own funds will be equal to the amount of the insurer's assets in excess of its liabilities, together with items which can be called up to absorb losses (such as unpaid share capital). Own funds are further classified into tiers, according to their loss-absorbing capability, and there are limits on the amount of each tier that can be used to meet the SCR.

SCR calculation

In calculating the SCR, the balance sheet is divided into five "risk modules". Each of the five risk modules involves a calculation resulting in the capital requirement for that module and the five are input into the calculation of the SCR, which represents the square root of the sum of the products of the capital charges for each possible combination of two modules adjusted for the correlation between these two modules. The capital charge for each module can be calculated using an insurer's own internal model if approved by its supervisor but, in the absence of such approval, Solvency II sets out standardised formulae for the calculation of capital requirements.

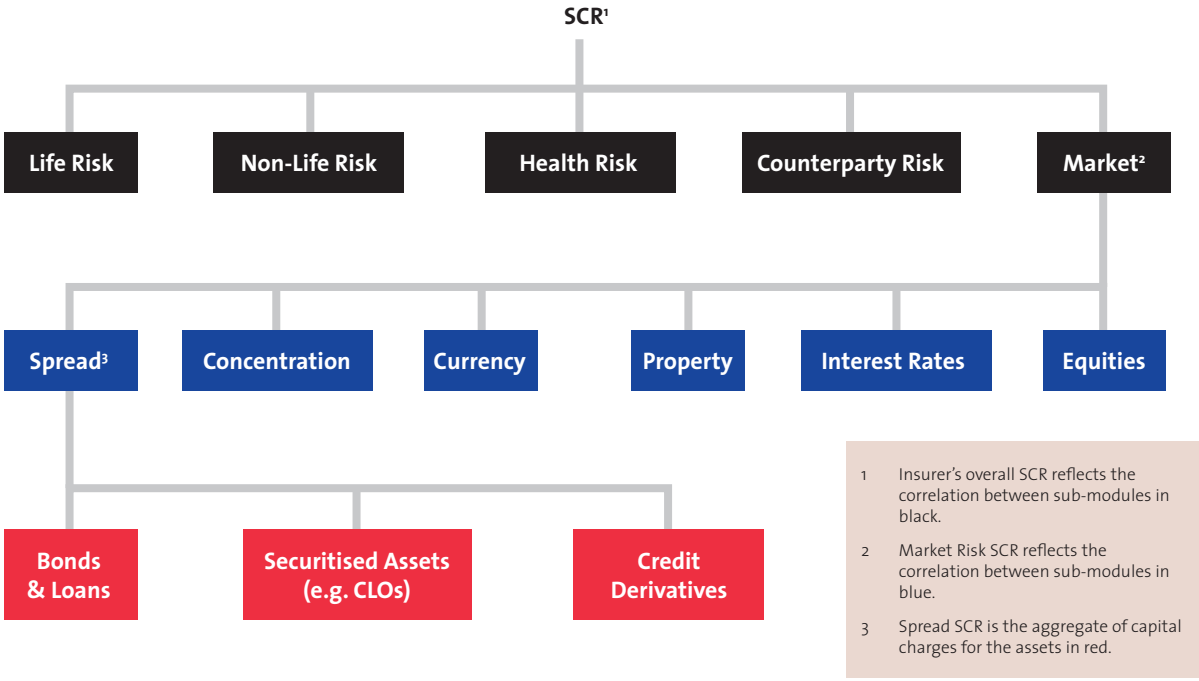
Market risk module

The "market risk module" calculates capital requirements covering the market risk of financial assets, i.e. the value-at-risk in a stressed market for that asset, rather than assessing the credit risk of the exposure. The market risk module is further divided so that financial assets are grouped together in buckets or sub-modules, such as equities, interest rates, property, currency, concentration and spread risk. Under Solvency II there is no longer any limit on the proportion of the insurer's balance sheet which can be invested in each bucket. However, the correlation between buckets is a factor used in calculating the capital charge across the entire market risk module.

What you need to know

- **Solvency II will start to apply to EU-based insurance and reinsurance investors from January 2016.**
- **Capital requirements for financial assets will depend upon diversification within the insurer's investment portfolio – removing the concept of investment limits.**
- **Capital risk factors for direct holding of loan assets or investment in loan funds will depend on rating and maturity, while holding of securitisation positions can be capital-intensive.**

Loan assets, bonds and other securitised assets are all assessed in the "spread risk" bucket, which assigns standard "stress factors" to the asset, depending on the type of asset, its modified duration and its rating. The capital requirement for the spread risk on the asset is equal to the loss in the insurer's own funds which would result from an instantaneous decrease in the value of the asset in a stress scenario. This decrease is presumed to be equal to the relevant standard stress factor.



Thus in each case, an insurer applying the standard formula to calculate its capital requirement for market risk will be looking at:

(a) the size of the stress factor applicable to that asset; and
(b) the correlation between:
  (i) the assets in the relevant bucket; and
  (ii) the other buckets of assets in its portfolio.

The diagram above demonstrates this.

Securitisation versus "look through" approach

Insurers investing in funds are required to "look through" the fund to the underlying assets in determining the applicable capital requirements.

Loans, bonds, securitised assets and credit derivatives are all assessed within the spread risk bucket and the capital charge for these assets is aggregated before the correlation with other buckets (such as equities, property assets, currency and interest rate risk, and concentration risk) is assessed. The stress factor applicable to direct investment in loan or bond portfolios versus securitisations of the same loan or bond portfolio is therefore an important driver in the decision as to which of those assets an insurer should hold.

Table 1 (see opposite page) shows the stress factor applicable to a loan or bond portfolio.

Table 2 (see opposite page) shows the stress factor for a securitisation of "Type 1" assets such as prime residential mortgage securitisations.

Table 3 (see opposite page) shows the stress factor for a "Type 2" securitisation position, such as a securitised loan portfolio.

