



INSTITUTE FOR LAW AND FINANCE
Goethe-Universität Frankfurt am Main

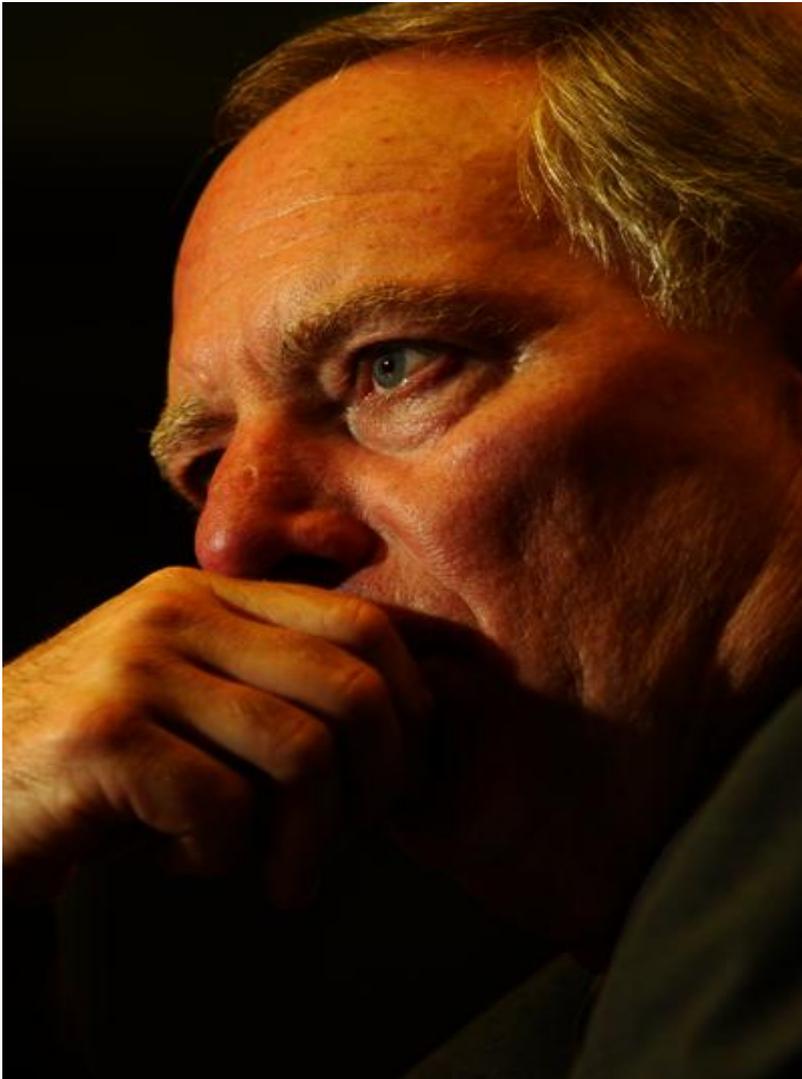


Titel:

Debt Funds – A Regulatory Challenge ?

Referent:

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„Finanzmärkte neigen dazu, Risiken lange zu unterschätzen; und danach neigen sie dazu, diese Risiken zu überschätzen.“

(Wolfgang Schäuble, IWF/World Bank Spring Summit April 2012)

(Quelle: <http://www.wolfgang-schaeuble.de/index.php?id=35>)



Debt Funds – Regulatory Landscape

- Regulatory Challenge
- We live in a regulatory decade, not to say in the regulatory century



Concept of Debt Funds

- "Debt Funds" are not a legally defined term but need at the first stage be considered as an as an economic phenomenon
- This economic phenomenon needs to be subject to legal scrutiny
- Thesis: We cannot easily define Debts Funds as a positive legal phenomenon, but we can segregate this from other legal phenomena



Economics (1)

- Non-Bank-Investors purchase debts
- Investment is not effected by market volatility
- Interesting for conservative investors who don't want to take equity risk and need steady returns
- Investment in Debt Funds adds stability to Investment portfolio

