

Loan origination by investment funds

Central Bank Discussion Paper

Overview

On 22 July 2013 the Central Bank published a new discussion paper on loan origination by investment funds, following up on its commitment to consider permitting lending by QIAIFs in CP60 on the implementation of AIFMD. The current regulatory framework permits loan participation by AIFs but does not permit lending. However, the Central Bank is now willing to consider reversing this position, subject to appropriate risk mitigants.

The paper points to an overreliance on bank credit in the EU economy versus the USA. It highlights evidence which suggests that significant segments of the EU economy appear to have severely restricted access to financial credit as a result of the financial crisis, bank deleveraging and the lack of alternative financing channels. On the other hand the Central Bank is concerned about “shadow banking” risks over permitting non-bank financing and considers that the work of the Financial Stability Board (FSB) should be taken into account.

The discussion paper outlines a number of potential risks and potential risk mitigants as a means to move forward on this discussion.

Key risks

Risks identified by Central Bank	<ul style="list-style-type: none">• Concentration risk• Illiquidity risk• Risk of investor runs• Leverage• Money creation• Dominant lenders• Misalignment of investor risk appetite and investor capability• Mispricing of credit
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Potential risk mitigants

Potential measures	<ul style="list-style-type: none">• Diversification requirements• Other product features – types of loans/loan term• Measures to address liquidity• Constraints on leverage• Financial commitment by the investment manager• Investment manager competence, remuneration and expertise requirements• Constraints on investor type• Credit assessment requirements• Monitoring of the loan book
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