So by way of example, under the standard formula a AAA-rated loan with a modified duration of four years will have a stress factor of 3.6 per cent while a AAA-rated high-quality or "Type 1" securitisation exposure with a four-year modified duration will have a stress factor of 8.4 per cent. Other, non-high-quality or "Type 2" securitisation tranches with the same rating and duration attract a stress factor of a huge 50 per cent of notional. "Type 1" securitisations for this purpose include asset classes such as prime RMBS positions, loans to SMEs, auto-loans and consumer credit. They do not currently include managed CLOs or other securitisations of corporate loans.

Clearly, a direct comparison between the stress factor applied to a securitisation tranche versus holding the underlying loan portfolio can only be done on a case-by-case basis, as each individual loan in the portfolio would need to be assessed – a six-year BBB loan, for instance, will attract a stress factor of 14 per cent – but it can be seen that very different results will be achieved according to whether loans are held directly or through exposure to securitisation.

A "securitisation" for these purposes is defined in the same way as in the Capital Requirements Regulation applying to banks. The definition requires a transaction in which the credit risk of an exposure or pool of exposures is tranched and losses on the pool are distributed according to priority of tranches. Thus, a single tranche fund will not be seen as securitisation, but a fund with more than one tranche of credit risk – which may not be clear from the debt structure but may arise from other credit enhancement within the transaction – will be treated as a securitisation and the securitisation stress factors will apply. Identifying whether a transaction is a securitisation, and whether or not it is "high

Table 1

Stress Factor applicable to rated loan and bonds

Rating		AAA		AA		A		BBB		BB		B or less	
Modified Duration in years (dur_i)	Stress Factor	a_i (%)	b_i (%)	a_i (%)	b_i (%)	a_i (%)	b_i (%)	a_i (%)	b_i (%)	a_i (%)	b_i (%)	a_i (%)	b_i (%)
Up to 5	$b_i \cdot dur_i$	–	0.9	–	1.1	–	1.4	–	2.5	–	4.5	–	7.5
More than 5 and up to 10	$a_i + b_i \cdot (dur_i - 5)$	4.5	0.5	5.5	0.6	7.0	0.7	12.5	1.5	22.5	2.5	37.5	4.2
More than 10 and up to 15	$a_i + b_i \cdot (dur_i - 10)$	7.0	0.5	8.4	0.5	10.5	0.5	20.0	1.0	35.0	1.8	58.5	0.5
More than 15 and up to 20	$a_i + b_i \cdot (dur_i - 15)$	9.5	0.5	10.9	0.5	13.0	0.5	25.0	1.0	44.0	0.5	61.0	0.5
More than 20	$\min[a_i + b_i \cdot (dur_i - 20);1]$	12.0	0.5	13.4	0.5	15.5	0.5	30.0	0.5	46.5	0.5	63.5	0.5

NB: Unrated loans/bonds have different stress factors according to whether the borrower has posted collateral.

Table 2

Type 1 Securitisation Stress Factor = lower of i) X x modified duration and ii) 100%

Rating	AAA	AA	A	BB
Where X =	2.1%	3%	3%	3%

Table 3

Type 2 Securitisation Stress Factor = lower of i) Y x modified duration and ii) 100%

Rating	AAA	AA	A	BBB	BB	B	<B
Where Y =	12.5%	13.4%	16.6%	19.7%	82%	100%	100%

NB: All ratings used in these tables are based on the ESA's Joint Consultation Paper on RTS for the allocation of credit assessments of ECAs to an objective scale of credit quality steps 06/03/15 under Article 109(a) of Solvency II, using S&P ratings as an example.

quality" for Solvency II purposes, is therefore a critical exercise for insurer investors.

Conclusion

Fund managers are becoming more alive to the potential impact of Solvency II on insurer investors and are factoring it into structuring their loan funds. This article demonstrates that there are several factors that have to be taken into account, the most pertinent being whether a fund structure is a securitisation or whether a "look through" approach can be taken. The actual capital calculation is dependent on an insurer's entire investment portfolio and is something that insurers will be calculating themselves to see if a certain structure is appealing.

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BEPS: A cause for concern?

by Paul Miller and Alexander Cox

New BEPS proposal brings fresh considerations for CLOs and credit fund structures.

The background to the OECD's base erosion and profit shifting (BEPS) proposals is the recent publicity around cross-border tax planning by multinationals. This led to the OECD, at the request of the G20, developing a number of workstreams, known as "actions", to counter the types of tax planning that were considered inappropriate.

While there are a number of BEPS actions which could, in theory, affect the CLO and credit funds market (see below), the BEPS action currently regarded as the one which could have the most significant impact in this sector is "Action 6" (also known as "Treaty Abuse").

A number of documents and proposals have been released in relation to Action 6 but a further key proposal document is expected from the OECD in the first half of May. That document may clarify some of the issues discussed below.

Potential impact of current proposals on existing fund structures

The OECD's original key proposal under Action 6 was to suggest that tax treaties are amended by the inclusion of either or both of a "principal purpose test" (PPT) and/or a "limitation of benefits" (LOB) clause. It was proposed that this would be the most effective way to counteract the obtaining of treaty benefits in "inappropriate circumstances". Naturally, however, there is a real concern that the way in which those tests are framed means that CLOs and credit funds could cease to be able to benefit from treaty relief if implemented wholesale (and the OECD acknowledged in their original proposals that the position of funds in respect of Action 6 had not yet properly been considered).

Current treaty relief

By way of background, unless an exemption applies, borrowers incorporated in a significant number of jurisdictions need to withhold tax on interest payments and pay those amounts over to their home tax jurisdictions. There are a number of exemptions; for example, most listed bonds attract an exemption. However, CLOs and other credit funds currently typically seek to rely on the exemption provided by the relevant double tax treaty to ensure that the borrowers do not need to withhold. That approach relies on the fact that an entity in the fund structure is able to benefit from treaty relief.