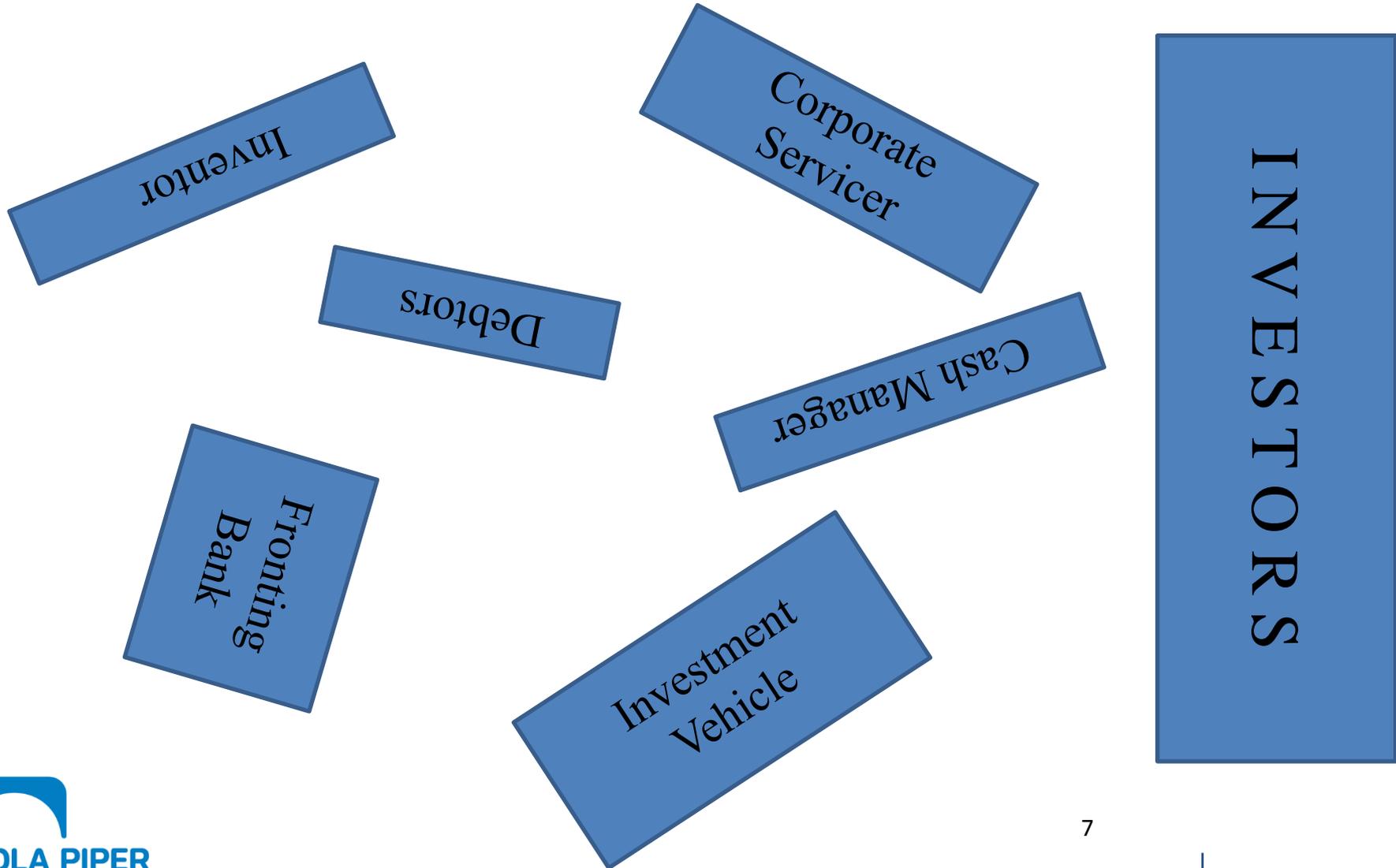


Economics (2)

- Debt Funds can provide liquidity based on the duration of the underlying
- Freedom to withdraw money when required
- Useful to create a well balanced portfolio



Structure of Debts Funds





How can we characterize Debt Funds? – A negative approach

- Interesting: Some Debt Funds definition approaches are negative approaches
 - Debt Funds \neq Securitisation Vehicle
 - "Originator" and "Holder" of the Debt Funds are different entities



