

AMF instruction
Organisation of asset management companies for managing loan-granting AIFs – DOC-2016-02

Reference texts: Articles L. 214-154, L. 214-160 and L. 214-169 of the Monetary and Financial Code and Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds.

Articles 316-3, 316-4, 317-2, 317-7, 318-1 and 318-58 of the AMF General Regulation.

Contents

1.	Lending-specific credit analysis system	2
1.1.	Written procedure for granting loans	2
1.1.1.	Lending conditions and the principle of proportionality	2
1.1.2.	Loan characteristics	2
1.2.	Credit risk analysis procedure	3
2.	Valuation, risk monitoring and control	3
3.	Expertise within the asset management company	3
4.	Use of an external service provider to prepare the credit analysis	4
5.	Legal analysis and assessment of capital requirements	4
6.	Conflicts of interest	4
7.	Debt recovery	5
8.	Reporting requirements	5

This instruction applies to asset management companies that would like a French or foreign AIF¹ that they manage to be able to grant loans, including when lending is an ancillary activity. The AIFs in question include European long-term investment funds (ELTIFs).

An asset management company that would like an AIF that it manages to grant loans shall file an application with the AMF for an authorisation or an extension of its authorisation, as the case may be, to include this business in its programme of activity under Articles 11 *et seq.* of AMF Instruction DOC-2008-03². This instruction describes the requirements that must be met when applying for such an authorisation or an extension of an authorisation.

Lending is separate from loan selection, which is limited to the acquisition of existing loans.

The loans referenced in this instruction may be of different types and subject to the laws of different jurisdictions. For example, loans subject to French law that may be granted by a French AIF may take the form of the different types of business loans defined in Articles L. 313-12 to L. 313-22-1 of the Monetary and Financial Code. In contrast, the use of advances from partners or shareholders is not considered lending and thus does not require an extension of an authorisation as described in this instruction.

¹ Subject to the law applicable to that fund.

² It is also possible to make such a request in the application for initial authorisation.

1. Lending-specific credit analysis system

1.1. Written procedure for granting loans

An asset management company that manages a loan-granting AIF must establish and implement a written procedure for granting loans. This procedure must define an exposure policy based on the lending conditions and the loan characteristics. This information must also be specified in the asset management company's programme of activity.

1.1.1. Lending conditions and the principle of proportionality

The type of lending should be determined on the basis of the diversification of the loans granted, the asset management company's relationship with the borrower (AIF target, client of the management company's group, etc.) and any other lender partners.

Examples of types of loans include but are not limited to:

- **loans to a target:** the AIF grants loans only to companies already included in the AIF's portfolio (through other instruments such as equities, bonds, etc.);
- **loans based on a quasi-automatic credit analysis:** the AIF grants loans to a large number of companies selected using a quantitative model, based on predetermined criteria that these companies must verify. This type of lending should be based on i) credit risk diversification to limit the impact of a default on net asset value and ii) the use of an automated discriminant credit analysis model. Unlike the acquisition of a receivables pool on the secondary market, where a purely statistical approach may be used, a credit analysis must be performed for each loan granted by the AIF. This analysis may be prepared automatically using the scoring model;
- **loans as part of a banking pool:** the AIF grants loans to a small number of companies as part of a banking pool or on a pari passu basis with a bank that retains a material economic interest in the transaction; or
- **loans to a limited number of companies** selected directly by the asset management company.

The programme of activity must specify the type of loan following the examples above.

1.1.2. Loan characteristics

The loan characteristics defined in the asset management company's programme of activity and the exposure policy must at a minimum cover the following:

- Type (size, sector, business, date of incorporation, etc.) and nationality of companies receiving loans;
- National law applicable to the loans;
- Type of loan (cash, investment, real estate, etc.);
- Type of collateral or guarantee;
- Loan maturity (short term, medium term, long term);
- Type of rate (variable or fixed);
- Loan seniority;
- Loan amount in euro;
- Any rating by an agency or the Banque de France;
- Relationship with the borrower (AIF target, client of another group entity, direct marketing, access via web platform, etc.);
- Any co-lenders.

1.2. Credit risk analysis procedure

The risk analysis system must also include a credit risk analysis procedure that consists of:

- a) The creation of credit files compiling all the qualitative and quantitative information on the borrowers;
- b) A clearly formalised loan decision procedure describing the organisation as well as any delegations or outsourcing. This procedure should specify the investment decision process (operations of the decision-making bodies).

For a loan granted using a quasi-automatic model, the preparation of the credit risk analysis procedure may be automated by defining eligibility criteria and, in some cases, using a system that assigns the loans a score. The algorithm used must be described in the programme of activity. In all cases, eligibility for the criteria must be documented in a credit file and the decision-making must be formalised.

For a loan granted within a banking syndicate, qualitative and quantitative information on the borrowers may be gathered by another participant in the banking pool (for example, a credit institution from the same group as the management company) but the asset management company must keep its own credit files and establish its own loan decision procedure.

