

FACTS & INSIGHT: REGULATORY UPDATE

Loan Funds Permissible for
German Insurance Companies and Pension Funds



AIFMD & Illiquid Credit:

Germany Liberalizes Rules for Insurance Companies & Pension Funds Investing in Corporate & Infrastructure Loans

Introduction

On February 25th 2015, the German government passed an ordinance to enact changes to its regulatory framework setting investment rules and restrictions for insurance companies and pension funds (the “Anlageverordnung”). Amongst others, these changes relax restrictions for investments in corporate and infrastructure loans.

Direct Loan Investments

Historically, investment rules governing the German insurance and pension fund industry asset allocation favored liquid listed securities and restricted direct allocation to corporate loans to only those corporations who exhibited long term operating histories and investment-grade issuer ratings. As a result, senior secured corporate loans rated below BBB- (“Leverage Loans”) and investment grade loans to project finance special purpose entities failed to meet said criteria due to either their low credit quality or lack of operating history.

The new rules now allow:

- secured loans to *any* corporation domiciled either in an EEA or OECD country **and**
- those loans exhibiting a credit quality of at least an equivalent “B-“ (“Eligible Loans”)

- for up to 5%* of the reserve stock, including both direct exposure and indirect exposure through funds.

*This new 5% quota for said Eligible Loans is counted towards the 35% risk asset bucket (which includes equity investments, subordinated debt and high yield bonds).

Loan Funds

Until recently, allocations to Leverage Loans and those loans financing infrastructure projects were largely possible only through investment-grade rated securitization transactions (such as CLOs). German regulators had, up until this point, tolerated indirect investments in syndicated senior secured loans that were rated at least a “B-“ via certain high yield bond funds with loan allocations capped at 30%. Investment funds allocated entirely to loans, however, were not permissible.

The new rules now permit investment funds with up to 100% allocation to Eligible Loans if these funds are:

1. open or closed-end Alternative Investment Funds (each an “AIF” as defined in the AIFMD) domiciled in an EEA country; AND
2. managed by an AIF Manager (“AIFM”) registered in an EEA member state.

Conclusion

That the Government now explicitly allows insurance companies and pension funds to invest in a wider range of corporate loans is certainly a welcome move. We expect German insurance companies to feel encouraged by this, particularly in light of the political objective to tap their long term capital as an additional source of funding. Going forward, they will likely allocate capital to loans predominantly through regulated and managed funds. With respect to structures, German insurance companies will likely prefer open-end fund-of-one structures or closed-end commingled structures.

For insurance companies subject to Solvency II starting in January 2016, this *Anlageverordnung* will not extend beyond the end of 2015. Some market participants, however, are speculating that the BaFin may require them to continue their reporting requirements under the *Anlageverordnung* which effectively could lead to a dual-reporting regime. For all other insurance companies and pension funds, this ordinance will remain valid beyond 2015. In any case, it is expected that the BaFin will release more information regarding the detailed implementation of the new rules.

We Can Help

Behring, Khan & Co. is an advisory firm specialized in providing customized credit solutions to its clients. Its Principals have extensive investment management and structuring experience in the credit and structured credit 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

- We develop, structure, set-up and operate AIFMD compliant loan funds
- Our affiliate, BKN Capital S.A.*, can help to launch, market and distribute Luxembourg based credit funds

Contact: Sohail Khan
sohail.khan@behringkhan.com
 UK +44 (0) 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 or 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 an affiliate of BKC and has filed an application with the Luxembourg Commission for the Supervision of the Financial Sector (the "Commission de Surveillance du Secteur Financier" or the "CSSF") to become an Alternative Investment Fund Manager ("AIFM") compliant with the AIFM directive.