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Loan Originating QIAIFs – Central Bank Issues Positive Update

Introduction

In a positive development, the Central Bank of Ireland ("**Central Bank**") announced on 25 November, 2016 that it intends amending certain of its rules in respect of Irish domiciled qualifying investor alternative investment funds ("**QIAIFs**") which engage in direct loan origination.

Readers will be aware that the Central Bank has (since October 1, 2014) been accepting applications for authorisation of loan originating QIAIFs.

Current Central Bank rules

Under current Central Bank rules, Irish loan originating QIAIFs are required to limit their operations to issuing loans, participating in loans, participating in lending and to operations directly arising therefrom, including handling assets realised through the enforcement of security. This gave no apparent leeway for Irish loan originating QIAIFs to invest in other assets such as debt or equity securities and so on. This restriction on asset class eligibility had been viewed as overly restrictive and did not equate with the reality that many loan managers combine loans with other asset classes as part of their credit strategy.

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Changes to Central Bank rules and effective date

Following engagement with industry, the Central Bank is revising its current position to allow other investments linked to the loan origination strategy to be undertaken, a policy which parallels European regulation (particularly Regulation (EU) 2015/760) on European Long Term Investment Funds) and the approach taken in a number of other EU Member States in relation to their loan origination fund rules.

The Central Bank's intention is that paragraph 2 of section 4 within Chapter 2 of the AIF Rulebook (which deals with loan originating QIAIFs) will now read as follows:

"*The loan originating Qualifying Investor AIF shall limit its operations to the business of issuing loans, participating in loans, participations in lending and to operations relating thereto, including investing in debt and equity securities of entities or groups to which the loan originating Qualifying Investor AIF lends or which are held for treasury, cash management or hedging purposes.*"

The remainder of Chapter 2 will remain unchanged. This revised rule, if implemented in its current form, will come into effect from **3 January 2017**.

Analysis

This is a significant improvement on the current position.

The rule as proposed will allow managers to engage in operations relating to the QIAIF's loan portfolio, for example, lending combined with an equity element. There is further flexibility for managers implied in the new language: the current requirement that non-loan operations are permitted only if "directly arising" from the loan portfolio will be replaced with a requirement that the operations must only "relate" to the loan portfolio and the new rule sets out a non-exhaustive list of examples of the other operations in which these funds are now permitted to engage. Exactly how far this will allow managers to go in constructing their portfolios remains to be seen at present and these and certain other elements will require clarification from the Central Bank over the coming weeks.

The rule change also clarifies that managers can engage in treasury or cash management and hedging operations and this will allow managers to use securities, repo and derivatives (for example, interest rate swaps for hedging) in this part of the portfolio.

Submission of comments to the Central Bank

A formal consultation is not being carried out by the Central Bank. Nevertheless comments can be submitted for consideration, while arrangements are being finalised, by email to fundspolicy@centralbank.ie

Please do not hesitate to reach out to your usual contact in Dillon Eustace with any queries or if you wish for us to submit comments on your behalf to the Central Bank.

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