2. Valuation, risk monitoring and control

Under Article L. 533-10-1 2 of the Monetary and Financial Code, asset management companies shall employ “*a process for accurate and independent assessment of the positions and transactions of the managed portfolio*”. This accurate and independent valuation should allow the asset management company to comply with the principle of equal treatment of unit- or shareholders of AIFs regardless of market circumstances. When the valuation is performed directly by the asset management company, this may be done by someone with credit analysis expertise and no lending experience if this improves the valuation's independence from the operational function that does have lending experience.

An asset management company that manages a loan-granting AIF must develop a **procedure for adequate monitoring**, at least on a quarterly basis, **of changes in the quality of each individual loan**, to determine, where applicable, the appropriate levels of depreciation or appreciation in the value of the loans and, where applicable, in the guarantees and collateral. This risk monitoring procedure must also describe the operational measures taken should a credit risk materialise (write-off, recovery, activation of collateral or guarantees, etc.). **The asset management company must also adapt its control system to the lending activity.**

3. Expertise within the asset management company

An asset management company that manages a loan-granting AIF must have expertise **in direct lending**. This expertise requires at least one manager or analyst with experience in a lending entity (credit institution, insurance company or asset management company). This expertise should cover the financial, legal and structuring aspects of loans. Credit analysis skills acquired only by managing bond funds or loan selection are not considered adequate.

When the loans granted include guarantees or collateral, the asset management company must also **have ad hoc internal expertise, or access to the expertise of a service provider, in the underlying asset** to be able to confirm their existence, quality and valuation until the debt is due. In that case, the asset management company must also analyse the eligibility of any **assets provided as guarantees** for the loans (e.g. real-estate assets, stakes in companies, tangible assets, etc.) to be included in the assets of the lending AIF or establish a procedure for the immediate disposal of these assets.

4. Use of an external service provider to prepare the credit analysis

The asset management company may employ a service provider to prepare the credit risk analysis, including the credit files and all the information needed to make the loan decision (scoring, business plan analysis or financial analysis, etc.). However, the final loan decision must be made by the asset management company which remains liable and must therefore maintain the resources and expertise needed to effectively monitor the service provider's activities. The prospectus, articles of incorporation or rules of the AIF must specify which functions are outsourced and the characteristics of the service provider.

The use of an external service provider should not be conflated with the delegation of management of an AIF open to professional investors, which may be conferred "*only upon undertakings which are authorised or registered for the purpose of asset management and subject to supervision or, where that condition cannot be met, only subject to prior approval by AMF; or an investment services provider, provided that a risk control and conflicts of interest procedure is implemented*" (in accordance with Article 318-58 of the AMF General Regulation).

5. Legal analysis and assessment of capital requirements

Asset management companies must conduct a legal analysis, before granting loans, to ensure that these loans comply with all the obligations applicable to lenders in the relevant jurisdiction.

In particular, the analysis must confirm compliance with:

- any rules on banking monopoly or banking secrecy applicable in the borrower's country;
- banking case law that may be applicable to management companies or to lending AIFs. For example, for a loan governed by French law, liability for a distressed borrower and the risk of improper financial support (Article L. 650-1 of the Commercial Code);
- rules on anti-money laundering and combating the financing of terrorism at the borrower level;
- updated KYC obligations and the lender's duty to advise and inform.

The legal analysis is not necessarily specific to each loan but a new legal analysis must be conducted when an important characteristic of the loans or the borrowers changes.

The operational risk management policies and procedures and measurement systems required under Article 13 of Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 must be adapted to the lending activity to protect the asset management company from the operational risks identified in the legal analysis.

Asset management companies must also reassess, in light of their lending activity, the additional own funds needed to cover potential liability risks arising from professional negligence, in accordance with Article 317-2 IV of the AMF General Regulation.

6. Conflicts of interest

Asset management companies need to pay particularly close attention to conflicts of interest resulting from the lending activity.

In particular, material conflicts of interest may arise in the following two situations:

- an asset management company that invests in equity instruments and debt instruments or in loans (or in debt instruments with different seniorities) of a single issuing body for two different AIFs that it manages (if the clients of the AIFs are different); and

- in the case of asset management companies that belong to a bank group, when one of the managed AIFs lends to a company that has had a business relationship with the group's credit institution.

7. Debt recovery

Asset management companies that wish to directly recover sums they have lent must describe in their programme of activity how they would like to proceed and what resources they would use. Including this information in the programme of activity does not exempt the company from all the other legal obligations relating to the recovery activity.

8. Reporting requirements

Asset management companies must report quarterly to the AMF and the Banque de France on all the loans their AIFs have granted. These quarterly reporting requirements remain in force until the debt is extinguished, including in the event of an assignment of the receivable.

The requirement that asset management companies report to the Banque de France is set out in the fourth paragraph of Article L. 144-1 of the Monetary and Financial Code. For each loan granted, and until the extinguishment of the debt, asset management companies shall provide the Banque de France's Service Central des Risques (Central Credit Register), which is fed into the FIBEN database, with the beneficiary's SIREN number, the amount outstanding on the reporting centralisation cut-off date and the main characteristics of the borrowings.

Pursuant to Article 319-26 of the AMF General Regulation, the report to the AMF shall specify, for each loan, the characteristics described in point 1.1.2. This reporting requirement shall apply as from January 2017.