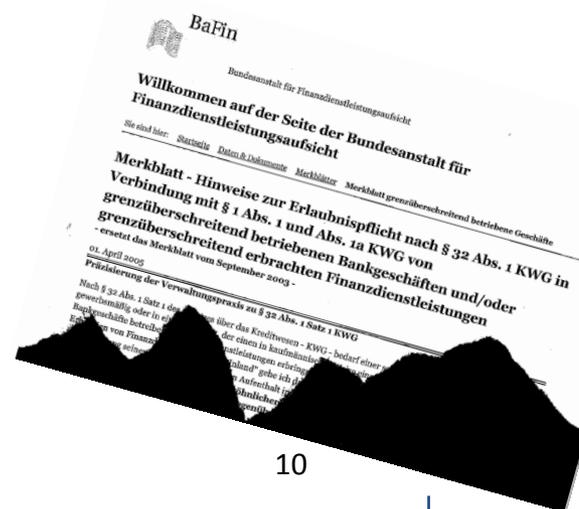
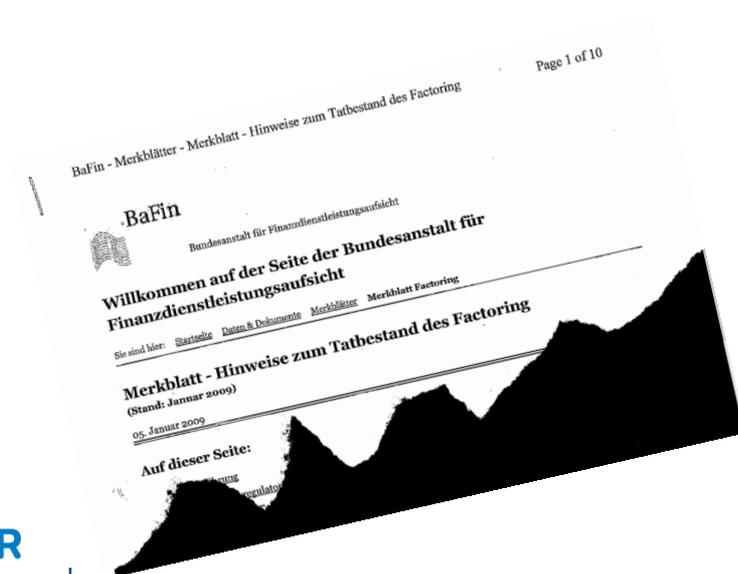
Legal Landscape

- Old School Approach - The German national law as it stands
- MiFID
- CRD IV
- AIFMD

Old School Approach (1)



- § 1 Abs. 1 S. 2 Nr. 2 KWG (Credit business)
- § 1 Abs. 1a S. 2 Nr. 9 KWG (Factoring)
- § 32 Abs. 1 S. 1 KWG (Cross-Border)



Old School Approach (2)



- § 1 Abs. 1 S. 2 Nr. 2 KWG (Credit Business):
 - ... Banking business comprises ...
 - (2) the granting of money loans and acceptance credits (lending business),...
- no explicit BaFin Guidance
- BaFin Circular as of 08.01.2009

Old School Approach (3)



- § 1 Abs. 1 S. 2 Nr. 2 KWG (Credit Business)
 - Neither disclosed or undisclosed assignment nor true sale of debts do trigger regulatory license requirements within the meaning of "gewähren" according to § 1 Abs. 1 S. 2 Nr. 2 KWG
 - However, the direct granting of the loans may well constitute Credit Business
 - Market Solution: Fronting Bank, which assigns the loans to the Debt Fund
 - as it is an intraday exposure → no capital requirements

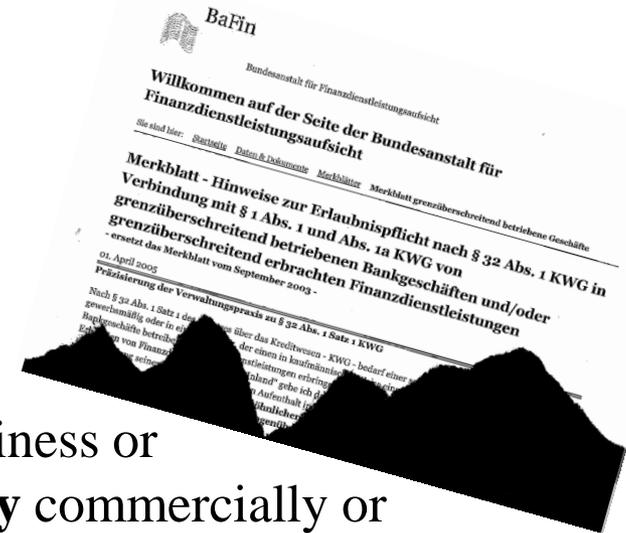
Old School Approach (4)