The concern with an unadulterated PPT or LOB clause is that, since interests in the fund are ultimately indirectly owned by investors who may be geographically widespread, and the choice of jurisdiction for the relevant vehicles will often be tax-driven (at least in part), any such test or LOB clause could prevent such vehicles from benefiting from the relevant treaty exemption. That is notwithstanding the fact that some or all of the underlying investors in the fund could often have themselves benefited from a tax treaty exemption if they had themselves lent to the underlying borrower direct.

That led to the OECD issuing a paper requesting views as to *"how these issues related to the treaty entitlement of sovereign wealth funds, pension funds and alternative funds/ private equity funds could be addressed in a way that would not create treaty-shopping opportunities"*.[1]

Possible approaches

There are a number of suggestions circulating for how one might redraw these Action 6 proposals. For example:

(i) a carve-out could be introduced so that funds that effectively provide full disclosure of their ultimate investor base to the relevant tax authorities would not be prejudiced by any proposals arising from Action 6 of BEPS. Given the position under FATCA and OECD common reporting obligations, many funds may have to do much of this work in any event; or

(ii) when deciding if a fund or its subsidiary holding vehicle should benefit from treaty relief, one should effectively look through to the ultimate investors in the fund to decide on the availability of treaty relief. More particularly, if sufficient investors are in jurisdictions with treaties which would mitigate the tax if the holding had been direct, then either all, or a pro rata portion, of that benefit would accrue to the relevant fund vehicle claiming treaty relief.

What you need to know

- **The current key proposal under Action 6 suggests that tax treaties are to be amended by the inclusion of either or both of a "principal purpose test" (PPT) and/or a "limitation of benefits" (LOB) clause.**
- **The current proposal could potentially prevent CLOs and credit funds from relying on a double tax treaty, which raises the question of who will then bear the increased withholding.**
- **A further key proposal document in relation to Action 6 is expected to be released by the OECD in the first half of May.**

There are a number of other variants being discussed but it is notable that a number of them could mean that the identity of a fund's ultimate investors will impact whether or not the fund (or its relevant subsidiary) can access treaty benefits.

All of these suggestions (and others) have been the subject of written and oral submissions to the OECD as part

1 Ashurst fed into a number of representative bodies who responded to these proposals. The public responses to the OECD's proposals are available on their website (www.oecd.org).

of the consultation process. The point has also been made to the OECD that, at a time when the market is desperate for credit, the implementation of any rules which could affect the feasibility of CLOs and credit funds should be very carefully considered. It will be interesting to see whether this point is specifically addressed in the revised proposals expected in the first half of May.

What can be done now?

There are still no definitive proposals to look at, let alone the proposed multilateral instrument that is likely to be used to introduce the new terms into the relevant tax treaties. Some fund managers have been considering a number of options including:

(i) an ability to force a transfer across to a "bad" fund of those investors (if any) that cause the original fund to suffer increased withholding;
(ii) an ability to apportion the cost of any increased withholding incurred under Action 6 to the investor(s) whose nature caused that increase; and/or
(iii) an ability to force a sale of such an investor's interests in the fund.

Some of these options are similar to those introduced in response to FATCA. However, they have not as yet been widely adopted, in part because the shape of the ultimate rules is still so unclear.

We await the next version of the OECD Action 6 proposal with interest, as it will be the first draft where the OECD will have had the chance to consider the issues for the credit fund industry and some of the proposals put by us and others as to how best to resolve these issues. As noted above, we currently expect to receive that proposal in the first half of May.

Transitional arrangements

It is also worth noting that there are no details yet of transitional arrangements. That makes sense given that the substantive issues need to be resolved first.

However, at some point, the potential impact on existing structures is going to come under close scrutiny. For example, in the European debt markets, CLOs, among others, rely on treaties to eliminate withholding that would otherwise apply to payments of interest by, for example, UK, Irish or Belgian borrowers. If those lenders ceased to be able to benefit from the relevant treaty, the question arises of who then bears the cost of the increased withholding. Under the standard form Loan Market Association drafting, that sort of change of law arising after the money had been lent would usually be a borrower risk. Accordingly, the borrower would have to gross up such a lender under many pre-existing loans. Ashurst has spoken to HM Treasury (who are heavily involved in the OECD negotiations) who are aware that imposing those sorts of extra costs cannot be appropriate.

Clearly, some sort of transitional relief may therefore be necessary in a number of sectors.

Credit funds may also find themselves receiving more due diligence queries from borrowers as to their fund structure and ability to obtain treaty benefits.

Other BEPS Actions

Action 6 is not the only relevant workstream for credit funds. There are also proposals in relation to interest deductibility and hybrid mismatches which we are watching closely. In theory, the former could cover securitisations, CLOs and the sort of debt-funded Luxembourg-incorporated subsidiaries held by certain types of credit fund vehicle. However, this proposal is at a fairly early stage and it is hoped that, because any significant restriction on the deductibility of interest in CLO and credit fund structures would be so fundamental and potentially distortive in the financing/lending sector, sense will prevail, and that these vehicles will either not be affected by the final recommendations or will be able to benefit from a fairly sensible looking carve-out.

Other areas to watch

This article has mainly focused on the BEPS proposals as they impact credit fund structures. However, there are a number of issues which are of more relevance to the group structure of asset management groups. The subjects potentially of relevance include the disguised investment management fees and diverted profits tax provisions in the UK's Finance Act 2015, and the EBA's consultation paper on remuneration.

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THE RISE OF THE PEER-TO-PEER LENDER:

A threat to traditional banks?

by Diala Minott and Melissa Ashdown

The peer-to-peer (P2P) lending industry has been gathering momentum in Europe, finally breaching the £2bn lending threshold in September 2014.

A paper published by the International Organization of Securities Commission last year explains how the global market for investment-based P2P lending has been growing exponentially each year, and in 2013 was estimated to be US$6.4bn, driven by an annual growth in P2P lending of 90 per cent.

