

LEGAL NEWSLETTER



Paris, June 2017

REFORM FOR FUNDS TO PROVIDE AND PURCHASE LOANS

The French market has been known to be restrictive due to the banking monopoly, which classically restricted the origination of loans and the acquisition of unmatured receivables to credit institutions and financing companies, with small exceptions. Due to the overregulation of credit institutions and financing companies, many transactions were structured abroad.

Recently, this trend has been reversed and the French Government has sought to render the market more competitive and open with its 897 billions Euros in outstanding amounts of loans to other actors, notably to investment funds. Consequently, the French legislator adopted an exception of the banking monopoly regulation in the primary market and will deregulate the secondary market, which is of particular importance in the context of Brexit.



1. LOAN ORIGINATION BY INVESTMENT FUNDS

Until recently, foreign investment funds could not directly originate loans in France, which resulted in the requirement for a bank intermediary. The bank would originate the loan and distribute a portion of it to the investment fund, which rendered the transactions more complex and increased costs. While the ELTIF Regulation¹ allowed AIFs agreed as ELTIFs to originate loans, it reserved this possibility for EU entities, as both the AIF and its manager have to be located in the European Union².

The French legislator created another exception in the banking monopoly for professional specialized investment funds (“fonds professionnels spécialisés”), professional investment funds of capital investment (“fonds professionnels de capital investissement”), and securitization vehicles (“organismes de titrisation”). While this exception is restricted to French funds, the investment fund manager can be French or foreign³. Any foreign investment fund manager has to be authorized by the French AMF and has to designate a legal representative in France⁴.

In order to manage a loan-originating fund, the manager must also have a credit-risk analysis system, a know-your-client process, must take into account the individual capacity of a borrower to reimburse a loan, and has to analyze the legal risks of the credit and any guarantee⁵. The borrowers can be companies, including holding companies, as long as they are not financial institutions⁶. The investment fund can finance itself by borrowing, as long as it does not exceed a leverage ratio to be fixed by ministerial order (“arrêté”) and it does not use the borrowed funds for lending.

In principle, the investment funds are meant to keep any loans that they originated in their portfolio⁷. However, the loans can be sold in case of financial difficulties of the borrower that would qualify the receivable as bad debt or if the remaining capital is below a certain percentage fixed by the investment fund and by ministerial order⁸. The loan receivables can also be transferred in case of a liquidation of the fund.

That could allow a foreign AIF manager therefore to originate loans directly, by creating a closed-ended investment fund in France, which could improve the benefit margins. Furthermore, this would allow investors to avoid any obligations for intermediary banks to keep part of the loan in their balance sheet.

This legislation falls within a more general movement towards liberalization of the banking monopoly. The European Securities and Markets Authority has recently expressed the desire to harmonize the sector on an European Union level⁹.

¹ Regulation (EU) 2015/760 of the European Parliament and of the Council of 29th April 2015 on European long-term investment funds.

² Articles 2, 3, and 5 of the ELTIF Regulation, together with Article 4(k) and (l) of the Directive 2011/61/EU of the European Parliament and of the Council of 8th June 2011 on Alternative Investment Fund Managers (the “AIFM Directive”).

³ Articles L. 532-9, L. 532-30, and L. 532-36 of the French Monetary and Financial Code, as well as Articles 316-12 and 316-13 of the General Regulation of the AMF (“Règlement général de l’AMF”).

⁴ Article L. 532-32 of the French Monetary and Financial Code.

⁵ Article R. 214-203-3 of the French Monetary and Financial Code.

⁶ Article R. 214-203-4 of the French Monetary and Financial Code.

⁷ Article R. 214-203-1 of the French Monetary and Financial Code

⁸ Article R. 214-203-2 of the French Monetary and Financial Code

⁹ ESMA Opinion from 11th April 2016, No ESMA/2016/596



2. DEREGULATION OF FRENCH BANKING MONOPOLY FOR THE PURCHASE OF DEBT

There is a parallel movement to liberalize the secondary market as well. Currently, French courts consider that acquiring unmatured loan receivables for value falls under the banking monopoly, because it is the equivalent of providing an advance payment to the seller. Therefore, French AIFs can acquire unmatured loan receivables only through limited exceptions. For example, open-ended AIFs¹⁰ and securitization vehicles can acquire loans, as well as professional funds of capital investment up to 10% of their net assets¹¹.

However, the Government is mandated to allow all collective investment funds, both UCITs and AIFs, to acquire unmatured loan receivables and to clarify the applicable rules under the law Sapin II. More importantly, foreign law financial investors will also be able to acquire directly, without having to go through a French intermediary, unmatured receivables of professional loans from credit institutions. Such financial investors will not be limited to investment funds. Although the Government is yet to publish any legislative project, we can assume that it will include an equivalence-based system.

Thus, a foreign AIF manager can directly provide loans by a French closed-ended fund or will be able to indirectly finance operations by acquiring unmatured receivables.

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¹⁰ Article L214-24-55 of the French Monetary and Financial Code.

¹¹ Article L. 214-160 of the French Monetary and Financial Code.