- § 1 Abs. 1a S. 2 Nr. 9 KWG (Factoring)
 - ... Financial services comprise ...
 - (9) the ongoing purchase of receivables on the basis of standard agreements, with or without recourse (factoring), ...
- no explicit BaFin Guidance
- BaFin Circular as of 05.01.2009
- Market Solution
 - no standard agreements

Old School Approach (5)

- Extempore – My favourite
- § 32 Abs. 1 S. 1 KWG (Cross-Border)
 - Anyone wishing to conduct banking business or to provide financial services **in Germany** commercially or on a scale which requires a commercially organised business undertaking needs written authorisation from BaFin; section 37 (4) of the German Act on Administrative Procedures (...) shall apply. ...
- BaFin Circular as of 01.04.2005
- Market Solution
 - Passive Freedom of Services





MiFID I

- Debt Funds as a Financial Instrument?
 - Sedes Materiae: Annex 1 Section C MiFID I
 - No. 1: Transferable securities
 - depends on the structure of the investment instruments
 - No. 2: Money-market instruments
 - probably not to be considered as Financial instruments within the scope of MiFID I



CRD IV

- Securitisation, Art. 4 Par. 1 No. 61
 - Transaction or Scheme
 - Credit Risk associated with risk exposure
 - Tranche (No. 67)
 - Payments depend upon the performance
 - Subordination determines distribution of losses
- Can a Debt Funds qualify as securitisation?



AIFMD / KAGB (1)

- Debt Funds to be qualified as a Fund within the scope of AIFMD ?
 - AIF ?
 - Exemption ?



AIFMD / KAGB (2)

- AIF ?
 - AIF = Any collective investment undertaking, which raises capital from a number of investors, with a view to investing it in accordance with a **defined investment policy** for the benefit of those investors and which does not require an authorisation pursuant to Art. 5 of the UCITS Directive (Art. 4 AIFM Directive 2011/61/EU)



AIFMD / KAGB (3)

- Defined Investment Policy ?
 - ESMA Discussion paper as of 23.02.2012 No. 31 and BaFin Circular as of 14.06.2013 give indicative criteria whether a strategy is considered to be an investment policy or not, e. g.:
 - Final form of the investment policy is fixed at the latest, by the time that investors' commitments to the entity become binding on them
 - Investment policy is likely to be set out in a document which becomes part/is incorporated in/ is referenced in constitutional documents of the entity
 - Contractual relationship between the entity and the investor binds the entity to follow the investment policy
 - Investment policy contains a series of investment guidelines, such as to invest only in certain categories, pursue certain strategies, invest in only particular geographical regions etc
 - Investment policy is clearly set out and disclosed to investor



AIFMD / KAGB (4)

- Exemption ?
 - Securitisation Special Purpose Entities
 - = Entities whose sole purpose is to carry on a securitisation or securitisations within the meaning of Article 1(2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 (...) and other activities which are appropriate to accomplish that purpose; (...)
 - Securitisation Special Purpose Entities excluded from the scope of the directive Art. 2 Par. 3 g)
- Debt Funds can be exempted from a qualification under AIFMD



The Commission on Shadow Banking

- Barnier is not much better than McCreevy (unquoted quotation)
- Shadow banking is the system of credit intermediation that involves entities and activities that are outside the regular banking system. Shadow banks are not regulated like banks; they operate outside the regular banking system and yet engage in bank-like activities.
<http://europa.eu/newsroom/calendar/event/447179/commission-adopts-communication-on-shadow-banking-and-proposes-draft-regulation>
- Will Debt Funds be regulated by the proposed EU legislation on Shadow Banking?



Another idea: ELTIF

- Will Debt Funds be regulated by the proposed EU legislation on ELTIF [COM(2013) 462 final 2013/0214 (COD)]?
- ELTIF = European Long -Term Investment Fund
- ELTIF can invest in different asset classes, such as
 - Equity or quasi-equity instruments issued by a qualifying portfolio
 - Debt instruments issued by a qualifying portfolio
 - Loans granted by the ELTIF to qualifying portfolio

 → Only EU AIFs shall be eligible for authorisation as an ELTIF



Path to go ...

- Issues to be discussed



Which legal topics are left open?

- Solvency II
- Balance Sheet Items
 - IFRS / US GAAP
- Tax
 - VAT, Income Tax
 - nothing new, however worth to be discussed
- Insolvency – will RRD apply?
- Data Protection



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