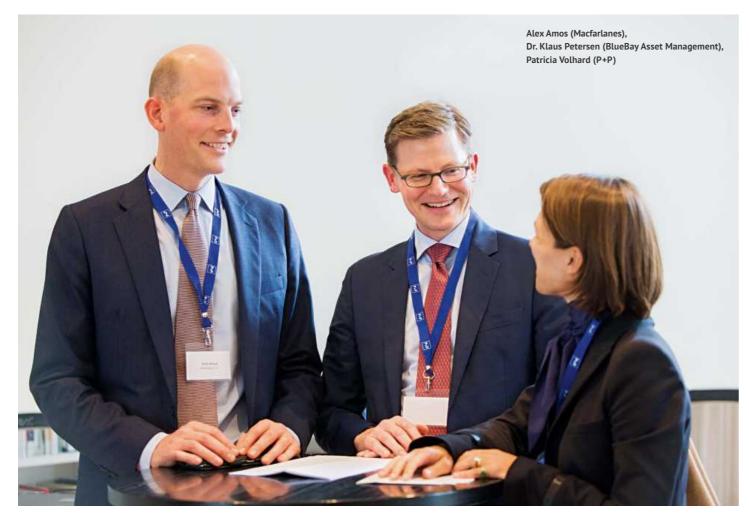
2016 PRIVATE EQUITY



Terms and Structure of Debt Funds

Patricia Volhard (P+P)

he regulatory environment for debt funds has substantially changed in certain EU member states over the last twelve months. For example in Germany, where lending has been considered a banking activity for many years now. Lending by German and other European funds and their managers has now

been accepted as an investment activity and hence eligible for an exemption for funds and their managers from license requirements under the German Banking Act.

However, in addition to such banking law aspects, it needs to be considered whether the relevant investment laws governing the rules for funds and their managers permit loan funds and if so, under what circumstances. In Germany the investment act (KAGB) provides for certain restrictions and requirements for German funds engaging in loan originating activities. Only closed ended funds with only professional and semi-professional investors may originate loans. Among others, leverage is limited and the managers of such funds must have appropriate risk management procedures in place.

Other European countries are more liberal when it comes to regulating debt funds. In the UK and Luxembourg for example there are little restrictions and requirements imposed on funds that engage in lending activities. As a result Luxembourg and the UK are more frequently used as locations for debt funds.

A harmonized (but reasonable) EU framework would be useful

In light of this diversified situation, the European Commission has initiated steps in view of implementing a harmonized EU regulatory framework for debt funds to achieve a little playing field for all debt funds within Europe.

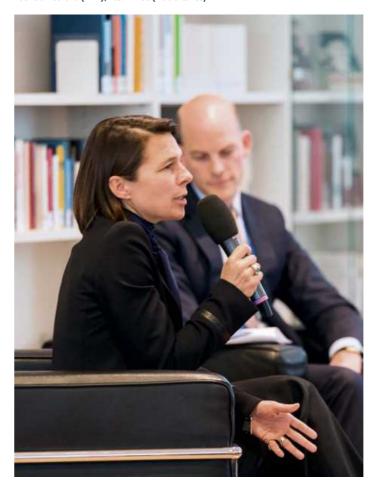
Regulatory Needs of German Investors

Certain German investors (German pension funds) are subject to the so called German Insurance Ordinance. Under such ordinance the investor can only invest in alternative investment funds if they have their seat in the EEA and the manager is also based in the EEA and fully AIFMD compliant.

Typical Debt Funds Structures and their Locations

In light of the above, Luxembourg and the UK are often chosen as locations for debt funds because they have a rather flexible investment law which does not particularly restrict debt funds or their managers while being at the same time EU and having implemented AIFMD.

Patricia Volhard (P+P), Alex Amos (Macfarlanes)





Under the new German rules a Luxembourg fund which is managed by a fully AIFM compliant EU AIFM could originate loans to borrowers in Germany without meeting further requirements and without triggering banking license requirements.

One question which remains open in that respect is whether special purpose vehicles which are often used by the fund to make the investment and which in fact originates and holds the loan will also benefit from such exemption under German law. The question is open but under review by the competent authorities.

Debt funds can be very different in their investment approach

Overall the panel agreed that a harmonized (but reasonable) EU framework would be useful so that the EU AIFM that complies with the requirements in one country can rely upon being exempt and not subject to additional obstacles or requirements in another EU country when investing in such country.

Terms of Debt Funds

After having discussed the structures and the regulatory environment the panel finished the discussion with some thoughts on typical legal terms of debt funds. One important aspect became obvious: debt funds can be very different in their investment approach and depending on the investment approach the economics and other terms such as performance linked fees, duration of the investment period, re-investments and fee set-offs can vary substantially. Where the fund invests in individually negotiated loans with interests but also equity kicker return models the economic terms will typically be more similar to those of a private equity fund as opposed to funds investing in fixed income bonds. The investment period is typically much shorter than in a private equity fund context and the range of fees charged by the AIFM can be broader (for example also including loan administration fees).

Panel: Dr. Klaus Petersen (BlueBay Asset Management), Alex Amos (Macfarlanes), and Patricia Volhard (P+P).

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