The deleveraging of European banks has triggered a material shift in the traditional lending framework, as banks pull back from their conventional lending role, forcing borrowers (particularly SMEs) to consider alternative sources of financing. Given the industry is still relatively young, the market for P2P lending has yet to reach all jurisdictions, with the US and Europe leading the charge. The P2P lending trend has spread as far as China, with internet giant Alibaba recently aligning itself with US P2P lending platform Lending Club by agreeing to facilitate loans to US businesses looking to purchase goods from Chinese manufacturers. Alibaba has also formed similar relationships with Ezbob and Iwoca in the UK.

The drastic growth of the P2P market has triggered industry bodies to start introducing regulation, with the Financial Conduct Authority ("**FCA**") imposing restrictions early last year. Similarly, the European Banking Authority ("**EBA**") and European Securities and Markets Authority ("**ESMA**") are now considering imposing regulatory standards on the fast growing P2P lending industry within the EU.

Banking partnerships

The establishment of banking partnerships has not only resulted in more industry participants, but has also drawn more media attention to the P2P lending industry. In June 2014, Santander announced its formal referral programme with Funding Circle, and earlier this year RBS followed suit, announcing its referral programme with both Funding

Circle and Assetz Capital. The aim of these programmes is to direct any potential borrowers – who the banks are unable to lend to – to the relevant P2P platform, providing such borrowers with the opportunity to elect an alternative form of financing.

In George Osborne's address to Parliament on 3 December 2014, he pledged his support for P2P lending platforms and specifically recognised these banking partnerships as aiding the development of the industry by removing traditional barriers to financing.

Is there security in securitisation?

There has been chatter within the P2P industry of the securitisation potential of P2P loans. In the US this has become a reality, with CircleBack Lending and Jefferies teaming up late last year to securitise US$500m worth of P2P loans. We expect similar transactions in Europe to follow in the near future.

Following the 2008 subprime mortgage crisis, securitisations had a generally tarnished reputation, with both investors and regulators becoming more wary of this product. However, creating securitisations of P2P loans would not only open up the sector to a broader investor base, it would allow P2P lenders to offer cheaper financing and would spur the growth rate of the industry even further, arguably attracting more attention and regulation.

While P2P lending platforms will each perform their own individual credit checks and analysis, the FCA rules discussed below also implement investor protection measures, ensuring that investors receive clear and accurate information so that they always know who they are lending to.

What you need to know

- **The deleveraging of European banks has triggered a material shift in the traditional lending framework.**
- **The global market for investment-based P2P lending has been growing exponentially each year.**
- **The drastic growth of the P2P market has triggered industry bodies to start introducing regulation, with the FCA imposing restrictions early last year.**

So what is P2P lending?

P2P lending is the fusion of banking and technology. It allows borrowers and lenders to connect with one another via an online platform where they can engage in direct lending transactions.

Who are the borrowers?

Depending on the platform, borrowers can range from SMEs to entrepreneurs financing new ideas to individuals seeking personal loans. There is no set form of borrower, and the borrower pool will change significantly depending on the platform. In Europe, while platforms such as Funding Circle and ThinCats will typically lend to businesses, firms such as Zopa and RateSetter will often focus primarily on lending to individuals.

Who are the lenders?

Lenders can be anyone. As with the borrower pool, the lender pool can contain a wide spectrum of individuals, SMEs and businesses. Depending on the platform, lenders can invest anything from as little as £10, often with no cap on the maximum amount.

How are they regulated in the UK?

The FCA started regulating the P2P industry from 1 April 2014. Firms which held appropriate Office of Fair Trading licences and who operated P2P lending platforms prior to this time could apply for interim permission to continue operating and remain in the market pending full authorisation. A set of more robust rules took effect in October 2014, and new entrants to the industry from 1 April 2014 have been subject to all of the rules in force from the date of their authorisation.

The rules imposed require platforms to meet minimum capital standards, to keep client money in third party accounts and to have resolution plans in place should the platform or repayment plan collapse. The capital requirements are currently being phased in and the transitional period will end in April 2017.

The P2P industry is not covered by the Financial Services Compensation Scheme (which guarantees deposits of up to £85,000) and, as such, investors are taking the risk that if a lending platform collapses or a borrower defaults, they could potentially lose their whole investment.

Conclusion

While P2P lending platforms were initially established with a view to disintermediating banks, the evolution of the industry has seen the largest participants align themselves with the banks, rather than circumventing them. Arguably, such bank alliances could be seen to be helping the traditional intermediary banking model, although given the recent publicity around Wells Fargo's employee ban on investing with such platforms, perhaps there is something for the banks to worry about after all.

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UNITRANCHE AND SSR CREDIT FACILITIES:

Evolution of the restructuring landscape

by Olga Galazoula and Ross Ollerhead

Unitranche facilities and accompanying super senior revolving credit facilities (SSRCF) have in the last few years proven to be an attractive alternative financing structure for European deals, particularly in the mid-market.

While it is relatively early days in the life of those facilities and the market is still evolving, a shift in "traditional" stakeholder dynamics will be inevitable if these facilities come to be restructured.

In issue 2 of Credit Funds *INSIGHT* we looked into the main features of unitranche facilities and their appeal for credit funds, banks and borrowers alike. We now turn our attention to unitranche/SSRCF structures in particular and look at the shift in stakeholder dynamics that these are likely to involve when they come to be restructured, compared to some of the common themes seen in European leveraged buy-out (LBO) restructurings of recent years.

What is a unitranche/SSRCF structure?

A unitranche facility is a single term loan, normally used for acquisition financing or a simple refinancing. Traditionally, unitranche facilities have been offered by credit funds, although banks are now beginning to consider offering their clients this product as well. As term debt, it does not lend itself well to the ongoing working capital needs of a corporate borrower, who is likely to require access to revolving and other ancillary facilities, such as letters of credit, bank guarantees, etc. These are products that credit funds themselves are not usually set up to offer. As a result, a unitranche facility will often be accompanied by a revolving credit facility (which can also be used by way of ancillaries), usually provided by a retail bank and ranking super senior to the unitranche facility it accompanies (the same super senior status is likely to apply to any hedging that the retail bank makes available to hedge interest rate risks in respect of the unitranche facility).

