

FACTS & INSIGHT: REGULATORY UPDATE

Germany Clears the Way for Direct Lending Funds



German Lending & AIFMD:

BaFin Announces Change of Administrative Practice to Allow Lending Activities Through Non-Banks

Introduction

Germany's financial regulator, the BaFin, is known for its conservatism. It maintained the status quo of the country's banking industry by allowing banks to practically hold a monopoly on lending. With a few exceptions to date, anyone extending loans to German borrowers on a commercial basis needed to be licensed as a bank if located domestically or abroad. No more.

On May 12, 2015, the BaFin announced it would change its administrative practice and allow lending activities through non-banks.

What This Means for AIFMs

To date, Germany's lending activity was strictly covered under its banking act (the *Kreditwesengesetz* or "KWG"). Going forward, the BaFin will also permit lending activity under Germany's investment act, the "KAGB"*. Alternative Investment Fund Managers ("AIFM") will be permitted to originate loans for certain types of Alternative Investment Funds ("AIFs"). In practice, this means that loan AIFs which hitherto were restricted to purchasing German loans only in the secondary market may now proactively source and originate loans – i.e. directly lend to German borrowers.

Best Lending Practices

In anticipation of future legislative changes, the BaFin has released a number of best practices for the lending business of German AIFMs. These recommendations include:

- restriction of lending activities to non-consumer borrowers,
- restriction of lending activities through closed-ended AIFs,
- an implementation of appropriate underwriting and risk management policies, and
- the limitation of leverage and minimization of asset-liability mismatches.

In other words, AIFMs should consider lending as an additional way to source assets and should not employ refinancing strategies turning them into de facto banks.

Allowing regulated funds to establish themselves as non-bank lenders in Germany follows close on the heels of an earlier decision in March, when restrictions on loan fund investments by German insurance companies were lifted on the condition that these must be AIFMD compliant funds. Both of these moves are consistent with recent decisions in Europe. Ireland and Luxembourg are also allowing registered

*The KAGB is the German implementation of the Alternative Investment Manager Directive ("AIFMD").

AIFMs to manage direct lending funds and the European Commission even granted, under Solvency II, a regulatory incentive to European Insurance companies to choose closed-ended AIFs over non-European structures.

Conclusion

All of this seems to suggest that there is a concerted effort by European policy makers to establish the European regulated fund

industry as a new structural layer of credit intermediation. This should help to lift pressure off of the banking system and ease credit conditions. The hope may be that AIFMD compliant funds become veritable, and perhaps, even safer alternatives to securitization products, helping to channel some of the pent up investment demand by European insurance companies and pension funds towards the credit starved sectors of the European economy.

We Can Help

Behring, Khan & Co. is an advisory firm specialized in providing customized alternative investment fund solutions to its clients. Its Principals have extensive investment management and structuring experience in the alternative investment market, including with the management, governance and oversight of European regulated fund vehicles. Behring, Khan & Co. is uniquely positioned to answer many of the pressing questions related to these matters and provides practical turn-key solutions to investors and managers alike.

Behring, Khan & Co. supports both institutional investors and investment managers.

- Behring, Khan & Co., together with our Luxembourg affiliate BKN Capital S.A.*, develop, structure and set-up AIFMD compliant loan funds.

Contact: Sohail Khan
sohail.khan@behringkhan.com
UK +44 203 603 649-1
United States +1 732 898 2531

Christian Behring
christian.behring@behringkhan.com
Luxembourg +352 278 614 22
United States +1 732 898 2532

Disclaimer: This disclaimer governs the use of this publication and by using this publication you accept and agree to this disclaimer in full. Behring, Khan & Co. provides this publication as a service to clients and other friends for educational purposes and general guidance on matters of interest only. It has been written in general terms and should not be construed or relied on as professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent (direct or indirect) of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication for any decision based on it. This publication may contain information that is not directed to, or intended for use by, anyone subject to any jurisdiction where the availability or use of this publication would be contrary to law or would subject Behring, Khan & Co. to any registration or licensing requirement within such jurisdiction.

© 2015 Behring, Khan & Co., LLP ("BKC") All rights reserved. Not for further distribution without the permission of BKC.

Behring, Khan & Co. LLP ("BEHRING KHAN") is a limited liability partnership registered in England with the number OC381895 and whose registered office is at Devonshire House, 1 Devonshire Street, W1W 5DR London, United Kingdom.

*BKN Capital, S.A. is authorized as an Alternative Investment Fund Manager by the Luxembourg financial supervisory authority CSSF (the Commission de Surveillance du Secteur Financier).