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Flash

Banking and Finance

New Regulation on Loan Assets Alternative Investment Funds

1. Introduction

The Portuguese investment services regulator (**CMVM**) enacted the Regulation 5/2020, on loan assets alternative investment funds, the so-called "OIAE de créditos" (**Loan Funds**[1]), in complement to the legal regime applicable (among others) to this type of vehicles, which is set out in Law nr. 18/2015, of 4 March (the **CMVM Regulation** and **Law 18/2015**).

This Newsletter presents a summary of the CMVM Regulation, in relation to Loan Funds, also taking into consideration the legal regime set out in the Law 18/2015.

2. Management

The management of Loan Funds is limited to entities authorised to manage UCITS and/or AIFs, pursuant to the UCITS Directive and the AIFMD respectively, as transposed in Portugal, or the venture capital management companies ("sociedades gestoras de fundos de capital de risco") subject to the provisions of Law 18/2015 which have transposed AIFMD.

Alternatively the Loan Funds may be incorporated as a company and self-managed, subject to compliance with the fit and proper and prudential requirements set forth in the Law 18/2015.

Portuguese law venture capital companies ("sociedades de capital de risco")[2], a local type of management entity subject to lighter regulation as compared to the ones governed by AIFMD and UCITS Directives, are therefore not permitted to manage Loan Funds.

3. Assets Portfolio, Diversification Requirements and Leverage

We highlight in the table below the rules on asset portfolio, diversification requirements and leverage of the Loan Funds.

[1] We refer to these undertakings as "funds" for clarity purposes, although they can assume the legal form of a fund or of a company.
[2] Meaning those whose assets under management are below the thresholds set out in article 6 no. 2 of Law 18/2015.

Nature	Limits	Characteristics
Loans	No limits in % of the Loan Fund assets Dispersion requirement: from the first 12 months, the credit portfolio must comply with a loans limit, per entity3, of 20% of the total assets of the Loan Fund[4]	May be originated by the Loan Fund or acquired in the secondary market Loans may be granted in connection with a syndicated financing Maturity date cannot exceed the duration of the Fund
Debt Securities	Maximum limit of 20% of the Loan Fund's assets	Debt securities issued by eligible debtors under Law 18/2015 (please see note below)
Liquidity	Maximum limit of 20% of the Loan Fund's assets Limit not applicable in the first 6 months of activity	Bank deposits capable of being mobilised at any time, certificates of deposit, participation units in money market or short-term money market collective investment undertakings and financial instruments issued or guaranteed by a EU Member State with a residual maturity of less than 12 months are admissible
Assets transferred in discharge of loans	N/A	Other assets that arise from the repayment of loans or that are demonstrably necessary to maximize the reimbursement of the credits
Leverage	May incur in any type of debt with the purpose of "granting loans" Limit of 60% of the total assets	Debt to be repaid before maturity date of the financed loan assets

Note: The following general limits/prohibitions apply:

- Each asset of the Loan Fund may not represent more than 30% of its global net asset value
- Prohibitions laid down in the Law 18/2015, notably the of granting loans to natural persons, credit institutions, and other entities in terms that may raise conflicts of interest.

4. Management requirements

Without prejudice to other requirements set out in Law 18/2015 and in the CMVM Regulation, in relation to Loan Funds, at least one of the members of the managing body of Loan Fund's management entity must have proven experience in loans assets and credit risk assessment and management.[5]

5. Relationship with Borrowers

Loan Funds are subject to the legal acts applicable to granting bank loans in respect of the following matters:

[3] Including entities in a control relationship.
[4] This limit is more restrictive than the general limit of 30% of the assets applicable to the specialized alternative investment undertakings under article 5 no. 1 of Law 18/2015.
[5] Article 9 –A of CMVM Regulation.

- Banking secrecy;
- Duty to inform borrowers about interest rates and other credit costs;
- Definition of loan maturity, ordinary and default interest, interest compounding and debtor default;
- Interest rate indexing and interest rounding.

6. Credit Risk Management

The Loan Fund manager must have in place a credit risk management system covering various models / procedures / policies, including the following:

- The loan granting model, which should include:
    - Loan selection criteria;
    - Debtor eligibility criteria;
    - Scoring;
- Credit files with borrowers' qualitative and quantitative information ;
- Credit granting decision procedure with description of the decision-making process;
- Collateral management policy;
- Delinquent borrowers procedures, including monitoring, restructuring and standstills management;
- Duty to establish an adequate monitoring procedure, at least on a quarterly basis, of changes in the quality of each individual credit;
- Credit measurement procedures;
- Obligation to carry out stress tests at least with a quarterly frequency.[6]

The CMVM Regulation expressly permits automation of credit risk analysis procedures, subject to certain requirements.

7. Reporting Duties towards CMVM

Loan Fund managers are subject to reporting duties towards CMVM according to the general regime to which they are subject.
In relation to Loan Funds, they shall in particular provide the following information to the regulator on a yearly basis:

- Breakdown of the loan assets held by the Loan Fund into secured debt, subordinated debt and interim debt;
- Breakdown of ratio between the loan assets value and the collateral value ; and
- Information on defaulting exposures and loan assets under renegotiation, subject to restructuring and with agreed standstills.

8. Investor Relations

Loan Funds may only be marketed to qualified investors.
In addition to other information duties arising of the applicable law and regulation, the CMVM Regulation provides that the pre-contractual information to be made available to investors must mention the risks arising from the investment in loans and whether they are unsecured, as well as the risk related with lack of liquidity and investment losses.

[6] This provision makes reference to article 59 no. 2 of Law 18/2015, in what respects liquidity management.

9. Conclusions

The CMVM Regulation, coupled with the Law 18/2015, allows in broad terms the investment in loans by the Loan Funds, both in the primary and secondary markets.

The diversification requirements are not demanding, notably the 20% limit on exposures to the same entity or economic group, and there are no special requirements on debtors quality assessment, but rather there is an emphasis on the requirements in terms of policies, models and procedures, which is understandable, bearing in mind that these funds are reserved for qualified investors, and the respective managers are already subject to stringent prudential and COB rules.

With regard to dispersion requirements, the 20% limit to investment in debt securities may not be in line with current market trends in Portugal, where there has been a growing number of financing deals conducted by banking institutions assuming the form of bond issues.

The CMVM Regulation also seeks to establish a level playing field in the relation with clients, extending to Loan Funds some of the main COB rules applicable to banking institutions, in matters such as banking secrecy, interest compounding, default interest and indexation.

It is, however, worth noting that Loan Funds will be subject to necessarily lighter COB rules as compared with Portuguese banking institutions, as they will be out of the scope of the Portuguese banking legislation and regulations, and its activities will not be supervised by the Bank of Portugal.

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