This financing structure, while more widely used in

the US, is a relatively new import in the European space, emerging in response to the bank leverage debt drought. This means that these deals have not, by and large, landed on the desks of restructuring professionals in Europe en masse yet. Nevertheless, and based on the LBO restructuring precedents in the recent financial crisis, one would expect to see the following themes dominating the restructuring landscape in connection with this type of funding structure.

Debt trading in the secondary market

In the last few years, we have seen a relative "demise" of the relationship banking model, particularly in the context of restructuring deals, as banks have been seeking to deleverage their balance sheets and offload distressed loans. This allowed the secondary debt market to flourish, as event-driven investors with a loan-to-own strategy have been quick to pick up stressed or distressed credit opportunities in their chase for yield, and their buying into the credit has often been the very factor that has driven a restructuring solution forward, especially in the case of debt-for-equity swaps.

It will be interesting to see how loan trading will impact unitranche facilities that are in need of restructuring. Unitranche facilities normally include provisions that preclude a transfer unless the transferee is included in a sponsor/borrower approved "white list", with the key exception that if an event of default is outstanding, debt transferability is no longer impaired by restrictions of this sort.

On the one hand, a credit fund as a lender is much more likely to make decisions to get out of a problematic credit swiftly, as these organisations tend to be smaller and more flexible. On the other hand, there is undoubtedly increased competition in the mid-market unitranche space. Credit funds rely on their existing relationships with sponsors and corporates to underwrite new business, and they are in this game for the longer term. Can they afford to be seen as the first to abandon ship when things get tough? Furthermore, when sponsors raise these issues with credit fund lenders, the response is frequently that the impact of a less than par recovery on the credit fund's internal rate of return would be so adverse that, on the contrary, the credit fund is incentivised to work with the sponsor to find a solution rather than trade out. They also point out that the size of their teams means that the same individuals who originated the deal will work on it through its life. As credit funds typically have no portfolio or special situations teams, they may find it more challenging to negotiate trade out terms.

What you need to know

- **The role of secondary debt trading (historically, a valuable entry point for event-driven investors and, fairly often, the trigger for a comprehensive restructuring solution) may become less significant in the context of unitranche restructurings.**
- **The usual LBO financing arrangement of "whoever is higher in ranking calls the shots" is challenged in unitranche/SSRCF structures.**
- **Contractual protections for junior lenders (such as debt buy-out rights), which were very rarely used in practice in the context of pre-2008 senior/mezzanine LBO restructurings, are now likely to provide powerful leverage to unitranche lenders.**

Does the traditional association of seniority with enforcement control still apply?

Many of the most high-profile LBO restructurings to date have involved senior/mezzanine financing structures. Those versed in such structures will recall that mezzanine lenders agree to forego certain protections when it comes to accelerating their loans or taking enforcement action in order to reflect the commercial nature of the deal for them, with acceleration and enforcement control predominantly concentrated in the hands of the secured creditors who rank first in the capital structure (the senior term and RCF lenders). In other words, for the traditional mezzanine lenders: **higher risk = higher pricing + lower level of control**.

The tables are somewhat turned in the context of unitranche/SSRCF structures. SSRCF lenders agree to forego some of the protections and controls that would normally be part and parcel of being the most senior lender, thus reflecting the new nature of these deals: **lower risk = lower pricing + lower level of control**.

SSRCFs are usually a small part of the capital structure and they are the "first out" in the event things go wrong. Therefore, even if the borrower suffers significant value destructive events, the likelihood is that the SSRCF will still be "in the money" and the unitranche lenders will be the fulcrum creditors.

Furthermore, in terms of the size of the respective SSRCF and unitranche commitments for the purposes of determining the all-important lender majority, SSRCF lenders will invariably form a non-blocking minority. Consequently, majority lender decisions (which are normally required for acceleration and enforcement) will be controlled solely by the unitranche lenders.

SSRCF lenders continue to enjoy certain protections, including an independent right to accelerate, but this applies in limited circumstances and requires the occurrence of a material event of default, such as non-payment, insolvency, etc. Moreover, even where such an independent acceleration right has become exercisable, the SSRCF lenders will be under standstill obligations akin to those imposed on the mezzanine lenders. It is only after the expiry of the applicable standstill period and if the unitranche lenders have not commenced enforcement action (or following any enforcement action if the SSRCF has not been repaid within a further period of time) that the SSRCF lenders can independently become the instructing group (and even then a requirement to consult with the unitranche lenders is likely to apply).

It is therefore evident that the classic LBO restructuring arrangements constructed on the basis of a positive correlation between the lenders' ranking in the capital stack and their ability to call the shots is not applicable in the context of unitranche/SSRCF structures. The fact that the most senior lenders in the structure hold the least amount of debt in that structure has resulted in a departure from the classic LBO restructuring position.

Intercreditor protections for unitranche lenders – will some rights now be more than just good on paper?

The lessons learned from the LBO restructurings of the recent economic downturn, particularly around the effectiveness

of the intercreditor agreement protections for mezzanine lenders, have been instructive in helping shape the more evolved (and, in various respects, more balanced) intercreditor arrangements we see today.

Classic senior/mezzanine intercreditor arrangements typically included a right for mezzanine lenders to buy out the senior lenders at par, designed to avert the risk of a senior lender-led enforcement that might result in a below par (or, even worse, zero) recovery for mezzanine lenders. However, in practical terms, the existence of the debt buy-out right in the intercreditor agreement has historically operated to the advantage of the senior lenders in the context of a senior lender-led restructuring plan, as they could rely on it as a defence argument to see off any valuation challenges by the mezzanine lenders, with the argument from the seniors being "if the mezzanine lenders are confident that value breaks in the mezzanine debt, they can always buy the seniors out at par and protect their original investment". Given the respective typical sizes of the senior and mezzanine facilities (with the latter only a fraction of the former) and the difficulties with raising finance during the economic downturn, this right has very rarely been used in practice, as it meant writing a huge cheque to the senior lenders, which most mezzanine lenders were simply not able or willing to do, leaving them with limited alternative ways of improving their recovery odds.

The debt buy-out right has been transposed into the unitranche/SSRCF intercreditor arrangements, granting the unitranche lenders the right to buy out the SSRCF lenders, with a view to preventing the SSRCF lenders from taking control of the enforcement process (following the expiry of any applicable standstill period). In light of the differences in the respective sizes of the SSRCF and unitranche facilities described above, it is evident that this right is a credible alternative for unitranche lenders and a powerful tool for their restructuring strategy. There could in theory be some technical difficulties with implementing such a transfer, given that credit funds are not set up to provide revolvers and ancillaries, but this should be capable of being addressed with the use of a fronting bank, covered by a back-to-back arrangement with the purchasing unitranche lender.

Conclusion

Unitranche/SSRCF structures have now become an established part of the continually evolving European financing landscape, and the usual stakeholder dynamics we have become used to seeing in the post-2008 era are set for a significant change. Furthermore, previously unexploited contractual rights of junior lenders may prove to be at the core of a workout solution.

There are interesting years ahead for the European restructuring community.

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THE VIEW FROM ASIA:

A US$1bn strategic platform for investments into Indian infrastructure debt

by Dean Moroz

India's infrastructure sector is on the up, and it offers foreign investors an appealing opportunity which some are already grabbing with both hands.

As in other regions, Asia has in recent years seen a marked increase in traditional blind-pool debt-fundraising activity as well as joint ventures, co-investment platforms and direct investment platforms for investing in debt securities. These platforms have become increasingly complex. They are characterised by highly bespoke structures and terms designed to implement the express legal and commercial requirements of parties pursuing particular (sometimes peculiar) debt investment opportunities in Asia.

An example is the establishment in July 2014 of a US$1bn institutional platform to invest in rupee-denominated mezzanine instruments issued by infrastructure companies in India by APG and Piramal Enterprises Ltd, the diversified company belonging to India's Piramal group. APG, through their asset management arm, are the largest manager of pension capital in the Netherlands, with more than €400bn of assets under management as of 31 December 2014. APG are also widely regarded as one of Asia's – and the world's – most savvy institutional investors.

Under the terms of the platform, each partner initially committed US$375m for investments with the option to increase that commitment to US$500m. APG's commitment represents a milestone, as it is one of the single largest commitments to date by a foreign investor to the infrastructure sector in India.

This article considers some key commercial and legal drivers behind the establishment of the platform and APG's landmark direct investment into this asset class in India.

Commercial drivers

Investment into infrastructure as an asset class is recognised as requiring long-term capital in return for steady yields, so it is easy to see the attractiveness of such investment for institutional investors, like APG, who seek prudently to overcome long-term funding liabilities represented by the capital they manage.

India's need for infrastructure funding is well documented. As Reuters notes, the country aims to spend US$1trn on infrastructure in the next couple of years, half of which will be funded privately.[1] The funding needs of Indian infrastructure companies also represent a unique investment opportunity in light of a recent slowdown in economic growth and a decline in the rupee to record lows following a period when the Indian economy was one of the fastest growing in the world, and many of those companies relied on bank debt for funding.[2] Within the asset class, infrastructure debt at a mezzanine level again represents a particular window of investment opportunity at this time in India for a variety of reasons, including the gap in the capital structure between senior debt and equity that has been identified in relation to Indian infrastructure companies. The high yields associated with investments in mezzanine debt represent an appropriate balance of risk and reward for the right kind of investor.

Perhaps auspiciously, APG's investment also coincides with renewed optimism for India generally as an investment destination, under the government of new prime minister Narendra Modi.

What you need to know

- **India's infrastructure funding needs represent a unique investment opportunity in light of a recent slowdown in economic growth and a decline in the rupee to record lows.**
- **Changes in Regulations help to ease entry barriers for "foreign portfolio investors" and provide an improved legal framework in which to make certain types of investments, including debt issued by Indian companies in the infrastructure sector.**
- **As in other regions, Asia has in recent years seen a marked increase in traditional blind-pool debt-fundraising activity as well as joint ventures, co-investment platforms and direct investment platforms for investing in debt securities.**

Legal drivers

Changes by the Securities and Exchange Board of India (SEBI) that came into effect in early 2014 in the form of the SEBI (Foreign Portfolio Investors) Regulations, 2014 (the Regulations) also helped to improve access to investments

1 See the article "Piramal, Dutch APG tie up for $1 bln infra investment", dated 30 July 2014, on the Reuters website.

2 Ibid.

in Indian mezzanine infrastructure debt by APG as a foreign investor. The Regulations help to ease entry barriers for foreign portfolio investors (FPIs) and provide an improved legal framework in which to make certain types of investments, including debt issued by Indian companies in the infrastructure sector.

To avail of the Regulations, a foreign investor must satisfy the prescribed eligibility criteria and become registered as a FPI. The Regulations identify three categories of FPIs, including a category for government-related entities (such as central banks and sovereign wealth funds) and a category for non-government entities (for example, banks, asset management companies and pension funds). A third category exists for those applicants who do not fit within the first two categories (such as endowments, foundations, trusts and family offices). Additional categories may be recognised by SEBI in the future.

The FPI eligibility criteria hold few surprises. They include a requirement that the applicant must not be a resident of India (as determined under the Income-tax Act, 1961, as amended) but must be a resident of a country that is either a signatory to a memorandum of understanding with SEBI directly or a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding. In addition, the applicant must be fit and proper for purposes of the relevant SEBI regulations concerning intermediaries. There are also particular further requirements applicable to certain types of FPI applicants.

Once registered, a FPI is permitted to invest only in certain types of securities identified under the Regulations,[3] which include listed and unlisted non-convertible debentures and bonds issued by Indian companies in the infrastructure sector. A FPI also has certain ongoing obligations that include obtaining an Indian income tax registration number (Permanent Account Number) and appointing a compliance officer. In addition, registration fees may be payable on a periodic basis, depending upon the category in which a FPI is registered, though such fees are generally of a nominal amount.

Conclusion

Asia continues to see an uptick in interest in the pursuit of debt investment opportunities, of which India is but one jurisdiction. A variety of traditional and novel structures are being used to access those opportunities, which are as diverse as the investors and their needs.

3 It is also possible to access other types of Indian investment opportunities under other regulatory regimes in India, such as by becoming registered as a "Foreign Venture Capital Investor" under the SEBI (Foreign Venture Capital Investors) Regulations, 2000, which are being amended by the SEBI (Foreign Venture Capital Investors) (Amendment) Regulations, 2014.

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AIFMD: Absolutely Insufferably Fundamentally Materially Defective?

by Jake Green

We have been considering writing an article along these lines for over a year now. However, every time that we were about to put pen to paper, we were stopped short by either something (AIFMD-related) even more absurd than what we had previously seen occurring, or a lull in time where we (mistakenly) believed that things were finally coming good.

Alas, the "good" has not come and therefore, in the spirit of sharing, this article has finally been written. Please note the purpose of this article (rant?) may be viewed as twofold:

(i) we simply needed to get some frustrations off our chest (and find out whether we are a lone voice in the crowd); and

(ii) to give the industry some comfort that, to some extent, complying with the AIFMD is extremely difficult and at times a "finger-in-the-air" job.

Accordingly, we hope that this article is read in the spirit in which it is meant. It is intended merely to highlight quite how difficult it is to implement directives such as this in a short time-frame, and that some emergency repair work may be needed.

Background

The AIFMD (Alternative Investment Fund Managers Directive) officially came into force on 22 July 2013. To all intents and purposes (and as a great oversimplification), there was a one-year transitional period up to 22 July 2014 where the AIFMD could have perhaps been viewed as being only softly

in place. However, since 22 July 2014, the AIFMD must be complied with in the EEA and broadly requires that:

- European fund managers are regulated under (and comply fully with) the AIFMD; and
- non-European managers that want to "market" their funds into the EEA comply with the disclosure and transparency requirements of the directive.

The straw that broke the camel's back

The following anecdote might be the reason why we finally "broke" and wrote this article.

On 9 January 2015, the European Securities and Markets Authority (ESMA) published a revised version of its "Questions and Answers" in respect of the application of the AIFMD (ESMA/2015/11). This is generally a very helpful publication. However, at question 50, ESMA responds to a query on how an AIFM should report information in relation to subscriptions and redemptions over the reporting period. The answer is simple: *"AIFMs should report the value of subscription and redemption orders and not the number of subscription and redemption orders"*.

On the face of it, this is a very sensible answer. However, ESMA's response comes some time after certain managers have been required to report information to regulators and not always in this way. Further, we know that ESMA itself had previously told some fund managers who had gone out of their way to ask the very same question that the redemptions and subscriptions should detail the number of subscriptions/redemptions rather than the dollar amount. Confused? Many are.

Below we have highlighted some of our other favourite "nits" to pick in relation to the AIFMD.

The EU "marketing passport"

The marketing passport is probably the most positive aspect of the AIFMD. It allows a European fund manager who manages a European fund to market this fund into other EEA states to professional investors by simply filling in a passporting form and sending it to their local regulator, who will onwardly submit such a request to the other relevant EEA regulators. The beauty of the passport is that it means that an AIFMD-regulated fund manager need only think about complying with the AIFMD rules (as implemented in its local jurisdiction) in order to be free to market into the rest of Europe (avoiding the need to take advice in each jurisdiction and/or complying with various restrictive private placement regimes). So far, so good.

It appears, however, that the *Autorité des Marchés Financiers* (AMF, the French regulator) has gold-plated the passport requirement (and note that there are no provisions within the AIFMD that allow this requirement to be gold-plated) by requiring that a non-French EEA AIFM that wishes to market a fund into France (via a passport) must appoint a centralising agent/correspondent in order to do so. Such an entity must be domiciled in France. This requirement has therefore led to confusion and inefficiencies in relation to operating the passport. ESMA has remained silent on whether it considers this permissible under the AIFMD. More importantly, if measures such as this are allowed, it renders the whole idea of a cross-border marketing passport (and, indeed, opening up such a passport to non-European managers) as practically pointless.

The definition of "marketing" under the AIFMD

"Marketing" is defined under the AIFMD as *"a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the union"*.

In our view, there are therefore two central strands to the definition of "marketing" under the AIFMD:

(i) it must be an offer or placement; and
(ii) the offer must be by or on behalf of the AIFM.

Both of these strands make sense. If a fund manager is not directly offering a fund (but rather talking about its fund manager capabilities as a whole, as an example), then it is surely not marketing (offering) a fund. Further, it must be possible to talk about or detail a fund without doing so, meaning that there has been an "offer" made in relation to such a fund. To stress this point, if someone with no connection to a fund manager recommends a fund to their client (and such a person has, for example, an advisory relationship with its client), then it cannot be said that, in doing so, that person is making an offer on behalf of the AIFM (it has nothing to do with the AIFM and is simply offering services in its underlying clients' best interests).

However, it is not quite so simple. Accordingly, the points below highlight our understanding of the different approaches to marketing in certain member states:

- the **UK** adopts a literal interpretation of the AIFMD definitions. Therefore (and see, for example, related FCA Perimeter Guidance Manual (PERG) guidance), draft documentation is unlikely to fall within the meaning of "offer", nor are documents that cannot be used by a potential investor to make an investment in an AIF;
- the **Dutch** adopt a similar approach to the UK position. However, there is no local guidance as to the meaning of "marketing" or "pre-marketing" in Holland. Provided there is no offer, however, something is unlikely (but this is not definite) to constitute "marketing" in Holland;
- we are not aware of any guidance issued in **Ireland** on what "marketing" or "reverse solicitation" mean under the AIFMD. However, the good news is that we understand that the Irish central bank is adopting a sensible approach (and/or following what the FCA (in the UK) does);
- the **German** approach is perhaps the most scientific. Broadly speaking, providing that no fund exists or is "marketable", any communications in relation to such are unlikely to constitute "marketing". However, the flip

side of this is that as soon as a fund does exist (and is therefore "marketable"), any communications that mention the fund are likely to constitute "marketing" under the directive (no matter who has made them, how they are made, or in what capacity they are acting);

- the **Swedish** approach is perhaps the most interesting. Sweden has adopted a far wider definition of "marketing" than what is detailed above. (Crudely put, this article probably constitutes us marketing several funds into Sweden!); and
- again, there is no defined term as to what constitutes "marketing" in **France**. However, on different occasions, the AMF has defined "marketing" as a presentation of a financial instrument by different means with a view to encouraging a potential investor to subscribe/buy the financial instrument. This means that sending brochures and presentations to potential investors in France is likely to be considered as "marketing" in France, especially if an end investment comes about as a result of such activities.

The material difficulty with the different views is that it creates inefficiencies. Indeed, "cap-intro" services (as an example) and investor advisers struggle to understand in which countries they can carry out their activities without potentially bringing unconnected fund managers and funds into the scope of the AIFMD.

Non-European private placement rules

Under AIFMD, a non-European manager may market a fund into the EEA if it complies with the local private placement rules (which have been amended as a result of the AIFMD) for each EEA jurisdiction where it wishes to market. This is commonly referred to as the "Article 42" notification process. In some respects, this process is working; it is broadly possible to market a fund into Europe using the Article 42 notification procedure.

However, the following bugbears exist:

- The "Approval" time-frame in each jurisdiction varies dramatically. For example, the FCA in the UK has generally been approving marketing notifications within a day or so (although recent applications appear to be taking much longer). This should be compared to the German (BaFin) process, where approval to market a professional fund is taking more than three months (and a similar length of time to prepare the required application). There is also little consistency in the approach taken by some national regulators; we have seen one regulator approve a request within two weeks for one fund and then take six months for another fund where there has been no material difference in the applications.
- The above issues are also complicated by a "chicken-and-egg" problem that appears in many member states. Certain regulators require final form documents in

order to approve an Article 42 notification. This can be particularly difficult in relation to closed-ended funds where investor documents (for example, subscription agreements and limited partnership agreements) are heavily negotiated with potential investors. Further, if providing such documents constitutes "marketing" in the relevant member state (as detailed above), how can fund managers provide these documents to an investor in order to negotiate them and not breach "marketing" requirements in the member states, and still be able to provide the relevant regulator with final form documents for the regulators' approval? For some questions, it appears there are no answers.

- Despite the Article 42 notification process broadly working in most member states, a couple of problem member states remain. Currently, we understand that there is no Article 42 type notification procedure for non-European funds that wish to market into Italy. While there is such a procedure for France, it appears so arduous that we are not aware of any manager who has successfully completed the process. In such jurisdictions, many managers are relying on reverse solicitation type concepts even though the relevant regulators have provided little comfort on the availability and use of such safe harbour.

AIFMD "regulator reporting"

A fund manager's problems are further compounded when, after navigating the quagmire of the marketing rules, they are faced with AIFMD regulator reporting requirements.

Without wishing to go into too much detail on the topic (because it may bring about sleep!), the following list demonstrates some of the problems relating to regulator reporting that currently exists across various member states:

- We have a client who applied to market into a certain member state a number of months ago. At a later date, we asked the regulator how the relevant reporting forms should be sent to them. Initially, the regulator said that they had never received our notification (which was worrisome). On being pushed further on this point, the regulator backtracked and said that they had found it but were "only working through them now" (which was odd because we had been given permission to market). We then asked them how we should go about reporting to them (i.e. which forms they want and through which channels); the short answer was "we don't know".
- Reporting requires AIFM and AIF codes/numbers. Unfortunately, there is a mixed response from European regulators as to what they expect in relation to these details. Some appear to want a number that they supply to you when you notify (although we have had instances when the number was never supplied), while others seem to want a number provided by the (non-EEA) home state regulator (with no answer to the question as to what happens if you do not have a home state regulator or have never been given such a number).
- As has been detailed above, there are also different views between leading regulators (such as the FCA) on how reporting cells are to be completed. Interestingly, it was the FCA that led with the view that the monetary value of subscriptions and redemptions should be supplied and not the amount of investors (which previously ESMA had indicated it wanted). The moral of this story might be that, when in doubt, choose the approach that seems to make the most sense!
- Certain member states have also developed their own form of reporting template. While such forms are similar to those set out by ESMA, they also require separate reporting to be given in respect of the manager's financial soundness (looking far more like a balance sheet type report relating to the manager than anything relating to the underlying fund). This clearly increases the ongoing compliance burdens on the manager.
- Lastly, certain member states are not in a position to accept reports at the moment. However, there is not a list of regulators that this applies to. The only way to find out is to seek out someone at the appropriate regulator who is sufficiently knowledgeable to give the answer, or simply choose which Chinese whispers you are most comfortable listening to.

Finally – a word of warning

If you are about to submit any AIFMD management or marketing passport applications to regulators in relation to sub-funds or compartments, please ensure you have had a stiff drink first!

Roll on MIFID II implementation...

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WATCH THIS SPACE:

Base Erosion Profit Shifting (BEPS):

A further key proposal document in relation to Action 6 is expected to be released by the OECD in the first half of May.

Forthcoming events

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

IIR's 13th Annual Private Debt and Mezzanine Finance Conference
2 – 4 June 2015, Marriott Champs Elysees Hotel, 70 Avenue des Champs-Elysees, 75008 Paris, France

iGlobal Forum Middle Market Direct Lending Summit
16 June 2015, Central London, for details please visit www.iglobalforum.com